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STATUTORY OBSOLESCENCE AND THE JUDICIAL PROCESS: THE REVISIONIST ROLE OF THE COURTS IN FEDERAL BANKING REGULATION

Donald C. Langevoort*

What do — or should — courts do when asked to interpret an apparently “obsolete” statute? This question is an important one half a century or more after the enactment of much of the fundamental federal legislation in such fields of economic regulation as labor, communications, antitrust, securities, and — the subject of this study — banking. For a variety of reasons, including political inertia and special interest pressure, many of these statutes remain substantially unchanged even though the assumptions about marketplace structure and conditions that formed the basis for the legislation have long since ceased to hold true.

The dominant jurisprudential tradition states that the courts are the “faithful agents” of the enacting legislature, and that their role is therefore limited to determining and carrying out the legislative intent of that body. If so, statutory obsolescence is irrelevant, a matter of concern for the legislature but not the courts.¹ At the same time, there has been vigorous dissent from this tradition. It finds its most notable expression in Guido Calabresi’s *A Common Law for the Age of Statutes*,² which urges judges to assume the power both to update and (in

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1. An important contemporary proponent of this view is Judge Richard Posner. See Posner, *Economics, Politics and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263 (1982) [hereinafter Posner, *Reading of Statutes*]; Posner, *Statutory Interpretation — in the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800 (1983) [hereinafter Posner, *Statutory Interpretation*]. Posner’s writing grows out of an earlier work, Landes & Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J.L. & ECON. 875 (1975). Judge Frank Easterbrook is also a proponent of fidelity, with the caution that when actual intent is difficult to discern, there should be a presumption of statutory inapplicability. See Easterbrook, *Statutes’ Domains*, 50 U. CHI. L. REV. 533 (1983); see also Easterbrook, *Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4 (1984) [hereinafter Easterbrook, *The Court and the Economic System*]. For an example of judicial expression of fidelity, see *American Bankers Assn. v. Connell*, 686 F.2d 953 (D.C. Cir. 1979), where the court took the unusual step of delaying the effect of its ruling to allow Congress to act.

2. G. CALABRESI, *A COMMON LAW FOR THE AGE OF STATUTES* (1982).

rare cases) invalidate statutes that have lost consistency with the prevailing "legal landscape."

Banking regulation provides an ideal subject for a study of the reaction of the courts to statutory obsolescence. Until fairly recently, the commercial banking marketplace in a particular location could properly be considered a discrete one, with the basic "banking" services provided only by a limited number of locally chartered competing participants.³ This understanding, for example, formed the basis of the Supreme Court's restrictive determination in 1963 that in applying the antitrust laws to bank mergers (1) the relevant product market to test for undue reduction in competition is the unique "cluster of services" offered by commercial banks, and (2) given legally imposed restraints on entry and expansion, the relevant geographic market is typically confined to the city or county in which the banks are located.⁴ If the assumption of limited entry is correct, bank regulation can succeed by making rules of conduct applicable to all banks in the relevant market. Since it is presumably impractical for bank customers to avoid the costs of regulation by seeking alternatives or substitutes, no outflow of funds from the market will occur, and no individual bank will be at a competitive disadvantage.⁵

Largely as a result of changes in available technology, the banking marketplace has changed radically.⁶ So-called "delivery innovations"

3. For an economic overview of market analysis and the question of local monopolies, see Heggestad & Mingo, *The Competitive Condition of U.S. Banking Markets and the Impact of Structural Reform*, 32 J. FIN. 649 (1977). The basic services to which the limited market concept was most clearly applicable were deposit accounts (both demand and savings) and commercial loans for medium and small businesses. Other banking services, e.g., consumer loans, have long been offered by nonbank competitors. Commercial loans to the largest corporations, similarly, are not localized — there has long been a nationwide market for this line of business. As to deposit accounts, savings banks and savings and loan institutions have provided time deposit alternatives; these institutions, being subject to restricted entry and regulated much the same as commercial banks, can be considered banks with respect to that sort of service.

4. *United States v. Philadelphia Natl. Bank*, 374 U.S. 321, 326-27 (1963). For a discussion of the evolution of antitrust theory as it relates to banking in light of some of the marketplace product changes, see Note, *The Line of Commerce for Commercial Bank Mergers: A Product-Oriented Redefinition*, 96 HARV. L. REV. 907 (1983); May, *Redefining the Product Market: Commercial Bank Mergers in the New Competitive Era*, 103 BANKING L.J. 124 (1986).

5. In practice, the uniquely American dual system of banking — which permits banks to choose a state or federal charter, and as a result establishes competition among regulators — has often frustrated attempts at effective regulation. See Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1 (1977). State-chartered banks are subject to federal regulation if they are members of the Federal Reserve System, controlled by a bank holding company, or insured by the Federal Deposit Insurance Corporation. That regulation, however, is secondary in nature, with substantial deference given the state chartering authority on questions such as bank powers. On the need for reform of this structure, see A. CARRON, *REFORMING THE BANK REGULATORY STRUCTURE* (1984).

6. An extremely useful and comprehensive review is found in OFFICE OF TECHNOLOGY ASSESSMENT, U.S. CONGRESS, *EFFECTS OF INFORMATION TECHNOLOGY ON FINANCIAL SERVICES SYSTEMS* (1984) [hereinafter *EFFECTS OF INFORMATION TECHNOLOGY*]; see also Phillips,

have permitted banks to offer deposit, loans, and other financial services to customers in remote locations. As a result, there has been a de facto destruction of geographic barriers to entry and growth. In addition, technology has allowed nonbanking institutions to offer products and services that far more closely resemble (without legally being) traditional banking ones. These developments in combination have given consumers means of avoiding regulatory costs by seeking providers of financial services that are subject to less intrusive regulation, or none at all, thereby frustrating many traditional regulatory strategies. At the same time, they have reallocated profits and resources within the industry. In this sense, the business of banking, and the regulation of banking, can rightly be termed transitional.

Where banking law has delegated discretionary authority to the various regulatory agencies, marketplace change has been accommodated through a dialectic between bankers' efforts to avoid profit-diminishing restrictions and regulatory responses to these efforts. The responses have rarely sought to foreclose the bankers' efforts entirely, and usually they have taken long enough to formulate that the industry has already moved on to a new set of products and techniques.⁷ But much of banking law is not discretionary; rather, it takes the form of fixed statutory rules. Here, the transitional nature of banking poses the dilemma for courts that are called upon to interpret such legislation. Many of the statutes governing banking were written long ago, well before many of the fundamental marketplace changes became manifest, and they naturally reflect the marketplace assumptions of their starting points in history. Yet they remain unrevised — not necessarily because those with influence in Congress still hold to the same assumptions, but because it is politically difficult to upset the status

Changing Technology and Future Financial Activity, in HANDBOOK FOR BANKING STRATEGY 125 (R. Aspinwall & R. Eisenbeis eds. 1985). For a discussion of similar changes as they affect the securities industry, see Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 HARV. L. REV. 747 (1985).

7. For a discussion of the industry-regulator dialectic, see Kane, *Strategic Planning in a World of Regulatory and Technological Change*, in HANDBOOK FOR BANKING STRATEGY, *supra* note 6, at 725, 733-35; Eisenbeis, *Inflation and Regulation: The Effects on Financial Institutions and Structure*, in HANDBOOK FOR BANKING STRATEGY, *supra* note 6, at 65, 66-68; Kane, *Accelerating Inflation, Technology, Innovation and the Decreasing Effectiveness of Banking Regulation*, 36 J. FIN. 355 (1981). The reasons why regulators have rarely reacted to foreclose marketplace innovations are numerous. One is, no doubt, a natural tendency to protect the industry, due both to the notion of "capture," *see* text accompanying note 130 *infra*, and to a legitimate concern for the industry's financial health. Also important is the politically significant fact that there is a strong consumer demand for better and less expensive financial services, a factor that can be compelling if a new service or product is publicly available as the regulators consider whether or not to take it off the market. Finally, there is the factor of regulatory competition, which permits banks to seek the least restrictive regulator and thus makes it unfeasible for any one regulator to regulate too strictly. *See* note 5 *supra*.

quo. A reviewing court, if sensitive, will recognize that invoking many of the traditional norms of statutory construction under these circumstances may do nothing more than breathe life into the dying hand of the past.

This article studies the behavior of the courts faced with this dilemma. After offering in Part I a more detailed analysis of the impact of marketplace change on banking regulation, it will trace the evolution in statutory interpretation of two sets of statutory provisions. The most extensive consideration (Part II) will be of a fundamental "product" restriction, the Glass-Steagall Act, a 1933 law purporting to force banks out of the securities business. Then, Part III will turn to one of the basic geographic restrictions on entry and expansion, the McFadden Act of 1927, which limits branching by national and member banks. These two studies should be useful in and of themselves, as intellectual histories and syntheses of important federal statutes. Indeed, they contain significant observations about the evolution and current state of the law that have not to this point received scholarly attention.

Of more general interest, however, is the observation that, in a remarkably similar way under each of the two statutes, judicial behavior changed dramatically with the onset of transition. This observation offers support for the view that judicial intervention to control the problem of obsolescence is more common than the rhetoric of fidelity would lead one to believe. While courts are likely to engage in truly purposive statutory construction during the early stages of a statute's "life cycle,"⁸ that impulse ceases as the statute ages. At some point there will be a noticeable but unexplained shift toward canons of construction such as literalism, strict interpretation, and extreme deference to administrative expertise. While the rhetoric of fidelity to statutory intent remains, application of these maxims in fact produces outcomes that are removed from any accurate understanding of original legislative will. This shift takes place at roughly the time when the obsolescence of the statute starts to become apparent. A strong implication — and the hypothesis of this article — is that these canons are chosen at this point because they effectively limit the applicability of statutes that may be approaching a stage of harmful senility.

This hypothesis, in turn, raises intriguing questions about the judicial process. Is there enough consistency in the judicial behavior to call it a predictable response to statutory aging? Is such behavior un-

8. The concept of a statutory life cycle is recognized in G. GILMORE, *THE AGES OF AMERICAN LAW* 97 (1977).

restrained judicial activism or is it governed by justifiable neutral principles of law? The conclusion (Part IV) will comment on the normative implications of these case studies.

I. BANKING IN TRANSITION

Before turning to the two specific statutory contexts, it is important to develop a thorough understanding of the transition in the business of banking that is the setting for the current legal controversies. Section A of this Part defines the traditional business of banking, and considers how changes in information technology have affected that business. Then, section B identifies the principal objectives of banking regulation and considers their efficacy in light of the marketplace changes so identified.

A. *The Business of Banking*

As traditionally understood, banking is simply one form of financial intermediation.⁹ The bank's historically most important supplier of capital, the depositor,¹⁰ has looked to the bank to provide a combination of three basic services: investment (*i.e.*, offering some sort of increase in wealth in return for use of the capital), safekeeping, and transaction execution (*i.e.*, facilitating transfers of the depositors' funds to third parties). While the relative importance of these functions varies from depositor to depositor, the attractiveness of a bank deposit is that it provides a convenient mix of safety, liquidity, and return on savings.

At the other end of the banking business stands the principal user of the capital, the borrower.¹¹ Historically, the bank's prime investment function was to provide relatively short-term credit to those businesses facing a time lag between incurring expenses and receiving expected income.¹² Such extensions of commercial credit facilitate both current operations and expansion.

That an intermediary has been needed to satisfy the conflicting

9. See, e.g., Clark, *The Soundness of Financial Intermediaries*, 86 YALE L.J. 1 (1976); see also R. POZEN, *FINANCIAL INSTITUTIONS: INVESTMENT MANAGEMENT* 2 (1978).

10. The depositor is the principal supplier of capital, but hardly the exclusive one. Shareholder-contributed capital and retained earnings, along with funds borrowed on a nondeposit basis, constitute other important sources. See Schweitzer, *Bank Liability Management: For Better or Worse?*, FED. RES. BANK OF PHILADELPHIA BUS. REV., Dec. 1974, at 3.

11. Other end uses of bank funds include investments in certain types of securities, loans to other banks, etc. See Anderson & Burger, *Asset Management and Commercial Bank Portfolio Behavior: Theories and Practice*, 24 J. FIN. 207 (1969).

12. See R. WEST, *BANKING REFORM AND THE FEDERAL RESERVE, 1863-1923*, 18-20 (1977).

needs of depositors and borrowers is obvious. A bank pools its deposits in a way that permits any given depositor substantial liquidity, yet — because the liquidity need of the depositors as a group tends to be relatively stable and predictable — allows the bank to invest in a portfolio of longer-term loans. Apart from this pooling function, the bank also serves as a specialist in seeking out and analyzing lending possibilities and monitoring those investments — internalizing the information and transaction costs the depositor would otherwise incur. A bank's principal source of revenue has been the aggregate spread between income received from its portfolio and the cost of its deposit base. In addition, of course, there are the fees generated from transaction services, safekeeping, and the like.¹³

Information technology has an immense impact on the historic banking process, because so much of what banks and other financial intermediaries do is simply to manage information and transaction costs.¹⁴ On the deposit side, there is no compelling reason why a person would choose a bank deposit, as opposed to some other form of investment, for that portion of savings for which near total liquidity is unnecessary. The historic preference for such deposits rests largely on some combination of tradition and habit, the convenience and safety such accounts afford, and the relative inaccessibility of available alternatives. An important impact of technology has been to increase substantially the range of attractive nonbank options available to the depositor. The most dramatic example is the money market fund.¹⁵ A money market fund is an investment company that offers to the public shares of stock on a continuing basis, and stands ready to redeem such securities on shareholder demand. No return on the investment is guaranteed, but the fund limits investment of its pooled assets to relatively secure, short-term obligations of the government and large financial institutions. Apart from the management and distribution fees paid to the fund's advisers and underwriters, returns on investment are passed through directly to shareholders. Communications technology

13. While substantial regulation prevailed, banks subsidized many of these services with profits made from the spread, pricing them at or below cost. With the recent deregulation, such subsidization has become impracticable, and banks have been forced to price such services more realistically — incurring substantial consumer (not to mention political) wrath in the process. See *Wall St. J.*, July 22, 1986, at 12, col. 1.

14. The most obvious impact, but not one of central importance to this analysis, is in the area of transaction services — the movement away from paper-based commercial transaction toward electronic funds transfer. See M. MAYER, *THE MONEY BAZAARS: UNDERSTANDING THE BANKING REVOLUTION AROUND US* (1984); Frisbee, *The ACH: An Elusive Dream*, *ECON. REV.*, Mar. 1986, at 4.

15. See Rosenblum, Siegel & Pavel, *Banks and Nonbanks: A Run for the Money*, *ECON. PERSP.*, May-June 1983, at 8-9; Langevoort, *supra* note 6, at 748 & n.5; NATIONAL ASSOCIATION OF SECURITIES DEALERS, *THE FINANCIAL SERVICES INDUSTRY OF TOMORROW* 22-23 (1982).

— toll-free telephone numbers, computer record-keeping, and wire transfers — allows the purchase and redemption process to occur extremely fast; the result, from the shareholder's perspective, is bank-like liquidity. During the 1970s, money market funds introduced payment mechanisms (with the assistance of participating banks) to allow redeemed funds to be directed to third parties as well, effectively creating checking accounts for fund shareholders.¹⁶

Technology has done more than facilitate the development of competing financial products that could draw funds away from bank deposits. The money market funds also demonstrated — as banks independently were discovering — that electronic communications facilities could expand the relevant geographic market from which funds could be drawn and to which investments could be directed. A toll-free telephone number connecting the customer to a highly efficient record-keeping office was sufficient for many investors; it was unnecessary that the firm have a physical presence near the customer in order to attract his or her funds.¹⁷

In tandem, these two technology-based developments have had a dramatic effect on the more affluent portion of the banking marketplace.¹⁸ At one time depositors seeking liquidity and return on rela-

16. The money market fund then became the base from which was built a more complex competitive product, the so-called cash management account. Securities broker-dealer firms, beginning with Merrill Lynch, invited customers to establish accounts that permitted prompt and easy electronic transfer of funds among a wide variety of investments; cash held in the money market fund could be shifted out when the need for liquidity was less pressing and higher-yielding investments more important, back when cash was necessary. Merrill Lynch's account also permitted customers the use of a Visa debit card to "charge" purchases which would be subject to immediate payment out of the cash account. Also a major part of the account is the ability to borrow on margin for securities transactions. The Merrill Lynch account is described in 42 Op. Or. Atty. Gen., 273-77 (1982), a matter where the status of the account was challenged as unlawful banking. That challenge was rejected.

17. See Frieder, *Legislating for Interstate Bank Expansion: Financial Deregulation and Public Policy*, 9 J. CORP. L. 673, 728 (1984); Smith, *A Global View of Technology's Future in Retail Banking*, 7 J. RETAIL BANKING 43, 46 (1985-86). For a description of Citibank's current plans in this regard, see *Mail Phone ATM = Bank*, BANKING EXPANSION REP., Feb. 4, 1985, at 14. Advice to consumers along these lines is found in Eisenberg, *When It Pays to Use an Out-of-State Bank*, MONEY, Apr. 1985, at 81.

18. This segment of the market is made up of those persons with substantial funds available for savings and investment. See Prickett, *Banking on a Segmented Market*, BANKERS MAG., Mar.-Apr. 1985, at 44. The lower end of the market spectrum is made up of those persons whose bank deposits are little more than what is needed for current consumption. Technology-based innovations have largely been directed at the former group, since they are the source of the largest profitability. It should be noted, however, that as information and transaction costs go down, the wealth level of the group to which such innovations can be marketed will decline as well. An example is the cash management account. When introduced, the account required a minimum of \$20,000 in cash or securities. Today, the minimum among the various competing accounts offered by the securities industry can be as low as \$2500. The lower-end group faces a marketplace that has not changed substantially in either product or geographic availability. What is new for this group is far higher fees which reflect the fact that such small accounts do not offer the bank a profit opportunity that exceeds the cost of handling the account. At one

tively small amounts of money had, for all practical purposes, a range of choices limited to those banking and savings institutions located in the immediate geographic area. With the advent of the new products, the depositor could choose to avoid banks altogether, or limit use of the bank to that small amount necessary to cover a local checking account. And with the development of electronically enhanced means of entering remote markets, the number of financial institutions — banks and nonbanks — competing for a given person's money quickly increased, again expanding consumer choice. A transitional deposit marketplace structurally different from that of twenty or thirty years earlier has resulted.

Comparable developments have taken place on the lending side of the business of banking. Financial institutions, including trust departments, pension funds, and insurance companies, are willing to loan money on a short-term basis, accepting rates of interest lower than those demanded by commercial banks. Through the so-called commercial-paper market,¹⁹ high-quality corporate borrowers have tapped this demand, utilizing communications and record-keeping technology that permits efficient matching and transactions between themselves and their creditors. By issuing commercial paper instead of borrowing from a bank, corporations effectively eliminate the intermediary in their acquisition of capital. The growth of the commercial-paper market has had significant impact on banks, eliminating some of the most profitable borrowers and pressuring banks to make lower-quality loans to more marginal borrowers to compensate for the loss. The result is higher risk in the core business of banking.²⁰

Institutional investor demand for short- and medium-term debt, evidenced by the expansion of the commercial-paper market, has led as well to a proliferation of the use of "securitized" debt as a financing device. Securitization is the process whereby a lender creates a pool of debt instruments (e.g., mortgages, automobile or credit card receiv-

point, a New York bank considered requiring smaller customers to use automated teller machines, reserving human tellers for "preferred" customers. This plan met with adverse public reaction and was not implemented. Some of the policy issues of this trend with respect to lower-income banking consumers are noted in *EFFECTS OF INFORMATION TECHNOLOGY*, *supra* note 6, at 243-44.

19. See M. STIGUM, *THE MONEY MARKET* 626-28 (1983). For an older study, see Note, *The Commercial Paper Market and the Securities Acts*, 39 U. CHI. L. REV. 362 (1972). See also Lowenstein, *The Commercial Paper Market and the Federal Securities Laws*, 4 CORP. L. REV. 128 (1981).

20. This point is made strongly by Moody's Investors Service, which in a recent report noted the decline in the credit quality of the banking industry itself as a result of this development. See 48 Banking Rep. (BNA) 152 (Jan. 19, 1987); see also M. MAYER, *supra* note 14, at 25-26 (1984). In addition, large borrowers are increasingly able to go overseas to meet their credit and borrowing needs.

ables), and sells to investors collateralized interests in the pool in the form of debt securities.²¹ The original lender's profits then come largely from the spread from the underwriting and distribution of the securities, rather than from compensation for the assumption of risk throughout the term of the loan. At the same time, the role remains one of an intermediary — albeit for a much shorter term, and with emphasis on locating and selling these instruments to net savers willing to bear some or all of the associated risks — in the commercial financing process. Over time, there is little reason to believe that securitization will not extend to the full range of loans (including commercial loans) in a bank's portfolio.²²

B. *Banking Regulation*

The structural change in the banking marketplace has reoriented thinking about bank regulation. Bank regulation in the United States is a complicated exercise, long limited in its effectiveness by the fact that persons wishing to organize a bank could seek either a federal or a state charter and, for all practical purposes, thereafter switch freely from one to the other if given reason to do so. History shows repeated examples of either federal or state regulatory initiatives that failed or were abandoned upon recognition that the effect would simply be to cause banks to switch their charters away from the regulatory authority.²³ The technology-based developments noted above have further complicated and restrained bank regulation, and in some cases have rendered it self-defeating.

1. *Promoting Bank Soundness*

A principal objective of bank regulation is the promotion of the

21. See CHAIRMAN OF THE HOUSE SUBCOMM. ON TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE OF THE COMM. ON ENERGY AND COMMERCE, 99TH CONG., 2D SESS., *RESTRUCTURING FINANCIAL MARKETS: THE MAJOR POLICY ISSUES* 287-90 (Comm. Print 1986) [hereinafter *RESTRUCTURING FINANCIAL MARKETS*]. The seller's motivations for securitization include lower cost of capital, the shifting of risk, and the avoidance of regulatory disincentives to the retention of particular assets (decreasing capital adequacy requirements and increasing lending capacity). *Id.*; Apar, *More Banks Sell Part of Loan Portfolios*, Wall St. J., Mar. 4, 1987, at 12, col. 1.

22. Under some circumstances, the originating bank or finance company will provide a guaranty against some or all liquidity or credit risk, thereby remaining as an "insurer" intermediary. See Corrigan, *Financial Market Structure: A Longer View*, in FED. RES. BANK OF N.Y., ANNUAL REPORT 1986, 3, 7-8. One impediment to full-scale securitization may be the regulatory structure itself. For instance, the Investment Company Act of 1940 gives favorable treatment to pools of mortgages and receivables, but not to commercial loans. See *Financial Restructuring: Hearings Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, 99th Cong., 1st Sess. 324 (1985) (testimony of Stephen Friedman).

23. See Scott, *supra* note 5, at 20-36.

financial soundness of banking institutions, *i.e.*, the prevention of bank failures.²⁴ The regulatory motivation here is two-fold: (1) to protect, as a political end in itself, depositors who otherwise might not be able to assess the risk of failures on their own, and (2) more instrumentally, to encourage deposits by those who might otherwise be discouraged by the risk of failure, leading to an expansion of available credit through the banking system and, in the end, economic growth. The soundness objective has been pursued in a number of ways:²⁵ restrictions on insider transactions that might involve overreaching, portfolio restrictions that prohibit banks from assuming too much risk, capital adequacy rules, and — importantly for present purposes — regulation designed to prevent “undue” competition among banks, which might threaten their financial stability. These strategies have been supplemented by a system of insurance for smaller depositors, in effect since 1933.²⁶

The history of limits on the interest rates that could be paid to depositors, known administratively as Reg. Q,²⁷ clearly illustrates how a changed marketplace structure thwarted what had before been an apparently successful form of regulation. By prohibiting banks from paying interest on checking accounts, and severely limiting the rate for time deposits below market levels, federal regulatory authorities for a long time virtually guaranteed banks a profitable spread between their income and their cost of funds. In this noncompetitive environment, bank failure was exceedingly rare absent affirmative management dishonesty.²⁸

Two developments combined to upset this strategy. One was the substantial growth in bank borrowing from other financial institutions in the various money markets at unregulated rates. The second was an erosion of the regulated deposit base. By the mid-1970s, the difference between the Reg. Q ceiling and what the unregulated market was pay-

24. See Clark, *supra* note 9, at 25-26.

25. For an overview of these particular techniques, see generally *id.*; E. SYMONS & J. WHITE, *BANKING LAW* (2d ed. 1984).

26. Deposits are insured up to \$100,000. To the extent that the foregoing regulatory strategies are based on the goal of promoting depositor confidence in the banking system, they are redundant if insurance by itself achieves this end. In many respects, the forms of regulation designed to promote soundness are really protective devices for the insurance fund — an effort by the insurer (the government-controlled fund) to control its own risk.

27. See Banks and Banking, Interest on Deposits, 12 C.F.R. § 217 (1987).

28. This strategy was coupled with a policy of limited entry. See Scott, *In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies*, 42 U. CHI. L. REV. 235 (1975). Limits on competition, of course, were not altogether benign. Consumers bore various indirect costs, such as those associated with reduced efficiency. For a discussion of some of these costs, see De Alessi, *The Economics of Property Rights: A Review of the Evidence*, in 2 RES. L. & ECON. 1, 22-23 (1980); see also Clark, *supra* note 9, at 34-40.

ing for funds was, because of high inflation, uncomfortably large. This permitted the emerging money market fund industry — not engaged in the banking business as legally understood and therefore not subject to any rate regulation — to attract billions of dollars of funds out of the banking system entirely.²⁹ What had been an effort to promote the financial soundness of the banking system forced banks instead to stand helpless in the face of competition from “nonbanks.” In 1980, Congress was forced to phase out Reg. Q, thus effectively mandating payment of market rates of interest, so as to remove the competitive disadvantage. In the process it eliminated the soundness protection that had theretofore been seen as desirable regulatory policy, and substantially increased the level of risk faced by commercial banks in their traditional activity by reducing the expected spread between costs and income.³⁰ Once close substitutes for bank deposits became publicly available as a result of the marketplace transition, allowing consumers with their savings dollars to opt out of the banking system, the existing form of regulation was impossible to sustain.

This in turn had an important second-level effect. Whereas regulatory strategies such as product-line restrictions (including Glass-Steagall) could once be justified as rules designed to prevent banks from taking on lines of business that were inherently more risky than the protected business of borrowing and lending, those restrictions now operated to force banks to operate in a relatively undiversified fashion in what had become a high-risk business.³¹ Moreover, other developments have combined to exacerbate the problem. The commercial-paper and securitized-asset markets now offer effective substitutes for traditional bank financing. Any policy of strict separation would preclude banks from engaging in activities that are not substantially dif-

29. See S. REP. NO. 378, 96th Cong., 1st Sess. 4-6 (1979); E. ROUSSAKIS, *COMMERCIAL BANKING IN AN ERA OF DEREGULATION* 72-78 (1984).

30. See Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 204, 94 Stat. 103 (1980) (codified at 12 U.S.C. § 3503 (1980 & Supp. 1987)). The phase-out mandated by the Act was completed in 1985. For a general discussion, see Note, *Markets for Money — Does the Garn St. Germain Money Market Deposit Account Overcompete With Mutual Funds?*, 36 VAND. L. REV. 1129 (1983).

31. There is some evidence that banks that have been able to diversify their income base away from traditional activities have fared substantially better in recent years than those that have not. See Schmitt, *As Big Banks Prosper in a Profit Recovery, Smaller Ones Languish*, Wall St. J., June 19, 1986, at 1, col. 6. That, of course, is not inevitable; adding risk to risk can simply compound exposure. For an excellent study of diversification and its relation to risk, see Litan, *Evaluating and Controlling the Risks of Financial Product Deregulation*, 3 YALE J. ON REG. 1 (1985); see also Edwards, *Banks and Securities Activities: Legal and Economic Perspectives on the Glass-Steagall Act*, in *THE DEREGULATION OF THE BANKING AND SECURITIES INDUSTRIES* 273 (L. Goldberg & L. White eds. 1979) [hereinafter *DEREGULATION*]; Boyd & Graham, *Risk Regulation, and Bank Holding Company Expansion into Nonbanking*, 10 FED. RES. BANK OF MINNEAPOLIS Q. REV. 2 (1986). For a study of diversification that questions its role in risk reduction, see Wall, *Nonbank Activities and Risk*, 71 FED. RES. BANK OF ATLANTA ECON. REV. 19 (1986).

ferent in economic function from their core business, even though the stress is now on risk transfer (and the necessary marketing effort to accomplish this) rather than risk assumption. Such separation would in turn foreclose sources of income that might compensate for the losses that result from the restructured marketplace — potentially, a safety and soundness-decreasing effect.³²

2. *Dispersion of Economic Power*

A second rationale underlying much of banking regulation over the course of history has been a desire to decentralize control over capital, to avoid undue concentration of economic power in a “handful” of large financial institutions. This objective finds expression in a host of regulatory strategies. Branching and interstate banking restrictions, as well as prohibitions on bank expansion into “nonbank” lines of business, are significant examples.³³ To some extent, this objective is based on a fear of financial “bigness” in itself; it also rests on concerns about potential conflicts of interest and anticompetitive practices in the industry (e.g., tying arrangements, cross-subsidization)³⁴ in the event of severe concentration.

The impact of technology on the ability to pursue this objective is also clear. As noted earlier, an emerging feature of the restructured marketplace is the absence of effective geographic barriers to entry in light of the ability to communicate and transact over long distances. Large banks, and competing nonbank institutions, have developed means of attracting deposit accounts and making both consumer and commercial loans without running afoul of legal restrictions currently in effect.³⁵ These developments are leading to substantially greater concentration in at least some markets.

3. *Channeling*

Probably the most underestimated recurrent political goal in banking regulation has been that of influencing the use of funds in the financial system. Both legislatively and administratively, strategies

32. See note 20 *supra*.

33. See Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 789, 835-36 (1979). Clark refers to this as a “Zaibatsu” risk, after the Japanese experience. The theory is that by foreclosing financial institutions from various geographic or product markets their growth (and thus influence) will be limited.

34. These individual potential abuses are specifically unlawful, either pursuant to particular banking law statutes (such as the anti-tying statute, 12 U.S.C. § 1972 (1985)) or the antitrust laws generally. The anticoncentration strategies merely supplement these. For a criticism of these strategies, see Fischel, Rosenfield & Stillman, *The Regulation of Banks and Bank Holding Companies*, 73 VA. L. REV. 301 (1987).

35. See note 20 *supra*.

have emerged that explicitly or implicitly purport to prefer one use of funds over another.³⁶ The development and protection through regulation of the savings and loan industry has been a way of channeling capital from savers to homeowners (and the real estate industry generally) via mortgage lending.³⁷ Branching and holding-company expansion restraints are at least in part premised on the desire to promote "local" use of "local" deposits. Restrictions on product expansion have been justified by the need to assure that banks will concentrate their resources on commercial lending — their "special" economic function³⁸ — rather than other more speculative forms of investment.

Here, the effect of technology-induced marketplace change is both obvious and subtle. Even small institutions now have the ability to seek out, with low search and transaction costs, both capital and investment opportunities on a worldwide basis. The assumption that a locally controlled bank will naturally concentrate its resources on community reinvestment — perhaps never entirely accurate — becomes all the more anachronistic as the cost of other investments diminishes. And the problem is compounded as geographic barriers to entry are reduced by remote banking activities.³⁹

The indirect effects are even more significant. As wealthier consumers have found a range of close substitutes for bank deposits (*e.g.*, money market funds and cash management accounts), any regulatory restrictions that put banks at a competitive disadvantage in attracting depositors actually *defeat* the channeling policy by causing some funds to leave the banking system altogether.⁴⁰ The experience of the sav-

36. A fairly recent attempt to allocate credit directly was a bill introduced in Congress in 1975 that would have specified what lending priorities were appropriate and what were not. *See generally* *Hearing on H.R. 212 Before the Subcomm. on Domestic Monetary Policy of the House Comm. on Banking, Currency and Housing*, 94th Cong., 1st Sess. (1975). Most strategies in this direction are more subtle.

37. While Reg. Q was effective as a limit on interest rates paid to depositors, savings and loans were permitted to pay a somewhat higher rate than commercial banks — clearly a channeling device.

38. There remains a substantial political interest in preserving a market structure that has entities devoted primarily to the provision of commercial credit. *See, e.g.*, Corrigan, *supra* note 22, at 17-21; RESTRUCTURING FINANCIAL MARKETS, *supra* note 21, at 137, 251-54. A statistic provoking concern in this regard, from 1984, is that less than 10% of the funds of 47% of all commercial banks were invested in commercial loans. *Id.* at 252.

39. It has thus become necessary for Congress to supplement this localism-oriented form of regulation with a more specific one, the Community Reinvestment Act, 12 U.S.C. §§ 2901-2905 (1985), which purports to force banks to give adequate attention to local credit needs. *See generally* McCluskey, *The Community Reinvestment Act: Is It Doing the Job?*, 100 BANKING L.J. 33 (1983); Booth & Smith, *The Impact of the Community Reinvestment Act on Branching Activity of Financial Institutions*, 15 J. BANK RES. 123 (1984).

40. An individual who chooses to place funds in a money market fund gives only initial control of the capital to the managers of the fund. When the fund buys securities, payment goes to the seller, who might then deposit that money in a bank. In this sense, the idea that funds leave the banking system may be overstated. Nonetheless, the bank in which the funds might

ings and loan industry in the late 1970s — when institutions faced a large loss of consumer funds and more than half were at least technically insolvent — is attributable in large part to the combination of interest rate restrictions placed on savings accounts and limitations designed to force savings and loans to channel their assets to the housing market only.

4. *Federalism*

Separate from the three foregoing regulatory objectives is one that can be explained only in historical terms. State authority to charter banks, and a federal commitment to nothing more than concurrent power, has long been assumed — first as a matter of constitutional law,⁴¹ then (once it was clear that Congress *could* preempt the field) as an ingrained and jealously guarded practice. The desire to preserve the “dual system of banking” — notwithstanding the difficulties it creates for effective regulation — finds expression in branching and interstate banking restrictions, as well as in numerous specific regulatory provisions governing national banks whereby standard-setting authority is delegated to the various states.

Structural change in the banking market has severely compromised this goal as well. A useful illustration is the experience with respect to usury rates. Federal law subjects national banks to the rate ceilings set by the state in which they are “located.”⁴² This regulation, designed to preserve competitive equality among state and national banks in each particular jurisdiction, was workable so long as the consumer lending market was essentially local. The dramatic growth of the credit card industry in the 1960s and 1970s has changed that, by allowing nationwide extension of credit (utilizing sophisticated communications and record-keeping technology) by banks physically located in only one state. In 1978 the Supreme Court held, quite sensibly, that the usury rate of the state of the lender’s home office governed such extension of credit, regardless of where the loan was actually made.⁴³ That meant, however, that the state with the clearest interest in protection of the particular borrower had lost the ability to govern the transaction. South Dakota and Delaware quickly seized upon the opportunity to take advantage of the ruling by deregulating

otherwise have been deposited has lost its opportunity to use the funds, along with the resulting profit.

41. For an older analysis, see Breckinridge, *Constitutionality of Federal Branch Bank Legislation*, 19 ILL. L. REV. 629 (1925). A recent view sympathetic to regulatory federalism is Miller, *The Future of the Dual Banking System*, 53 BROOKLYN L. REV. 1 (1987).

42. 12 U.S.C. § 85 (1985).

43. *Marquette Natl. Bank v. First of Omaha Ser. Corp.*, 439 U.S. 299 (1978).

interest rates and other banking functions in order to attract banks and credit card companies that operate solely on an "export" basis.⁴⁴ As in corporation law, the practical effect has been to force competing states to deregulate similarly, or face a loss of that segment of the banking business. Whatever federalism interest once justified this regulatory strategy has no utility whatsoever in an era of "remote" consumer lending. The same sort of breakdown will occur in bank regulation generally over time if remote full-service banking becomes the norm in some or all segments of the market. There is little doubt that Delaware and others are prepared to take the lead on broader-scale deregulation as well, absent federalization of bank regulation. And even this may not be enough; the internationalization of the banking and capital markets is likely to provide both borrower and depositor choices that will thwart even comprehensive national regulatory strategies.⁴⁵

5. Summary

The four foregoing regulatory objectives are by no means independent of each other; many strategies, like branching restrictions, are justified by a combination of some or all of the goals. Nor is the list complete. Other social policies historically have been pursued via banking regulation (e.g., equal credit opportunity, anti-redlining, etc.), and the need for administrative convenience by itself explains why some strategies exist in the form they do. Moreover, some banking regulation undoubtedly was either originally intended as or has evolved into little more than special-interest protectionism, whatever the justifications publicly given for it.⁴⁶ These four objectives are, however, the dominant legitimate — if not necessarily wise⁴⁷ — goals

44. For a description of the aftermath of *Marquette*, see Eckman, *The Delaware Consumer Credit Bank Act and "Exporting" Interest Under Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980*, 39 BUS. LAW. 1264 (1984). On South Dakota's position, as described by its governor, see Janklow, *South Dakota and Financial Deregulation*, BANKERS MAG., Sept.-Oct. 1985, at 32. See generally Frankel, *The Dual State-Federal Regulation of Financial Institutions — A Policy Proposal*, 53 BROOKLYN L. REV. 53 (1987).

45. There is little doubt that the growth of the so-called Eurodollar market and the alternative financing vehicles offered abroad have provoked much rethinking of American banking regulation. For example, pressure to revise the Glass-Steagall Act comes at least in part from the recognition that foreign banks and bank holding companies have far greater securities powers than their American counterparts (at least as they operate domestically), leaving the latter at a competitive disadvantage in world-wide financing. See Wallison, *The Statutory and Policy Underpinnings of United States Bank Securities Activities Abroad*, 4 B.U. INTL. L.J. 117 (1986). Conversely, the fact that American financial institutions operate abroad without being subject to the Act — without, to this point, causing serious problems — points out the weakness in much of the Act's justification.

46. See J. HAWKE, COMMENTARIES ON BANKING REGULATION 303-08 (1985).

47. Nothing in the foregoing discussion is necessarily meant either as an endorsement or a

underlying the prevailing system of banking regulation, and banking law cannot be understood except by reference to them.

To generalize: the impact of structural marketplace change on these regulatory objectives can be seen by observing that each of them works only if a discrete number of localized market participants has exclusive province over the business of banking in its particular market. At one time, that was by and large a valid assumption, and much of the statutory language that today governs banking law was written under its influence. Change the assumption to some degree, in light of the new opportunities for entry into the traditional product and geographic banking markets, and those strategies become less effective, perhaps even counterproductive. Continued adherence to original intent then offers little more than foolish consistency. This is the insight that complicates the task of courts faced with interpreting the older statutes, and that tempts them to update. This article now turns to two of the primary sources of such temptation.

II. INTERPRETING THE GLASS-STEAGALL ACT

The portion of the Banking Act of 1933 known as the Glass-Steagall Act,⁴⁸ dealing with the securities activities of banks, is of obvious importance in the process of marketplace transition. As the preceding discussion has shown, two characteristics of the altered market are the consumer's ability to shift funds rapidly among banking and investment accounts and the availability of new financial products covering the entire risk/return spectrum; there is little reason to park substantial funds in a relatively low-yield deposit account awaiting future use, in light of the attractive alternatives currently available. The rational consumer's inclination, given lowered search and transaction costs, is to expand his or her portfolio of investments. By apparently erecting a wall of separation between banking and the securities business, however, the Glass-Steagall Act has limited the ability of commercial banks to offer consumers the full range of higher-risk, higher-yield se-

criticism of these goals. Without question, some (like the soundness objective) are compelling, with debate only about the means of achieving them. On the other hand, strong arguments can be made that they often mask protectionism and impose significant regulatory costs on consumers and society generally. See Clark, *supra* note 9, at 34-40, 48-58, 79-85.

48. Ch. 89, 48 Stat. 162 (1933) (codified in scattered sections of 12 U.S.C. (1982)). For a variety of views on the Act in contemporary perspective, see Norton, *Up Against "The Wall": Glass-Steagall and the Dilemma of a Deregulated ("Reregulated") Banking Environment*, 42 BUS. LAW. 327 (1987); Clark & Saunders, *Glass-Steagall Revised: The Impact on Banks, Capital Markets, and the Small Investor*, 97 BANKING L.J. 811 (1980); Karmel, *Glass-Steagall: Some Critical Reflections*, 97 BANKING L.J. 631 (1980); Huertas, *An Economic Brief Against Glass-Steagall*, 15 J. BANKING RES. 148 (1984); DEREGULATION, *supra* note 31, at 273-353; Orbe, *Glass-Steagall: Lest We Forget*, 11 FLA. ST. U. L. REV. 163 (1983).

curities to fill out the portfolio. In contrast, securities firms — traditional specialists in this end of the portfolio spectrum — have been able to move much closer to the full range via the money market fund, very much a deposit account substitute. At the same time, the line between commercial lending and securities distributions has blurred considerably. Thus, a competitive imbalance exists, leading the banking industry to test as severely as possible the Act's outer limits.

The Glass-Steagall Act is in four sections. Section 16 limits the securities activities of banks that are members of the Federal Reserve System (including all national banks) to purchasing and selling securities solely upon the order and for the account of their customers — not investing for their own account or underwriting issues of any stock except as specified in the statute.⁴⁹ Section 20 prohibits affiliations between a member bank and any entity “engaged principally in the issue, flotation, underwriting, public sale or distribution” of securities.⁵⁰ Section 21 prohibits entities engaged in the securities business from engaging at the same time in the business of receiving deposits.⁵¹ Finally, section 32 bars director and management interlocks between member banks and entities primarily engaged in the securities business.⁵²

A. *The Supreme Court and Glass-Steagall's Purpose*

The starting point for a modern intellectual history of the Glass-Steagall Act is *Investment Company Institute v. Camp*,⁵³ the first major Supreme Court case to construe the Act's restrictions on bank powers — a case that, significantly, was not decided until nearly forty years after the law's enactment. *Camp* considered the legality of a proposal by First National City Bank to establish and market to the public a collective investment fund. Customers would be solicited to purchase interests in the fund; the bank would pool the money so invested and purchase and sell securities therewith, which would be held for the benefit of (and income and gains distributed to) the investors. The bank would earn a sizable fee for administering the fund. In this sense, the program was the functional equivalent of an open-end investment company, *i.e.*, a mutual fund, and was no doubt intended by the bank to be competitive in that market. It was an early step into

49. See the seventh provision of 12 U.S.C. § 24 (1985), made applicable to state chartered banks that are members of the Federal Reserve System by 12 U.S.C. § 335 (1985).

50. 12 U.S.C. § 377 (1985).

51. 12 U.S.C. § 378a (1985).

52. 12 U.S.C. § 78 (1985).

53. 401 U.S. 617 (1971).

the transitional marketplace, motivated by the renewed popularity of the stock market during the 1960s.⁵⁴

In reversing a determination by the Comptroller that the proposed fund was simply an extension of the trust powers long assumed in the banking industry, the Court established a fundamental interpretive principle for Glass-Steagall. In its view, Congress effected the total separation of commercial and investment banking out of concern for bank soundness, fearing a variety of adverse consequences to individual banks and the banking system as a whole if banks were permitted to remain in the securities business. Invoking a traditional "purposive" approach to interpretation, the Court indicated that judicial determinations under the Act should therefore be based on whether a particular proposal implicates these same concerns. To this end, the Court acknowledged that the City Bank proposal would not put any bank deposits or capital at risk. Nevertheless, it determined that the proposal was unlawful because it posed a series of more "subtle hazards"⁵⁵ to bank safety and soundness of the sort that caused Congress to effect a complete separation of commercial and investment banking.

At this crucial point in the Court's opinion, the reasoning begins to fall of its own weight, for its historical explanation for why divorce was compelled — its touchstone for statutory interpretation — is less than convincing. A primary set of concerns articulated by the Court,

54. One of the interesting features of *Camp* is the Court's resolution of the issue of standing to challenge the Comptroller's ruling. The prevailing test required not only injury in fact but a determination that those bringing suit were at least arguably part of the class of persons that Congress was seeking to benefit or protect through enactment. Under a strict reading of the "zone of interests" test, members of the securities industry should not have had standing to sue the Comptroller if the sole purpose of the legislation was to protect bank soundness or the health of the banking system. The Court, however, dismissed the standing question with a simple citation to previous cases where members of competing industry groups had been granted standing to challenge the Comptroller's rulings with respect to bank subsidiary powers in their fields. *Data Processing Serv. v. Camp*, 397 U.S. 150 (1970); *Arnold Tours v. Camp*, 400 U.S. 45 (1970) (per curiam). In those cases, however, the Court had been able to find in the legislative history of a completely different provision, the Bank Service Corporation Act, an articulation of concern for nonbank competitors who might be put at an unfair competitive disadvantage were banks allowed to enter particular fields. Absent an articulation of similar concern in the history of the Glass-Steagall Act — which will be demonstrated below — this precedent is completely distinguishable. Yet since *Camp* the question of securities industry standing to challenge bank expansion under Glass-Steagall has not seriously been questioned; it has been raised, but lower courts have felt bound by *Camp* to reject the argument. See, e.g., *Investment Co. Inst. v. Conover*, 593 F. Supp. 846 (N.D. Cal. 1984), *revd. on other grounds*, 793 F.2d 220 (9th Cir.), *cert. denied*, 107 S. Ct. 422 (1986). A recent Supreme Court decision involving the battle between the banking and securities industries with respect to branching powers under the McFadden Act adopts once again a very broad approach to the zone of interests test. *Clarke v. Securities Indus. Assn.*, 107 S. Ct. 750 (1987). On the extent to which courts really do inquire into legislative history under the zone of interests test, see Note, *A Defense of the "Zone of Interests" Standing Test*, 1983 DUKE L.J. 447.

55. 401 U.S. at 630.

for example, had to do with potential conflicts of interest. A bank with substantial investments in an issuer might, for example, be tempted to misuse its lending or trust authority to support the issuer, or a distribution of its securities, through bad investments or bad loans.⁵⁶ That is a legitimate concern, and examples of such abuse were given in the Act's legislative history.⁵⁷ But it is difficult to believe that Congress would have effected a radical separation of two industries based on that concern alone when the problem could so easily have been addressed by regulation, well short of divorce.⁵⁸

A second set of concerns the Court identified, relating to the bank's public identification with its securities affiliate and the effect on confidence in the bank's soundness if the investment affiliate was doing poorly, seems even less compelling.⁵⁹ Not only does it assume that the public is misinformed about the relationship between the affiliates, but contemporaneous adoption of deposit insurance makes the scenario unlikely.⁶⁰ Again, this seems a weak motivating factor for such an aggressive legislative initiative.

The final set of concerns related to a fear that a "salesman's interest" in particular securities might compromise the role of the banker as a faithful servant of its customers.⁶¹ What this has to do with bank soundness is by no means clear; it is highly unlikely, for instance, that consumers would withdraw their money from the banking system because of some perceived conflict. Once more, the suggestion that this in fact led Congress to compel divorce is implausible.

The relative frailty of the justifications given by the Court for what Congress was seeking to accomplish through Glass-Steagall makes it an unsatisfying opinion. Transitional marketplace or not, it offers no persuasive answer to the question of why, given the ability to regulate

56. 401 U.S. at 631.

57. In fact only one instance of a bank failure related to bank securities activities was discussed in the legislative history (that of the Bank of the United States), and that instance involved grave personal misconduct by bank insiders. 401 U.S. at 629-30. The use of bank funds to "throw good money after bad" is not rational; certainly, the temptation to do so pursuant to an investment banking relationship is no greater — probably less — than in the situation where the bank has a long-standing commercial banking relationship with the borrower. A more serious concern, however, might arise if bank officers or directors had a personal interest in the success of the securities affiliate or the issuer of the securities.

58. In proposing repeal of the prohibition on bank underwriting of corporate securities in 1935, Senator Glass offered a set of simple regulatory restrictions which, in his view, would easily suffice to prevent abuse. See 79 CONG. REC. 11,933-34 (1935). For a recent proposal to control these possible abuses through regulation, see Note, *Restrictions on Bank Underwriting of Corporate Securities: A Proposal for More Permissive Regulation*, 97 HARV. L. REV. 720 (1984).

59. 401 U.S. at 631.

60. As the drafters of the separation provision were actively opposed to deposit insurance and hoped to defeat it, the legislative history does not assume its existence.

61. 401 U.S. at 631-33.

proposed bank securities activity, Congress would want instead to bar banks from this field completely. This lingering dissatisfaction — that there must be something more to the story — is important, for it raises the possibility that the subsequent permissive development of the case law is a product of this unanswered question, rather than any conscious judicial updating of the statute. Along these lines, a number of influential writers have concluded that the ostensible rationale for the legislation must be a mere pretext. Instead, they contend, the Act is simple special-interest legislation on behalf of the investment banking community. Noted economist George Benston has written, for example, that “the evidence supports the belief that the investment bankers and underwriters were concerned about severe competition from banks and bank affiliates and sought (successfully in 1933) to eliminate these competitors.”⁶² In his 1984 Supreme Court foreword in the *Harvard Law Review*, Professor (now Judge) Frank Easterbrook criticized a 1984 Glass-Steagall Act decision as “in several ways . . . the most troubling economic decision of the Term,” for failing to take into account the interest of the plaintiff, the Securities Industry Association, in claiming the “spoils of victory” in the legislative process.⁶³ Similarly, though urging an interpretive approach designed to thwart the power of special interests, Professor Jonathan Macey contends that Glass-Steagall was in fact enacted at the behest of the investment bankers.⁶⁴ If this more accurately describes Congress’ motivation, then *Camp*’s weakness, and all the subsequent twists in the Act’s construction, are understandable but intellectually insignificant, for statutory interpretation based on misleading statements of intent is doomed to incoherence. For this reason, and because at least under an interpretive approach like Easterbrook’s such “deals” are to be given controlling effect, the historical issue requires further consideration.

1. *Intent Reconsidered*

Determining who was responsible for the separation of commercial

62. Benston, *Federal Regulation of Banking: Analysis and Policy Recommendations*, 13 J. BANK RES. 216, 222 (1983).

63. Easterbrook, *The Court and the Economic System*, *supra* note 1, at 57. Easterbrook’s view is that, by analogy to private contracts, courts should seek to carry out the true (not simply ostensible) intent of the legislature, even if that means in some cases effectuating a raw political “deal” between legislators and some special-interest group. He does not go so far as to determine that the plaintiff in the case in question was in fact the victor with respect to the issue before the Court — only that the Court should have inquired in that direction.

64. See Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223 (1986) [hereinafter Macey, *An Interest Group Model*]; Macey, *Special Interest Groups Legislation and the Judicial Function: The Dilemma of Glass-Steagall*, 33 EMORY L.J. 1, 15-21 (1984) [hereinafter Macey, *Special Interest Groups*].

and investment banking — and why — resembles solving a murder mystery in which all the evidence is circumstantial. The claims made by Benston, Easterbrook, and Macey are based on deduction rather than discovered fact: convinced that there is no *rational* economic policy to support a wall of separation between banking and the securities industry (as opposed simply to oversight and regulation of the securities activities of banks), they conclude that the only possible alternative explanation is a skewing of the political process by those who later turned out to be immense beneficiaries of the statute.

Admittedly, private investment bankers had a strong motive for seeking a wall of separation. Prior to World War I, investment banking in America was the province of a small, closely-knit group of Wall Street institutions, led in influence and prestige by such firms as J.P. Morgan & Co. and Kuhn, Loeb & Co.⁶⁵ In the century's first decades, however, larger banks began to establish securities affiliates as means for engaging in the sale and distribution of securities, generally bonds.⁶⁶ The earliest securities efforts were justified by the need to provide wealthier bank customers with "full-service" financial assistance; often, these services were part of the bank's trust activities, separately incorporated in order to take advantage of the more liberal powers granted under state corporation (as opposed to state or federal banking) law. In the 1920s, this emphasis changed. As the public's appetite for securities grew, many large corporations switched their sources of funding from bank loans to new issues of stock. Both to replace the loss of income from this transition, and to take advantage of the profit opportunities from the popularity of securities distributions generally, these bank affiliates expanded both the nature and scope of their activities — now competing fully with the private investment bankers.⁶⁷ Drawing on their large capital bases and networks of affiliated institutions, they were successful competitors. By the end of the decade, bank securities affiliates — most importantly, those of Chase National Bank and National City Co. of New York — were sponsoring over half of all new securities issues.⁶⁸ This trend naturally provoked expressions of concern from the private investment bankers,

65. See V. CAROSO, *INVESTMENT BANKING IN AMERICA* (1970); S. HAYES, A. SPENCE, & D. MARKS, *COMPETITION IN THE INVESTMENT BANKING INDUSTRY* 5-28 (1983). Another useful history of investment banking is found in the court's exhaustive opinion in an antitrust case brought against the investment banking industry, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

66. See W. PEACH, *THE SECURITIES AFFILIATES OF NATIONAL BANKS* (The Johns Hopkins University Studies in Historical and Political Science, series LVIII, No. 3, 1941).

67. See W. PEACH, *supra* note 66, at 24; see also Osterweis, *Security Affiliates and Security Operations of National Banks*, 11 HARV. BUS. REV. 124, 126 (1933).

68. S. KENNEDY, *THE BANKING CRISIS OF 1933*, at 212 (1973).

noted most clearly at the annual convention of the Investment Bankers Association in 1929.⁶⁹ No doubt, doing away with commercial bank competition was an attractive thought.

Motive notwithstanding, the circumstantial case against the investment bankers as a special interest group responsible for the divorce of commercial and investment banking is untenable. One obvious weakness is that New Deal banking legislation has, among historians and political scientists, been one of the most studied and commented upon of all economic subjects. Yet none of the major studies cites special-interest pleading as a major factor in the passage of the Banking Act of 1933.⁷⁰ Nor does one find allegations to that effect in the recollections or biographies of those close to the legislative process at the time,⁷¹ and this is significant. While those actually responsible for the Act might well try to hide any less than public-regarding motivation, the many who opposed the legislation certainly had reason to publicize its true origins.

More important than the absence of hard evidence, however (for history has certainly known cover-ups), is the existence of a persuasive alternative explanation for the deed. By all accounts, the legislative history begins with Senator Carter Glass of Virginia, principal drafter of the Federal Reserve Act in 1914, and the preeminent congressional authority on the business of banking.⁷² Glass, as influenced by his principal advisor, Professor H. Parker Willis of Columbia University, was an old-fashioned banking theorist; he believed that the proper role of a commercial bank was lending evidenced by short-term commercial paper. So long as bankers concentrated on this function, the money supply was subject to a natural discipline. This "real bills doctrine" — today discredited — was an underlying philosophy of the Federal Reserve System, and Glass believed that it would make future long-term economic depressions unlikely.⁷³

69. See W. PEACH, *supra* note 66, at 103-04.

70. See, e.g., W. PEACH, *supra* note 66; Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 BANKING L.J. 483 (1971).

71. See, for example, the account of Glass' principal advisor, H. Parker Willis, in H. WILLIS & J. CHAPMAN, *THE BANKING SITUATION* (1933), and of Franklin Roosevelt's principal advisor Raymond Moley, in R. MOLEY, *THE FIRST NEW DEAL* (1966).

72. For a personalized account of Glass' interest in banking, see R. SMITH & N. BEASLEY, CARTER GLASS 296-308, 327-38 (1939). Study of this aspect of the Act's history is aided by the fact that Glass' private papers and correspondence are indexed and available at the Alderman Library of the University of Virginia.

73. See Perkins, *supra* note 70, at 501-03; Huertas, *supra* note 48, at 149-50. Willis has provided one of the most complete contemporaneous histories of the Glass-Steagall Act, including substantial commentary on the politics of the legislation. H. WILLIS & J. CHAPMAN, *supra* note 71, at 56-91; see also Willis, *The Banking Act of 1933 in Operation*, 35 COLUM. L. REV. 697 (1935).

Glass was extremely troubled during the later 1920s by extensive bank lending to finance securities purchases, not because he was opposed to the stock market itself, but because he believed that such lending was taking money away from local businesses in need of credit. He sought to use his influence to pressure the Federal Reserve and the bankers to adopt policies of restraint on brokers' call loans and margin lending, but he was not successful.⁷⁴ Research under his direction a few years later uncovered perhaps the most significant statistic leading to eventual passage of the legislation — by 1930, *some forty-one percent of all commercial bank assets* were invested in securities or securities-related loans.⁷⁵ It was during this period that Glass formed a negative view of bank securities affiliates, which he considered a major source of the temptation to divert bank funds away from commercial uses. Indeed, he took personal offense at the deliberate and pointed failure of the officers of the largest banks with such affiliates (particularly Charles Mitchell of National City Bank) to adopt a program of voluntary restraint with respect to brokers' call loans.⁷⁶

With the stock market crash, the onset of the Depression, and the rise in both business and bank failures at the beginning of the new decade, Glass felt vindicated in his long-standing beliefs about the business of banking. He was given a vehicle for exploring the issue in late 1930 when the Senate, reacting to public pressure, resolved to hold hearings on the relationship between the banking system and the recent events. Glass and Willis prepared a "discussion draft" bill that, on the securities affiliate issue, had two alternatives — complete divorce of investment and commercial banking, or regulation and inspection of bank securities affiliates.⁷⁷ At the time, Glass had no confidence that anything as radical as complete separation could pass through Congress. Though he apparently favored such an approach and believed that the public did so as well, inclusion of the strong alternative was probably just a bargaining chip.⁷⁸

In the first set of hearings, the idea of divorce was supported in testimony by such persons as the New York State Superintendent of

74. See Glass, *The Federal Reserve System Grossly Misused*, AM. REV. OF REVIEWS, Sept. 1928, at 257.

75. *Operation of the National and Federal Reserve Banking Systems: Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency, 71st Cong., 3d Sess. 999 (1931)* [hereinafter *Hearings*].

76. See J. Lyle, *The United States Senate Career of Carter Glass, 1920-1933* at 145-48 (1974) (Ph.D. dissertation, Dept. of History, University of South Carolina); J. SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 7 (1982).

77. See H. WILLIS & J. CHAPMAN, *supra* note 71, at 68-69.

78. See Perkins, *supra* note 70, at 505.

Banking, the chairman of the board of the General Electric Company, and Professor William Z. Ripley of Harvard.⁷⁹ It was opposed by a series of commercial bankers, led by Charles Mitchell of National City Bank and Albert Wiggin of Chase National Bank. Neither the White House nor the banking regulators actively supported Glass' effort.

At this point, there was little likelihood of legislation coming from the Republican-controlled Senate, and little interest in Glass' ideas in the House. But as the Depression lengthened, public demand for Congress to "do something" and a growing opinion that bankers were somehow to blame for economic conditions kept the issue alive. Though apparently willing to compromise, Glass insisted that the proper response was divorce, along with liberalization of branch banking powers and increased Federal Reserve Board control over lending for "nonproductive" (*i.e.*, speculative) uses. He was strongly opposed to more intrusive reforms, particularly the idea of federal deposit insurance, a politically attractive idea being pushed by the more populist elements of Congress.⁸⁰

The 1932 Democratic platform included (at Glass' insistence) a call for the complete separation of commercial and investment banking, and Glass believed that Roosevelt's election enhanced the prospects for his bill's passage. Ironically, however, Roosevelt never pushed the legislation.⁸¹ Instead, two other factors coalesced to result in enactment. The first was congressional hearings on stock market practices (the Pecora hearings), which generated much public interest. During the early part of 1933, these hearings focused on the securities activities of Mitchell of National City Bank, exposing substantial personal and institutional wrongdoing, and the Morgan bank, which (while there was no real evidence of criminal misconduct) involved a pattern of less than high-handed behavior. This exposé intensified the public impression of a harmful tie between the big banks and the stock market.⁸² The second factor was an increase in popular (and thus

79. *Hearings*, *supra* note 75 at 183-209, 271-83, 285-322, 353-69, 479-96.

80. A useful history of the Banking Act of 1933, concentrating on the deposit insurance aspect, is Golembe, *The Deposit Insurance Legislation of 1933: An Examination of Its Antecedents and Its Purposes*, 75 POL. SCI. Q. 181 (1960).

81. Roosevelt was ambivalent about the bill, largely because of his opposition to the idea of deposit insurance. See F. FREIDEL, *FRANKLIN D. ROOSEVELT: LAUNCHING THE NEW DEAL* 442 (1973).

82. Many historians cite the Pecora hearings as a dominant reason for passage of Glass-Steagall. See A. SCHLESINGER, *THE AGE OF ROOSEVELT — THE COMING OF THE NEW DEAL* 435-38, 442-45 (1958); Perkins, *supra* note 70, at 522-23; W. PEACH, *supra* note 66, at 177-79; J. SELIGMAN, *supra* note 76, at 38. A broader view is offered by Willis, who wrote in 1933 that [t]he changes which had taken place both in the Senate and in the House had led to the elimination of a banking and financial influence which had been dominant during the pre-

political) support for deposit insurance, and for the possibility of radical regulation (perhaps nationalization) of the banking industry.

By March 1933 effective industry opposition to the idea of divorce ended. Having recently replaced Albert Wiggin as chief executive officer of Chase, Winthrop Aldrich announced that he *avored* the Glass legislation and that Chase would voluntarily divest itself of its securities affiliate.⁸³ National City Bank did the same. While Aldrich spoke publicly in terms of returning banking to its traditional calling, his motive was probably more political. The large banks (indeed most banks) vehemently opposed deposit insurance, and worried about what else the new Congress might have in store for them. By appearing to be recreant in light of the recently exposed abuses, and by aligning with the moderate conservative Glass, they no doubt were simply seeking to head off more restrictive legislation. In addition, one historian has noted that by 1933 investment banking was not a profitable business — and with the bad publicity and the political changes in Washington, there was some doubt as to whether it would ever become so again.⁸⁴ Divestment was not only politically wise, but also a loss-cutting measure; certainly, there were no large profits at the time to be fought for.

In the end, the populist pressure for deposit insurance was irresistible. Both Glass and the White House ultimately gave in to the forces led by Congressman Henry Steagall of Alabama, and a compromise bill was worked out to break what had become a legislative logjam; it contained an insurance plan as well as the most important measures that Glass had been pushing.⁸⁵ The Banking Act of 1933 was passed in June and signed by the President.

Thus, there is an explanation for the separation of investment and commercial banking that does not involve special-interest pressure

ceding régime, but had substituted the domination of other elements which professed a desire for legislation directed against property owners and property-holding in general . . .

H. WILLIS & J. CHAPMAN, *supra* note 71, at 98-99. For a view that Charles Mitchell was unfairly blamed in this process, see Huertas & Silverman, *Charles E. Mitchell: Scapegoat of the Crash?*, 60 BUS. HIST. REV. 81 (1986).

83. See W. PEACH, *supra* note 66, at 157-58; A. JOHNSON, WINTHROP W. ALDRICH: LAWYER, BANKER, DIPLOMAT 150-51 (1968). Schlesinger suggests that Aldrich's action was essentially a Rockefeller family assault on the House of Morgan. A. SCHLESINGER, *supra* note 82, at 443. Professor Kennedy suggests that it was largely a "gesture" to restore lost prestige. S. KENNEDY, *supra* note 68, at 212-13.

84. Perkins, *supra* note 70, at 522; see also Preston, *The Banking Act of 1933*, 23 AM. ECON. REV. 585, 604 (1933). Among the uncertainties was the impact of the imminent Securities Act on the securities business. See J. SELIGMAN, *supra* note 76, at 76-77.

85. For a discussion of the final days of the legislative history, including Roosevelt's role in arranging a compromise, see R. MOLEY, *supra* note 71, at 81; S. KENNEDY, *supra* note 68, at 220. Even at the last moment, Glass was not at all convinced that his legislation would succeed. See H. WILLIS & J. CHAPMAN, *supra* note 71, at 101.

from the private investment bankers. For Carter Glass and those closest to this portion of the legislation the principal motivation was pursuit, perhaps more emotional than rational, of the channeling objective — an attempt to force banks to redirect their resources, efforts, and energies to the traditional business of commercial and agricultural lending by foreclosing the securities temptation.⁸⁶ If any special interest group was instrumental in this regard, it was probably the smaller businesses and farmers (not surprisingly, Glass' Virginia constituents) who considered the unavailability of credit at least partially responsible for their current woes. Many in Congress (and probably Glass as well), also viewed separation as a politically attractive way of appearing to respond punitively to the bankers' recently exposed excesses.⁸⁷ Others saw it as simply part of a legislative package that contained something far more important, federal deposit insurance.

The conduct of the investment bankers themselves, both before and after the legislation, provides further evidence against the special interest theory. By 1930, control of the investment bankers' principal lobbying arm, the Investment Bankers Association of America, had fallen to the commercial bankers; its opposition to the Glass bill was, until the adverse publicity generated by the stock market hearings, intense.⁸⁸ Furthermore, the final bill offered by Glass once the effective opposition ceased had one provision that severely hurt the private bankers. Prior to 1933, the major investment banking houses obtained a sizable portion of their capital by accepting deposits from large institutional customers. By prohibiting investment firms from taking deposits, section 21 of the Act dried up much of the capital pool and compromised the long-standing independence of these firms.⁸⁹ Section 21 was apparently written at the urging of (if not by) Winthrop Aldrich of Chase National Bank.⁹⁰

86. See Legislation Note, *The Glass-Steagall Banking Act of 1933*, 47 HARV. L. REV. 325, 326 (1933). This has not always been emphasized explicitly in the more recent literature, though it follows logically from the evidence. Cf. W. PEACH, *supra* note 66, at 177. Many of the passages from the legislative history of the Act quoted in *Camp* as evidence of a soundness concern are really, when read in context, explicit statements of a channeling motivation. Most notable in this regard is a speech on the floor of the House by Congressman Steagall, which "call[s] back to the service of agriculture and commerce and industry the bank credit and the bank service designed by the framers of the Federal Reserve Act." 77 CONG. REC. 3835 (1933), quoted in *Camp*, 401 U.S. 617, 632 n.29 (1971).

87. See, e.g., 77 CONG. REC. 4028 (May 23, 1933) (remarks of Rep. Fish).

88. See Perkins, *supra* note 70, at 496, 519; H. BURNS, *THE AMERICAN BANKING COMMUNITY AND NEW DEAL REFORMS 1933-1935*, at 65 (1974) (quoting an IBA resolution stating that the continued "existence of affiliates of banks is necessary for the distribution of securities and the financing of corporations").

89. See V. CAROSO, *supra* note 65, at 372.

90. This is noted by Aldrich's biographer. See A. JOHNSON, *supra* note 83, at 150-51, 156. Obviously, Aldrich was doing some "turf protecting" of his own.

Even more interesting is the conduct of the investment banking firms after enactment. One bit of history that on first glance might seem to support the special interest theory is Carter Glass' fairly close relationship with the most influential of the private investment firms, J.P. Morgan. Two Morgan partners, Russell Leffingwell and S. Parker Gilbert, were Glass' good friends and had been his close advisors as Secretary of the Treasury. Glass reportedly tried to protect the Morgan interests during the stock market hearings.⁹¹ There, if anywhere, is the link between Glass and Wall Street and the opportunity for pursuit of monopoly rents. Yet upon passage of the legislation, J.P. Morgan & Co. chose to quit the *investment banking* business in order to comply with the law and retain its ability to accept deposits as what is today Morgan Guaranty Trust Co. Approximately one-third of the other private investment bankers (including Brown Brothers Harri-man and Drexel & Co.) did the same.⁹² That seems strange behavior for a group that had just been successful in obtaining special-interest legislation on its behalf. In 1935 certain Morgan interests, wishing to reenter the securities business, did form Morgan Stanley & Co., today one of the largest investment banking firms. The three Morgan partners who resigned to form the new firm apparently waited to take that step, however, until it was clear that a 1935 effort in Congress to repeal the portion of Glass-Steagall prohibiting commercial bank underwriting of securities issues — an effort *led* by Carter Glass — had failed.⁹³

2. *Camp and the Traditional Rhetoric of Banking*

This rather lengthy consideration of the history of Glass-Steagall shows that the critics were correct in their suspicion that *Camp's* weakness stemmed from its misappreciation of the legislative history, but wrong in their explanation of what that history showed. *Camp*

91. See V. CAROSO, *supra* note 65, at 349.

92. *Id.* at 372.

93. Contemporaneous accounts suggest that persons in the investment banking business viewed the formation of Morgan Stanley as a reentry by the House of Morgan into the investment banking field notwithstanding Glass-Steagall, see *Investigation of Concentration of Economic Power: Hearings on Pub. Res. 113 Before the Temporary National Economic Comm. of the 76th Congress*, 76th Cong., 2d Sess. 11,768-69 (1939) (exhibit nos. 1642-43, correspondence between Charles Mitchell and Charles Blyth), raising the possibility that reentry was part of a long-term plan on the part of the Morgan interests. That seems implausible, however. The attempt to repeal the underwriting prohibition for national banks was probably (given Glass' connections with Morgan) Morgan-influenced. Publicly Glass urged repeal because, he said, he had been wrong in his earlier expectation that the investment banking industry would be able to handle the capital needs of American businesses without commercial bank involvement. See 79 CONG. REC. 11,827, 11,933-94 (1935). The legislative proposal was defeated, in part at least, because of White House support for the separation policy. See Letter from Franklin Roosevelt to Carter Glass (Aug. 1935), *quoted in* H. BURNS, *supra* note 88, at 171.

failed to see the Act as an attempt to rechannel financial resources and energies for the benefit of commerce and agriculture, something that would happen only if a banker's interests were solely in the successful operation of the bank itself and thus logically achievable only through complete separation. The soundness- and conflict-related concerns on which the Court rested its analysis, though real, were simply part of the story. In fact, it is likely that had they been Congress' only fears — had Congress considered securities activities a proper part of the business of banking — they would have been dealt with by regulation rather than divorce. *Camp*'s analytical weakness rests in taking these objectives out of context and promoting them to an interpretive significance they do not merit.

For the development of case law, the rhetoric used in a Supreme Court opinion is often more important than the opinion's analytical structure. Language and style have a signaling function; they set a tone that can thereafter be invoked for purposes of doctrinal continuity when the analysis itself does not compel a particular result. Here, the Court came closer to mirroring the sentiments of the drafters. The separate sphere to which Carter Glass and his colleagues consigned commercial banking in 1933 was hardly an unattractive one. Marketplace entry was limited by law; this was the high point of concern about overbanking, and of reluctance to grant new charters if a "sufficient" number of banks was already present. In addition, the Banking Act of 1933 introduced another regulatory strategy; banks were prohibited from paying interest on demand deposits and the Federal Reserve Board was given authority to limit the payment of interest on time deposits. This further limited competition in the bank marketplace and increased the expected profitability of the banking business.⁹⁴ While the securities portion of the Act might well have been designed to appear to the public as a punishment for excess, Glass' expectation was probably much more benign. With the wall of separation in place to reduce temptation (and a Federal Reserve Board hopefully more sensitive to the risks of stock market speculation), commercial banks would naturally return to the comfortably profitable business of providing credit for business and agriculture.

This belief is the basis for *Camp*'s dominant rhetorical theme. According to the Court, Congress was of the opinion that the public should be able to seek financial advice and services from bankers in this less than fully competitive environment; it should be able to as-

94. The articulated intent of this provision was to prevent interbank competition that had the effect of, among other things, causing the movement of funds from smaller "country" banks to larger city banks — again, a channeling objective.

sume that its best interests would be protected. The Court believed that the image of the "prudent and disinterested"⁹⁵ banker was lost when there was promotional pressure to sell a particular investment: "It is not the slightest reflection on the integrity of the mutual fund industry to say that the traditions of that industry are not necessarily the conservative traditions of commercial banking."⁹⁶ This is classic fiduciary language, a view of banks as something of public trustees or a public utility, a sentiment perhaps justified given the regulation-induced monopolistic conditions in the post-1933 banking marketplace.⁹⁷ The service role that Carter Glass very much wanted the commercial bankers to reassume became the sharpest textual image in *Camp*.⁹⁸

In concluding this critique of *Camp*, it is worth noting that had the Court properly described the intent behind Glass-Steagall, and focused directly on the desire to channel bank funds to productive (*i.e.*, industrial and agricultural) rather than speculative (*i.e.*, stock market) uses, it might still have decided against the Citibank proposal. Under market conditions prevailing at the time, large-scale marketing of "investment fund" products by banks would probably have encouraged a shifting of funds from deposit accounts to stock market investment fund accounts unavailable for lending use,⁹⁹ something that likely would not have pleased the Act's drafters. But nowhere in its opinion did the Court make reference to that objective. With *Camp*'s weakness, a new stage in statutory evolution had begun.

95. 401 U.S. at 634.

96. 401 U.S. at 637.

97. This sentiment was recognized in a *Harvard Law Review* note soon after the legislation, which pointed out that "Senator Glass thought the bankers could be coaxed into regarding their position as a public trust." Legislation Note, *supra* note 86, at 326.

98. The Court's rhetorical emphasis makes quite clear that its analytical narrowing of legislative purpose was unintended. Passage of time and a restoration of public confidence in the stock market and the securities business could easily obscure the feelings that prevailed in 1933, especially with so many different purposes possible. (Professor Radin's classic attack on statutory intent as a meaningful basis for legal decisionmaking notes that when many different actors in the legislative process have many different motives in seeking legislation, identifying a particular intent is impossible. See Radin, *Statutory Interpretation*, 43 HARV. L. REV. 863 (1930).) Soundness protection was, during the 1960s, far and away the dominant objective in banking regulation generally. In this light, the Court's undue emphasis on soundness was predictable.

99. Sophisticated savers, of course, would move their money to a non-bank-affiliated mutual fund if such a fund seemed a desirable investment. This channeling point assumes, probably realistically, that the very fact that the bank sponsors and promotes the fund — and provides a convenient means of shifting money from deposit accounts to fund accounts — would result in some shifting that otherwise would not occur.

B. *Rhetoric Transformed: The Beginning of Transitional Jurisprudence*

The second major Supreme Court decision on the securities powers of banking institutions, *Board of Governors v. Investment Company Institute ("ICI II")*,¹⁰⁰ came exactly a decade after *Camp*. It involved a relatively narrow issue — whether bank holding company nonbank subsidiaries could sponsor and advise closed-end investment companies. Closed-end companies differ from the mutual funds involved in *Camp* in that they do not continuously sell and redeem their shares; instead, there is an initial public offering, and perhaps occasional subsequent offerings. Shareholders wishing to dispose of their interests in the companies must find a purchaser (there are thus organized secondary markets for such shares). The Federal Reserve Board, by rule, approved bank holding company expansion into this field so long as distributions were not contemplated in the ordinary course of business, distributions were handled by an unaffiliated underwriter (not the adviser), there would be no extensions of credit to the company by the adviser, and affiliated banks in the holding company structure would refrain from any involvement with sale or distribution of the company's securities (including expressing any opinion on the advisability of purchasing those securities).¹⁰¹ In other words, specific restrictions were imposed by rule to regulate each of the "subtle hazards" identified in *Camp*.

The Court upheld the Board. By contrast to the purely purposive reasoning in *Camp*, the Court's opinion is a study in line-drawing.¹⁰² The question before the Court was whether the advisory affiliate would be engaged in the business of selling, distributing, or underwriting securities. *Technically*, the answer was no; an unaffiliated company would do the actual selling. But *Camp* called for a broader inquiry: Could the affiliation of an investment company advisory firm and a bank create the sorts of conflicts that Congress ostensibly was

100. 450 U.S. 46 (1981).

101. 450 U.S. at 51-52.

102. It emphasized, for example, that only one of the three principal Glass-Steagall sections, section 20, applies at all when the activity is carried out by an entity legally distinct from the bank itself, 450 U.S. at 59 n.24 — a holding that by itself authorized a new wave of bank securities activities. Most significant was the recognition that, since section 20 only applies to the activities of member banks, there was no bar in the Act to the full range of securities activities by affiliates of state-chartered nonmember banks. See *Investment Co. Inst. v. FDIC*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,063 (D.C. Cir. Jan. 16, 1987), *amended*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,197 (D.C. Cir. Apr. 7, 1987). This is correct as a technical matter; the drafters of the Act believed that they were acting largely to preserve the Federal Reserve System from abuse and that they substantially lacked power over the conduct of state-chartered nonmember banks.

worried about? The Court's answer — a negative one — rested completely on the fact that the Board had adopted rules to control otherwise clear-cut conflicts.

While the Court is no doubt correct that so long as the restrictions set forth in the Board's regulations are followed there is no real potential for abuse, it nowhere addresses *Camp*'s conclusion that Congress' decision to force a complete separation of commercial banking and the securities business was based on a lack of confidence that rules of this sort would ever be effective in the face of distraction or temptation.¹⁰³ *Camp*'s purposive construction of a statute such as Glass-Steagall proceeded in two steps: first, defining in a generic sense the various words and phrases of the statutory provision (to which "subtle hazard" or other purposive inquiry is crucial, but not in a case-specific sense); and second, determining whether the proposed conduct substantially falls within that generic definition.¹⁰⁴ If it does, it is unimportant that for this particular applicant the possibility of abuse is remote (or guarded against). The interpretive approach of the *ICI II* opinion collapses the two inquiries, standing *Camp* on its head by determining that so long as agency rules exist to control abuse, the Act's policy of separation does not come into play. In effect, the Court transformed Glass-Steagall into a procedural exercise resembling that set forth in the Bank Holding Company Act for nonbanking activities generally — a process that delegates to the Board the power to expand the powers of banking institutions incrementally in response to marketplace changes, so long as there is a reasonable effort to control threats to bank soundness, conflicts of interest, and potential anticompetitive impact.¹⁰⁵ That, however, was precisely the road not taken in Glass-

103. See Macey, *Special Interest Groups*, *supra* note 64, at 23-24. There is no hint in *Camp* that had the Comptroller imposed restrictions on the bank's proposed fund (or required that it be in a separate subsidiary) the result would have been different. Yet that is the implication of the *ICI II* reasoning. See note 132 *infra*.

104. See Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 YALE L.J. 106 (1981). The question then would have been whether the rendering of advisory services in the closed-end context makes the bank and/or its affiliate so interested in the selling and distribution process that conflicts of interest are likely to arise.

105. Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1343(c)(8) (1985), permits the Board to authorize bank holding company expansion into fields so closely related to banking so as to be a proper incident thereto. Under the prevailing legal standard set forth in *National Courier Assn. v. Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975), endorsed by the Supreme Court in *Securities Indus. Assn. v. Board of Governors*, 468 U.S. 207 (1984), such expansion is permissible if banks historically have provided such services, if the services are functionally similar to historical banking services so as to equip the holding company to provide them particularly well, or if "[b]anks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form." 516 F.2d at 1237. This test essentially permits expansion into product lines that (1) are part of the business of banking as commonly understood, (2) are the functional equivalent of part of that business, or (3) are demanded by consumers in a bundled form with a product justified under (1) or (2). The effect of

Steagall.

The Court effected an even more dramatic shift in its rhetorical emphasis. The image of the public banker, whose interests were supposed to be a world apart from (and immune from the pressures of) the securities industry and the stock market, disappeared. A normatively neutral blueprint for bank holding companies — showing so far as possible what sorts of expansion in the securities business are permissible, and what sorts are not — replaced the prophylactic fiduciary emphasis in *Camp*.

What explains this change? Perhaps the Court simply recognized that *Camp*'s analysis of the separation objective was fragile, and that there was really no reason, if soundness and potential conflicts were the only concerns, why such concerns could not be dealt with through simple rulemaking. But the shift in the opinion's rhetoric indicates something more fundamental and demands a broader explanation. Such an explanation may be found in the circumstances of the decade separating the two Supreme Court decisions, corresponding almost precisely to the period of technology-induced transition in the structure of the banking marketplace described in Part I of this Article. In 1971, the banking and securities businesses were still largely segmented, the money market fund an insignificant institution to the banking industry. By 1981, the blurring of the product distinctions had led to an immense drain of funds from the banking to the securities industry, causing among other things congressional repeal of one of the basic anticompetitive strategies of banking regulation, Reg. Q's interest-rate ceilings. The banking industry was by then well into the transition from a relatively comfortable, less than fully competitive series of geographically discrete markets to a much more integrated, extremely competitive nationwide financial services marketplace, requiring a new set of resources and talents — and probably a much more diversified product base¹⁰⁶ — in order to deal with the increased level of risk.

The new structure of the banking industry makes a complete anachronism of *Camp*'s fiduciary rhetoric. One doubts that many sophisticated people today see the banker as anything but a businessperson under pressure to sell products and generate profits — not a likely source of “disinterested investment advice” unless that service is paid

this test is gradually to increase holding company powers as the nature of banking changes over time. A good illustration of this is the recent expansion of Citicorp into extensive data processing and software marketing. See *Association of Data Processing Serv. Orgs. v. Board of Governors*, 745 F.2d 677 (D.C. Cir. 1984), a significant opinion by Judge (now Justice) Scalia.

106. See Part I.B.1. *supra*. One such product line might well involve sponsorship of closed-end mutual funds.

for. *Camp*'s reference to the "conservative traditions of commercial banking," in contrast to the promotional emphasis of the securities industry, rings hollow if consumers treat the financial services products offered by the two industries as in fact fungible. The monopoly rents that once could be appropriated by the industry have in many respects disappeared in the face of vigorous competition, and with them the normative basis for expecting any compensating sense of public responsibility. It is reasonable to suppose, then, that *ICI II*'s literalism and rhetorical neutrality stem from a fundamentally different understanding of the business of banking than that held by the drafters of Glass-Steagall or the panel that decided *Camp*, and that its shift in both interpretive method and style was meant to be a pruning of a now obsolete statute — in other words, a subtle exercise in transitional jurisprudence.

C. *The Transitional Rhetoric Extended*

The transitional thrust and tone of *ICI II* began another stage in statutory evolution. This section will look at three current controversies under the Act — bank brokerage activity, the marketing of individual retirement accounts, and ownership of banks by securities brokerage firms — where legal decisionmaking has reflected the new style of interpretation.

1. *Brokerage Activity*

In the wake of *ICI II*, the commercial banking industry expanded to provide customers with securities brokerage services, through the bank itself, a subsidiary, or a holding company affiliate.¹⁰⁷ To date, most of this expansion has been in the form of so-called discount brokerage — execution of customer-directed transactions, on an agency basis, without investment research or advice as to particular securities. One attractive "portfolio" feature of this line of business is that it offers increased earnings to the bank or the holding company at times when the stock market is strong and customer funds are moving out of deposit accounts for securities purchases.¹⁰⁸

107. Even before the Court's decision, there had been a gradual expansion in this direction, particularly in the area of automatic investment services. See *New York Stock Exchange v. Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *vacated*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 932 (1978); Lybecker, *Bank Sponsored Investment Management Services: Consideration of the Regulatory Problems, and Suggested Legislative and Statutory Interpretive Responses*, 1977 DUKE L.J. 983.

108. The impact is to even out fluctuations that might otherwise occur in the integrated company's stream of income. In the last two years or so — with interest rates low and the stock market strong — banks with brokerage affiliates have fared better than those without. See Schmitt, *supra* note 31; see also Litan, *supra* note 31, at 11.

The courts have endorsed this expansion without serious question. In *Securities Industry Association v. Board of Governors*¹⁰⁹ (the *Schwab* decision), the Supreme Court held that a holding company was free to enter this line of business because section 20, read strictly, reaches only those entities principally engaged in activities traditionally associated with the *distribution* of securities. Given the explicit language in section 16 permitting nonrecourse transactions solely upon customer order, this holding was predictable. Since a discount broker is not cast in the role of "selling" a particular security, neither conflict of interest nor temptation to use bank funds to support the issuer or the market for its securities is likely to be present.¹¹⁰ Still, the fading of *Camp's* rhetorical influence is evident; the Court did not even pause to consider whether a combination banker/broker could really be expected to be a source of "disinterested financial advice," given the incentive to generate commissions through aggressive trading in stocks generally, whether the banker gave advice as to specific securities or not.¹¹¹

Can banks combine brokerage services with investment advice, thereby coming into direct competition with full-service brokerage firms in the securities industry? Here, there have as yet been no judicial decisions, and there is some disagreement between the two principal federal bank regulators.¹¹² From the standpoint of the historical

109. 468 U.S. 207 (1984). Banks themselves are permitted to offer discount brokerage activities as well. See *Securities Indus. Assn. v. Comptroller*, 577 F. Supp. 252 (D.D.C. 1983), *affd. on branching issue*, 758 F.2d 739 (D.C. Cir. 1985), *revd. on branching issue*, 107 S. Ct. 750 (1987).

110. See 468 U.S. at 220-21; see also Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 MICH. L. REV. 1498 (1983).

111. Following *Camp* closely, there is also the question of whether a bank might be tempted to encourage customers to borrow heavily to make securities purchases. See note 114 *infra*. An interesting issue that has arisen recently is the extent to which a discount broker can engage in cooperative efforts with securities firms in the sales and distribution process. The Charles Schwab firm proposed to sell its customer lists to certain investment companies, who would contact Schwab customers about the availability of securities and indicate that Schwab was available to execute purchase transactions in such securities. The Federal Reserve Board's General Counsel took the position that this would not violate Glass-Steagall. See 47 Wash. Fin. Rep. (BNA) 483, 522 (Sept. 29, 1986) (correspondence between Federal Reserve general counsel Michael Bradfield and Margery Waxman). A suit brought against the Federal Reserve Board in federal district court was dismissed on jurisdictional grounds. See *Court Dismisses SIA's Suit Against Schwab, Fed, for Lack of Jurisdiction*, 47 Wash. Fin. Rep. (BNA) 721 (Nov. 3, 1986).

112. The Comptroller has taken the more liberal approach, allowing banks effectively to combine the two functions (albeit in an awkward institutional arrangement). See Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 VA. L. REV. 1303 (1983); American Natl. Bank of Austin, Tex., [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,732 (Sept. 2, 1983). The Federal Reserve Board had been more restrained, and its regulations on bank holding company nonbank activities preclude the combination. See 12 C.F.R. § 225.25(15) (1986). Recently, however, it has taken a less restrictive position in the context of services for institutional investors, concluding that solely as a matter of Glass-Steagall the two functions can properly be combined. See *BHC Securities Brokerage Serv.*, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,610 (June 13, 1986). In July 1987, this ruling was affirmed by the D.C. Circuit. See *Securities Indus. Assn. v. Board of*

intent of Glass-Steagall (more properly, of the 1935 amendment which is the source of the authority for whatever stock brokerage services are permissible¹¹³), combining banking services with full-scale brokerage activities might seem troublesome. Even though direct concerns relating to bank soundness might be minimal, a public endorsement of a particular investment might carry with it the temptation to use affiliated bank funds in a less than prudent fashion — a concern expressly noted in *Camp*. Moreover, an aggressive combination of brokerage and banking leading to a redirection of energy and resources away from the traditional deposit/commercial loan focus recalls the experience of the 1920s when so much of banking seemed to Carter Glass and his colleagues little more than an adjunct of the investment business.¹¹⁴

On the other hand, the transitional jurisprudence of Glass-Steagall points toward expansion. The channeling function has, as a matter of law, been forgotten, and any judicial reasoning that thwarts a competitive response by the banking industry would only cause control over some funds that otherwise would be directed to the banking industry to shift to the securities industry,¹¹⁵ frustrating that historic (but unattainable now) goal underlying the legislation. Strict statutory interpretation suggests that sections 16 and 21 are satisfied so long as the customer makes the investment decision, with or without advice. What minimal soundness concerns there are can readily be dealt with by rulemaking.¹¹⁶ All these factors combine to present a compelling

Governors, No. 86-1412, Slip. op. (D.C. Cir. July 7, 1987). See also Yang, *Bank Firms Win Round in Case Over Securities*, Wall St. J., July 8, 1987, at 5, col. 1.

113. As originally drafted, the nonrecourse customer-directed transaction exception of section 16 was limited to purchases of investment-grade securities. The 1935 amendment, adopted at the recommendation of the Comptroller's office, was designed to expand the accessibility of brokerage services in communities that had no broker-dealers. See U.S. DEPT. OF THE TREASURY, ANNUAL REPORT OF THE COMPTROLLER OF THE CURRENCY 11 (1934).

114. One aspect of the problem that was of substantial concern to the drafters was the diversion of funds to support securities borrowing. The existence of retail brokerage affiliates creates an incentive to channel loans for this purpose. See *Camp*, 401 U.S. at 632. Of course, the passage of section 7 of the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 886 (current version at 15 U.S.C. § 78g (1982)), which gives the Federal Reserve Board complete regulatory authority over margin lending — a channeling provision itself, see H.R. REP. NO. 1383, 73d Cong., 2d Sess. 7 (1934) — reduces this concern substantially.

115. This raises the question whether consumers really want "one-stop" financial service firms — in which case they will switch to those firms with broad product offerings — or whether they are perfectly content to "unbundle" their services, finding different providers for each need and taking advantage of technology innovations to shift funds back and forth. In the latter case banks would not lose substantial funds simply because they did not have the full range of services. For a skeptical view of the desirability of the "financial supermarket," see Bennett, *Consumer Demand for Product Deregulation*, ECON. REV., May 1984, at 28.

116. There is at present disagreement among the Securities and Exchange Commission and the banking regulators as to who should be the primary regulator for brokerage affiliates. The SEC adopted a rule requiring registration with it of such affiliates, notwithstanding the definition

case for a court disinclined to deny banks a usefully diversified source of earnings to support profitability in an environment where there is far more risk attendant to the traditional banking functions than was imagined in the post-1933 marketplace.

2. *Individual Retirement Accounts*

One of the most notable economic developments of the recent decades in the United States has been the growth in tax benefit-induced retirement savings,¹¹⁷ particularly in the form of the individual retirement account (IRA). Until the recent tax reform legislation the IRA permitted certain individuals a credit of up to \$2000 for annual contributions; it still allows deferral of taxation on the income generated in such accounts. As part of normal banking business, commercial banks offer IRAs in the form of certificates of deposit and money market accounts. However, a number of banks have sought in addition to offer IRA accounts to persons wishing higher returns on their investments via collective investment funds, for which the bank acts as trustee. These collective funds invest in a wide variety of securities, including common stocks, and in this sense are functionally identical to mutual funds offered by the securities industry — also major competitors for IRA dollars.

Because of the extreme similarity between these collective trust funds and the commingled managed agency accounts declared unlawful in *Camp*, the securities industry has charged that bank marketing of these accounts violates Glass-Steagall. In the first reported decision to address the issue, a federal district court in the Northern District of California agreed.¹¹⁸ Subsequently, that decision was reversed,¹¹⁹ and the courts of appeals for both the Second¹²⁰ and District of Columbia Circuits have upheld the Comptroller's authorization to national banks to go forward with these plans.

of broker in section 3(b) of the Securities Exchange Act, which appears to exclude banks from broker status. See SEC Exchange Act Rel. No. 22205, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,800 (July 1, 1985). This rule was struck down by the District of Columbia Circuit, in an opinion that is interesting for its exploration of the relationship between Glass-Steagall and the Securities Exchange Act of 1934. *American Bankers Assn. v. SEC*, 804 F.2d 739 (D.C. Cir. 1986).

117. For a consideration of this development in a broad perspective, see Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561 (1981).

118. *Investment Co. Inst. v. Conover*, 593 F. Supp. 846 (N.D. Cal. 1984), *revd. on other grounds*, 793 F.2d 220 (9th Cir.), *cert. denied*, 107 S. Ct. 422 (1986).

119. *Investment Co. Inst. v. Conover*, 793 F.2d 220 (9th Cir.), *cert. denied*, 107 S. Ct. 422 (1986).

120. *Investment Co. Inst. v. Clarke*, 630 F. Supp. 593 (D. Conn.), *affd. without opinion*, 789 F.2d 175 (2d Cir.), *cert. denied*, 107 S. Ct. 422 (1986).

The District of Columbia Circuit's decision in May 1986, *Investment Co. Institute v. Conover*,¹²¹ is the archetypal transitional banking law decision. The court acknowledged the similarity between the Citibank proposal at issue in *Camp* and the same bank's collective IRA trust now under challenge, and noted that the proposed trust was competitive with mutual fund products. However, it concluded that technical differences made the proposed product more like the traditional collective trust arrangements long used in the banking industry, which concededly did not violate the Act. While not denying that *Camp*'s "subtle hazards" could exist under the proposal as well, the court simply — and accurately — noted that most of the same concerns could also be raised with respect to the traditional collective trust. The court therefore determined that IRA participations were not securities for purposes of Glass-Steagall.

The court did not address at any length the difference between the traditional collective trust and the IRA program that the securities industry emphasized in the litigation — the nature of the promotional effort by the banks in support of the product. The traditional collective trust was a vehicle for taking advantage of economies of scale for the benefit of the multitude of individual trusts for which the bank operates as trustee. Historically, that sort of trust activity has not been a particularly profitable activity for banks; rather, it has been an accommodation service to retain the good will of wealthier bank customers. By contrast, IRA products — like the investment fund in *Camp* — are designed and marketed as major income-producing vehicles for the banks, to capture funds that might otherwise be directed to the securities industry.¹²²

While the court did not say so (and indeed hid from deeper inquiry by invoking the rule of deference to administrative expertise), its decision is little more than a repudiation of *Camp*. In a transitional marketplace, any extension of the *Camp* reasoning to products such as IRAs is counterproductive. The promotional and sales efforts necessary to attract retirement savings dollars away from competing broker-dealers, mutual funds, and insurance companies (not to mention

121. 790 F.2d 925 (D.C. Cir.), cert. denied, 107 S. Ct. 421 (1986).

122. See Note, *Units of Participation in IRA Common Trust Funds Offered by Commercial Banks: A Violation of the Glass-Steagall Act?*, 60 NOTRE DAME L. REV. 745, 760 (1985); Note, *Glass-Steagall and Collective Investment Trusts for Individual Retirement Accounts: Fiduciary Purpose or Investment?*, 42 WASH. & LEE L. REV. 961 (1985). One significant difference between the typical trust fund and the IRA account, from a consumer perspective, is that the consumer is investing for his own benefit (albeit with principal and gains deferred until retirement), whereas the trust has generally been used for transferring wealth. The trust aspect of the account is by legal requirement, not consumer preference. The incentive to speculate is arguably greater when the account is a personal one.

other banks) are inconsistent with the image of the concerned banker, unaffected by a "salesman's interest," to whom members of the public could turn for prudent and sound financial advice. But those promotional and sales efforts are no different from what banks engage in on a daily basis as they compete in the financial services marketplace for desirable depositors and borrowers. This is indeed a competitiveness the public has come to accept. As noted in the previous section, the fiduciary rhetoric loses whatever persuasive force it might once have had under circumstances where monopoly rents have largely disappeared. The *Conover* court's failure to invoke it, notwithstanding its centrality in *Camp* fifteen years earlier, is easy to appreciate.

3. *Ownership of Banks by Securities Firms*

The legal decision most apparently at odds with the historic intent of the drafters of the Glass-Steagall Act is not judicial but administrative: the determination by the Comptroller in cases involving J.W. Seligman & Co. and Dreyfus & Co. to allow full-service securities firms to acquire control of national banks.¹²³ Normally, issues relating to control of banking institutions are decided by the Federal Reserve Board under the Bank Holding Company Act. The banks in question, however, were structured so that they were in the business of accepting demand deposits, but not of making commercial loans. Because the Board's authority under the Act extends only to companies which control banks that perform *both* functions, it lacked jurisdiction over this acquisition;¹²⁴ hence, the matter was one for the Comptroller as the chartering authority for the banks. The objective of the securities firms — e.g., Dreyfus as one of the country's largest sponsors of mutual funds — was to give their customers the option of placing a portion of their funds in an FDIC-insured checking account,¹²⁵ and

123. *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463 (Feb. 2, 1983); *Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464 (Feb. 7, 1983). See Pitt & Williams, *The Glass-Steagall Act: Key Issues for the Financial Services Industry*, 11 SEC. REG. L.J. 234, 248-54 (1983).

124. At the time, the Board protested the Comptroller's action, contending that it did have jurisdiction based on a revised reading of the definition of deposits and commercial loans. Subsequently, the Comptroller's view of the Holding Company Act issue was, for all practical purposes, accepted by the Supreme Court. See *Board of Governors v. Dimension Fin. Corp.*, 106 S. Ct. 681 (1986). For a general discussion, see Note, *Avoiding the Glass-Steagall and Bank Holding Company Acts: An Option for Bank Product Expansion*, 59 IND. L.J. 89 (1983).

125. The one important competitive advantage that had been retained by commercial banks vis-à-vis the cash management-accounts of securities firms is deposit insurance. This expansion by the securities firms was designed to eliminate that disadvantage. Merrill Lynch's acquisition of a nonbank bank was structured so that the bank would make commercial loans but not accept demand deposits. See *Wall St. J.*, Aug. 12, 1986, at 1, col. 1.

therefore the possibility of shifting funds at will among the full range of banking and investment accounts.

Before turning to the reasoning used by the Comptroller, it is worth stepping back and considering the approval in terms of the traditional understanding of Glass-Steagall. The bank is a separate legal entity; hence, depositor funds are not directly at risk as a result of the parent firm's securities activities. Beyond that, however, many of the concerns articulated in *Camp* are clearly present. The bank is a captive of the securities firm, with little reason for existing other than to aid the sales and marketing effort of the investment firm complex — hardly disinterested in the securities choices of its customers. In addition, the notion in *Camp* that there is a danger in public association of a banking institution with the success or failure of an investment entity applies here a fortiori. The only dangers that are lacking are those related to potential misuse or skewing of the banks' lending powers — and that only because the banks are structured in such a way that they have no commercial lending powers. Finally, were the channeling objective to be invoked, the acquisition clearly invites a shift in deposit funds to an institution *legally prevented* from engaging in precisely what the drafters were trying to encourage via Glass-Steagall — the provision of commercial credit.

This legal conclusion is even slightly colorable only because of the transitional literalism and normative neutrality of the Supreme Court's *ICI II* decision, a demonstration of the influence of styles of judicial decisionmaking beyond the context of the particular case. The Comptroller employed this approach in a series of interpretive steps. First, it recognized correctly that only section 20 applies, since the bank is an entity separate from the parent securities firm.¹²⁶ Second, it concluded that only a small percentage of the securities firms' income is attributable to underwriting and distributing securities on behalf of its sponsored funds; most of the income comes from advisory fees,

126. A possible "loophole" in Glass-Steagall is the fact that section 20's prohibition on affiliation extends only to banks that are members of the Federal Reserve system. Therefore, there is no Glass-Steagall bar to affiliations between nonmember insured banks and securities firms. In *Investment Co. Inst. v. FDIC*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,063 (D.C. Cir. Jan. 16, 1987), *amended*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,197 (D.C. Cir. Apr. 7, 1987), the court adopted a literalist approach in rejecting the securities industry's attempt to overturn the FDIC's acceptance of this conclusion. It should be noted that other banking law provisions might limit the manner in which a nonmember bank engages in securities activities. The FDIC used its general rulemaking authority to promote the safety and soundness of insured banks by placing limits on affiliations between banks and securities firms. The recent "noncontrol" affiliation between Japan's Sumitomo Bank and the investment banking firm of Goldman Sachs raised no section 20 issue because Sumitomo's American bank was a nonmember bank. See *BHC Investment in Sec. Brokerage Firm*, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,735 (Nov. 19, 1986).

which the Comptroller viewed as outside the scope of section 20. Therefore, it determined that the firms were not "engaged principally" — statutory language that is becoming the most important battleground for Glass-Steagall skirmishing¹²⁷ — in section 20 activities. As a result, the affiliation between the bank and Dreyfus or Seligman was not unlawful. Finally, the Comptroller determined that the firms did not "control" the funds they sponsored because a majority of the directors of those funds were not associated with the firm. Hence, no affiliation existed between the bank and the funds themselves (which presumably were engaged principally in section 20 activities).

The flaws in the reasoning are not difficult to spot.¹²⁸ The Comptroller's "single entity" theory, which led him to view the Dreyfus component entities as an integrated whole in determining the fractional denominator, is inconsistent with his willingness to separate out the distribution income as a distinct line of business for purposes of constructing the numerator. More realistically, all of Dreyfus' income comes from the integrated business of sponsoring mutual funds, which inseparably involves underwriting and distribution. The suggestion that Dreyfus does not "control" its funds is patently absurd; the adviser-sponsor has total day-to-day authority over the funds' activities, assumed in return for a compensation package largely dependent on net asset value of the fund. It has both the ability and the motive to cause both the funds and the bank to operate coordinately.¹²⁹

127. In *Seligman*, the section 20 income figure was 1.2%, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) at 86,601; in *Dreyfus*, it was less than 0.5%, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) at 86,611. In support of this reading, the Comptroller relied on *Board of Governors v. Agnew*, 329 U.S. 441 (1947), the first Supreme Court Glass-Steagall case, which held that the management interlock portion of the Act, section 32, did bar a particular affiliation between a bank and a securities firm. In this case of relatively small practical importance, the Court gave a narrow reading to the term "primarily engaged." In a subsequent Federal Reserve Board decision, the Board adopted a broader test for "principally engaged," indicating that only if a firm's securities-related income was "insubstantial" (perhaps below 5% of the entity's total) could the impact of section 20 be avoided. Otherwise, in the Board's view, firms could avoid Glass-Steagall altogether by creating securities affiliates that had sufficiently diversified lines of business that no single activity reached the level of a majority. In addition, the affiliate would be restricted to a relatively small market share. *Bankers Trust New York Corp.*, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,770 (Dec. 24, 1986); see also *Chase Manhattan Corp.*, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,912 (Fed. Res. Bd. Mar. 18, 1987); *Citicorp*, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,957 (Fed. Res. Bd. Apr. 30, 1987). In a lawsuit filed by the Securities Industry Association, the Second Circuit stayed the Board's approval of the Citicorp proposal pending appeal on the section 20 issue. See *Second Circuit Stays Fed's Section 20 Decision*, 48 Banking Rep. (BNA) 928 (May 25, 1987). Obviously, this litigation presents an opportunity to adopt a construction of section 20 that operates to destroy Glass-Steagall, at least in the holding-company context.

128. See Note, *Ownership of Member Banks by Mutual Fund Advisers Under the Glass-Steagall Act*, 52 *FORDHAM L. REV.* 691 (1984).

129. The Investment Advisers Act of 1940, 15 U.S.C. §§ 80a-1 to 80b-21 (1985), the principal regulatory statute governing mutual funds, is constructed almost entirely on the need to

Why, then, did the Comptroller approve the acquisitions? At first glance, the action appears to belie the "capture theory" often used to describe the Comptroller as a functionary of existing banking interests,¹³⁰ who could not have been pleased by securities firm entry in this fashion. There are two possibilities, probably in combination providing an answer. One has to do with the dual system of banking. If the Comptroller did not permit the acquisition of a national bank, the securities firms probably would simply have sought state-chartered non-member banks — to which section 20 would not apply at all — to accomplish the same purpose.¹³¹ This way the Comptroller at least retains some regulatory control over the affiliation. Second, it is worth noting that the same reasoning utilized by the Comptroller would in theory also allow a commercial bank both to sponsor a set of mutual funds and engage in a host of other securities related activity, evading the *Camp* decision through the simple step of making the funds and their adviser separate legal entities.¹³² On the assumption, appropriate in the transitional marketplace, that "even playing field" competition between banks and securities firms with respect to financial service products is desirable without artificial regulatory constraints, the Comptroller apparently was inclined to eliminate at least one of those barriers.¹³³

protect against the possibility of overreaching by the investment adviser given de facto day-to-day control. See generally T. FRANKEL, *THE REGULATION OF MONEY MANAGERS* (1978).

130. See Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335, 341 (1975); Macey, *Special Interest Groups*, *supra* note 64, at 37-39.

131. Indeed, J.W. Seligman subsequently switched over to a state charter, apparently to avoid further problems with the Federal Reserve Board. See Note, *supra* note 128, at 703 n.51. Certain "nonbank bank" acquisitions by securities and other financial services firms have also been of state-chartered banks. The Prudential-Bache Insurance Company is an example. It is also possible for banks themselves to switch to state charters (and drop out of the Federal Reserve system) in order to free themselves to create securities subsidiaries. Indeed, in light of recent actions by the state of New York liberalizing the securities powers of state-chartered banks there, see *Ruling of the New York State Superintendent of Banks*, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,771 (Dec. 23, 1986), federal regulators are taking seriously the threat of charter-switching by some large New York banks. Indeed, there is the possibility of dropping bank charters entirely. See Wall St. J., Dec. 29, 1986, at 1, col. 6.

132. Of course, such separation would have to be bona fide. A situation where, notwithstanding legal separation, the bank "sold" shares of the affiliated fund would raise the question of whether it was in fact selling or underwriting within the meaning of section 16 or 21. An interesting variation on the concept of bank sponsorship of mutual funds has been introduced by Chase Manhattan, which offers a "market index investment" account that pays the depositor a rate of interest tied to the performance of the stock market. The Investment Company Institute has brought suit, charging a Glass-Steagall violation. 48 Banking Rep. (BNA) 768 (Apr. 27, 1987).

133. For a useful exploration of section 20 in light of the interpretive techniques utilized in *Dreyfus* and other recent judicial and administrative pronouncements, see Bock, *The Glass-Steagall Act and the Acquisition of Member Banks by Unregulated Bank Holding Companies*, 100 BANKING L.J. 484 (1983).

D. *The Limits of Transitional Jurisprudence: Commercial-Paper Underwriting*

Any hypothesis that the evolution of Glass-Steagall has been a conscious updating process must confront the single recent instance where the transitional rhetoric failed (at least on a first effort) to erode the Glass-Steagall Act's restrictions. This is the question of bank underwriting of commercial paper. As noted earlier, the increased use of commercial paper as a means of corporate financing has meant that banks have lost many of their highest-quality borrowers, and must turn to higher-risk loans to compensate in the core banking business. To recapture at least a portion of the lost income, a few banks have sought to act as commercial-paper "placement agents," assisting issuers in locating and selling the paper to institutional investors. In response to a petition by Bankers Trust Co., the Federal Reserve Board authorized such activity, finding no Glass-Steagall violation on grounds that the short-term notes do not constitute securities within the meaning of the Act. Instead, commercial paper is the functional equivalent of a bank loan — the core business of banking. The Board's ruling was affirmed by the District of Columbia Circuit.¹³⁴

The Supreme Court, in *Securities Industry Association v. Board of Governors*¹³⁵ (referred to as *Bankers Trust*), reversed in an opinion that leads one to question the theory so far espoused that the evolutionary direction of Glass-Steagall interpretation is inevitably to accommodate marketplace transition. Notwithstanding the opportunity to use legislative intent in a way that would narrow the scope of Glass-Steagall's restriction, the Court defined security in the broadest possible fashion. On close examination, it seems that three discrete factors combined to influence the Court's decision. First, the Court, having assumed (perhaps mistakenly) that sections 16 and 21 attempt to draw the same line of separation, was forced to observe that section 21 expressly uses the term "note" in defining the scope of the prohibition on underwriting and distributing. Given the literalism of the post-*ICI II* jurisprudence, it was led to reject an interpretive approach that would ignore that language; in this sense, a transitional interpretive technique was turned against itself. Second, the Court saw a potential conflict of interest that made *Camp* difficult to distinguish. By contrast to the discount brokerage context, or even the investment fund at issue in *Camp*, commercial-paper underwriting activity involves a formal

134. *A.G. Becker, Inc. v. Board of Governors*, 693 F.2d 136 (D.C. Cir. 1982), *revg.* 519 F. Supp. 602 (D.D.C. 1981).

135. 468 U.S. 137 (1984), *revg.* *A.G. Becker, Inc. v. Board of Governors*, 693 F.2d 136 (D.C. Cir. 1982).

(probably long-term) association between the issuer and the bank. This association raises the question whether the bank could serve as an impartial source of either advice or credit or whether instead it would be tempted to favor those with whom it had this kind of investment banking relationship and disfavor others. Third, the Board's ruling was a bald assertion of the inapplicability of Glass-Steagall as a matter of law, rather than an approach that sought in advance to control potential abuses through regulation. Faced with these three factors, the Court engaged in a predictable rhetorical overreaction and reinvoked many of the weaker conceptual anachronisms of *Camp*, even some of the fiduciary ideology.

Under an interpretation of Glass-Steagall that emphasizes the soundness and conflict-of-interest elements of legislative intent, the Court's result is plausible¹³⁶ — although it still leaves unresolved how it is that banks can deal in or invest for their own account (as they surely must be able to) in many common lending equivalents, given the breadth of the Court's definition of security.¹³⁷ There is, however, an important irony in the Court's decision. Were the Court to have recognized that the principal objective of Glass-Steagall was to take away the incentive to divert savings dollars from productive to speculative uses (and that the elimination of conflicts of interest and other soundness threats was an ancillary motivation understandable only in the context of this broader objective), it would have concluded that bank underwriting of commercial paper was an entirely legitimate use of bank energies and resources. An underwriter plays the role of reducing search and transaction costs in the movement of short-term borrowed capital — precisely the basic function that a bank performs when it acts as an intermediary generally. Though the "subtle hazards" the Court considered are possible, they arise whenever a bank enters into a long-term financing relationship with a borrower. So long as the underwriting in question promotes the use of funds on such a credit basis, the historical intent of the Act is furthered, not compromised. But in the statutory evolution of Glass-Steagall, that

136. See Macey, *Special Interest Groups*, *supra* note 64, at 29-34; Note, *supra* note 104, at 118.

137. See Glidden, *Bank Sales of Commercial Paper Under the Glass-Steagall Act: The Hazards of the Bankers Trust Decisions*, 42 BUS. LAW. 1, 17-19 (1986). Glidden observes in addition that it was both unnecessary and unreasonable for the Court to base its analysis on the assumption that sections 16 and 21 seek to draw an identical line of separation. He argues that Congress intended section 16 to describe limitations on bank activities, and section 21 to deal only with the banking activities of investment banks. This is important because section 16 does not contain the word "note" in its reference to prohibited securities activities. For another criticism of *Bankers Trust* along these lines, see Note, *Security Under the Glass-Steagall Act: Analyzing the Supreme Court's Framework for Determining Permissible Bank Activity*, 70 CORNELL L. REV. 1194 (1985).

original goal had completely disappeared from sight. In this, *Camp's* myopia may have taken its heaviest toll.

Bankers Trust dealt only with the "security" question, not the issue of whether the bank's proposed conduct in acting as an agent for issuers of commercial paper would in fact violate the Act. The second phase of the proceeding thus began, with Bankers Trust revising its proposal to eliminate certain practices (e.g., extending credit to issuers, buying up unsold securities) which the Court had noted as potential problems. The Federal Reserve Board then ruled that, the Court's decision notwithstanding, what the bank proposed to do did not constitute prohibited selling, distributing, or underwriting within the meaning of sections 16 or 21. Its decision was quickly overturned by a federal district court,¹³⁸ which found disingenuous the Board's attempt to avoid the Supreme Court's teachings. In turn, the court of appeals reversed that decision and reinstated the Board's decision.¹³⁹

The court of appeals' decision, plainly reaching for the particular result, reverted to the style and reasoning of *ICI II*. It began with the command of deference to agency expertise, and throughout the opinion indicated its willingness to follow the Board's reasoning so long as there was any plausible basis for so doing.¹⁴⁰ The court determined that, read literally, section 16's permissive phrase allowing a bank to buy or sell securities "solely upon the order, and for the account of, customers" described the proposed conduct, and was not limited (as the legislative history suggested) to brokerage services. Then, eschewing literalism, the court delved into legislative history analysis to find that "underwriting" occurs only in the context of a public offering of securities, not the sort of private placements that Bankers Trust was proposing. Finally, the court dismissed the district court's "subtle hazards" analysis, finding that given the current nature of the commercial-paper market and the restrictions agreed to by Bankers Trust, only one of the hazards identified by the Supreme Court might be present in any significant sense (possible reputational harm if commercial-paper purchases recommended by the bank turned out to be poor ones), and one such hazard was not enough.¹⁴¹

What is most notable about the court's opinion — apart from its

138. *Securities Indus. Assn. v. Board of Governors*, 627 F. Supp. 695 (D.D.C. 1986).

139. *Securities Indus. Assn. v. Board of Governors*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 55 U.S.L.W. 3849 (U.S. June 22, 1987) (No. 86-1429).

140. A key holding — the definition of underwriting — rested on nothing more than the court's finding that "it seems highly plausible that one line Congress might have drawn" was that offered by the Board, 807 F.2d at 1066 (emphasis added).

141. One of the most debatable of the court's assertions is that *all* of the subtle hazards must be present in order to find a particular "borderline" activity violative of the Act.

internal inconsistency in choosing its canons of construction — is the mode of analysis that relegates the subtle hazards inquiry to the fact-specific level, thus permitting it to avoid most of the Supreme Court's concerns by determining that in view of Bankers Trust's promises and the current status of the commercial-paper market, most of the abuses would be unlikely to arise. That, as noted earlier, misses the point of intent-based statutory interpretation in the context of a prophylactic statute like Glass-Steagall. Words like "selling" or "underwriting" are to be defined generically, with reference to the possible hazards feared by Congress; the only remaining question is whether the proposed conduct fits within those generic definitions, without reference to specific features of the market for a particular security or representations of intent about avoiding particular conflicts of interest. Had the court of appeals followed this approach (as did the district court), it would have been difficult to avoid a contrary holding.¹⁴²

Reasoning aside, the court's conclusion has at least the virtue of marketplace realism. Once again, what Bankers Trust was proposing did not in fact take it outside the business of banking in economic terms. The bank simply plays a different intermediary role in the process by which capital moves in the form of commercial credit from net savers to business enterprises in need of funds. To rule to the contrary would pose a substantial roadblock not only to participation in the commercial-paper market that has become an effective substitute for bank lending, but also to participation in the variety of new securitized financing vehicles that have become a large part of the marketplace in short- and medium-term debt.¹⁴³

E. Conclusion

The Glass-Steagall Act evolved in distinct stages. The actual motivation of its drafters was admittedly an amalgam of concerns, but to

142. Most significantly, the restriction of the term "underwriting" to public distributions would have been difficult as a generic matter in light of the Supreme Court's finding of significant potential for abuse in the securities distribution process, even to sophisticated investors. See *Bankers Trust*, 468 U.S. at 156, 159. It is also questionable whether the *current* state of the commercial-paper market should be given controlling effect. With the market expanding so rapidly, what might be of minimal concern today could become far more significant.

143. With the Supreme Court's denial of certiorari in the second phase of the proceeding, leaving standing the D.C. Circuit's accommodationist holding, even the commercial-paper litigation in the end falls into the transitional jurisprudence category. Still, there will be more litigation, especially in the context of securitization. See *Security Pacific Gets OCC Go-Ahead to Sell Mortgage-Backed Certificates*, 48 Banking Rep. (BNA) 1120 (June 29, 1987) (litigation over sale of collateralized obligations). Hopefully, the courts will recognize that where the bank itself securitizes some of its own loan portfolio, there is no overriding reason why it should not be able to shift the risk and return interest to individual investors; this is still the process of matching net savers with net borrowers in the provision of commercial credit.

those most responsible for its enactment it was as much as anything the desire to redirect the resources and energies of the banking industry back to the historic role as provider of commercial credit, a need sorely felt in the earliest years of the Depression. Nearly forty years later, that intent was reformulated in the Supreme Court's anomalous *Camp* decision. While seeking to carry out what it considered Congress' objective, the Court in fact narrowed the appropriate inquiry to issues of bank soundness and fiduciary responsibility, and thereby diminished the strength of the apparent legislative justification. Still, the approach was one of expansive purposive construction of the Act's prohibitions. The third stage — concurrent with the onset of fundamental marketplace transition in the financial services industry — took that already-narrowed focus and transformed it yet again, to a rather sterile set of restrictions readily planned around, unencumbered by the rhetoric of the public role of the banking industry that was so engrained in the prior understanding.

Two points bear emphasis. One is that, through the process of statutory interpretation, prevailing interpretive doctrine has moved away, to a significant degree, from an emphasis on furthering the drafters' ostensible objectives in choosing to separate commercial and investment banking. The other is that — apart from an aberration like *Bankers Trust* — the realities of the transitional marketplace have been accepted, and the frustrating and potentially dysfunctional effects that Glass-Steagall might otherwise have on the development of the market for financial services have been minimized.

This transition in judicial construction has not been explicit or candid. To the contrary, two facially neutral interpretive techniques have emerged in this process as updating vehicles for courts inclined to use them. The first is narrow, literal, "bright-line" statutory interpretation, with an emphasis on the value of predictability. This canon is invoked even though it seems clear that Glass-Steagall is drafted in an inartful and inconsistent fashion, showing the press of time and other legislative business.¹⁴⁴

144. See Hawke, *The Glass-Steagall Legacy: A Historical Perspective*, 31 N.Y.L. SCH. L. REV. 255, 257-60 (1986). Literalism, generally thought of as a rule of construction more suited to a criminal context than New Deal prophylactic regulation, naturally limits the restrictive reach of the statute, and this is precisely the result desired in order to accommodate marketplace change. Another important banking law decision of the Supreme Court, *Board of Governors v. Dimension Fin. Corp.*, 106 S. Ct. 681 (1986), is a vivid example of narrow construction producing a result that effectively accommodated marketplace change — there in the context of the nonbank bank. See note 124 *supra*. In that case the Court struck down an attempt by the Federal Reserve Board to expand its jurisdiction under the Bank Holding Company Act beyond the literal confines of the word "bank," and thereby thwart the market-driven proliferation of "nonbank banks" in the United States. While the Court's decision stresses the virtue of literalism, it would also appear that the result is a correct one in light of actual legislative intent. In

The second is deference to administrative expertise. The nature of the banking industry is such that the acquiescence of the primary regulator is generally necessary before an initiative is undertaken. As noted earlier, the regulators have accommodated marketplace change. Hence, Glass-Steagall litigation has generally been in the form of challenge to or review of a permissive administrative rule or decision. Here, too, there has been a noticeable shift toward deference as a basis for the judicial decision, without any truly principled articulation for why deference is compelling in one case but not in another.¹⁴⁵ But clearly, the consequence of deference has been to lessen the impact of the Act.

Exactly how conscious the judicial shift from the traditional to the transitional has been is a matter for speculation. *Bankers Trust* shows that, for some judges, whatever transitional impulse exists is not an overriding one, and that old ideas and rhetoric may be reaffirmed if there is no way to abandon them gracefully. As to the cases that are plainly transitional in result, a variety of factors unrelated to a desire to update can contribute to gradual doctrinal change. Judges' personal and professional contacts with banking and financial services create assumptions and dissonances, reflecting the current marketplace, that can skew even a careful attempt to determine legislative purpose. Dicta in one case, perhaps not well thought through by a judge (or law clerk) because of its tangentiality, can subsequently form

Dimension, the Court observed that literalism can also be a useful vehicle for assuring that the "hard fought compromises" of the legislative process are not undercut in the name of effectuating the legislative victors' particular "purpose." 106 S. Ct. at 689. The intellectual history of the shift in interpretive styles under the antifraud provisions of the federal securities laws from broad interpretation, see *SEC v. Capital Gains Research Bureau Inc.*, 375 U.S. 180, 186 (1963); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971), to literalism, see, e.g., *Chiarella v. United States*, 445 U.S. 222, 235 (1980), reflects an increasing awareness of the severe liability consequences, civil and criminal, of a securities law violation. That same concern is not nearly as pressing in a context like Glass-Steagall, where the likely consequence of a ruling against an industry participant is simply ceasing to offer a service, or, at most, to divest a newly acquired subsidiary.

145. The Supreme Court's leading case on deference, *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984), is relied upon heavily in the transitional decisions. That case has itself been described as simply the "latest in a long series of erratic Supreme Court decisions reviewing agency actions." Note, *Leading Cases of the 1983 Term*, 98 HARV. L. REV. 87, 255 (1984). There are a few principles that underlie the law of deference: long-standing interpretations, for example, are entitled to more deference than new administrative constructs or reversals of position. But by and large a safe generalization seems to be that the rhetoric of deference is invoked after the court concludes that the administrative decision is a sound one. In that sense, it adds little or nothing to the analysis. In evaluating the Court's approach on deference, it is worth comparing the two Glass-Steagall decisions of 1984, decided on the same day, which contain contrasting language on deference. Compare *Schwab*, 468 U.S. at 217 with *Bankers Trust*, 468 U.S. at 143-44. See also *Board of Governors v. Dimension Fin. Corp.*, 106 S. Ct. 681, 686 (1986).

the basis for a holding in another. What is really a doctrinal departure is then cloaked by an illusion of consistency.

In the end, however, it is difficult to believe that the more sophisticated courts — perhaps the Supreme Court in *ICI II*, certainly the courts of appeals in the IRA cases — have not appreciated the extent to which their decisions have departed from both the logic and the rhetoric of the *Camp* decision (which purported to reflect congressional intent), if not from the actual legislative intent itself. The turn that the law has taken in both rhetoric and result is far too visible to any careful observer. Accordingly, there is at least tentative reason to hypothesize that much of the judicial updating of the Glass-Steagall Act has indeed been intentional.

III. INTERPRETING THE MCFADDEN ACT

A second statutory provision that has become obsolete in the transitional banking marketplace is the restriction on branching by national banks and members of the Federal Reserve System, imposed by the McFadden Act of 1927.¹⁴⁶ The Act, as amended in the Banking Act of 1933, provides that those banks may establish branches within their state only to the extent that state-chartered banks are authorized to do so. “Branch” is defined in an open-ended fashion to “include any branch bank, branch office, branch agency, additional office, or any branch place of business . . . at which deposits are received, or checks paid, or money lent.”¹⁴⁷

The transitional marketplace is characterized, as noted earlier, by declining geographic barriers to entry in certain market segments.¹⁴⁸ Technology has provided means for attracting deposits from and making loans to individuals and businesses geographically far removed from the bank’s physical location. Both the desire to expand and the increased level of risk inherent in the traditional banking business have pressured banks to take advantage of these opportunities and to seek to diversify geographically both the sources and uses of their funds.

This Part will focus on the case law interpreting the branching restriction as applied to so-called electronic branching by banking institutions. It will be shorter than the preceding one, for there are fewer

146. 12 U.S.C. § 36 (1985). The restrictions on branching are extended to member banks in 12 U.S.C. § 321 (1985). One interesting aspect of the 1927 Act is that it also confirmed (and perhaps validated previously unlawful) securities powers of national banks — powers that were taken away six years later in the Glass-Steagall Act. See Prefatory Note, *Glass-Steagall Act — A History of Its Legislative Origins and Regulatory Construction*, 92 BANKING L.J. 38, 39-40 (1975).

147. 12 U.S.C. § 36(f) (1985).

148. See Part I.A. *supra*.

cases to consider. Nonetheless, the intellectual progression reflected in a series of three cases on this issue from 1969 to 1985 is clear, replicating to a remarkable degree the evolution of Glass-Steagall. Once again, in the latest of these cases, transitional jurisprudence is readily observable.¹⁴⁹

A. *The McFadden Act's Intent*

The legislative history of the McFadden Act reflects the interplay of economics and politics in a way even more pronounced than the usual banking legislation.¹⁵⁰ A natural political goal, if economic growth through credit extension is to be achieved, is making banking services readily available in all communities of the country. One way this can occur, of course, is by allowing a bank chartered in one location to expand freely into others by branching. This has noticeable economic advantages. It permits the most efficient banks to grow and make their services available to a larger segment of the population. At the same time it allows diversification of both assets and liabilities in a way that avoids excessive concentration at the home location, reducing the risk to the bank that would otherwise follow from a severe downturn in the local economy.¹⁵¹

Throughout much of its history, however, American banking policy has gone in the opposite direction. In the earliest years of the National Banking Act it was assumed that national banks could not branch at all. In response to the pressure to make banking services more accessible in smaller communities, Congress and the federal regulatory authorities (as well as the states) pursued policies of granting new charters freely, often without sufficient regard to the capital or qualifications of the promoters, rather than permitting expansion by

149. The discussion that follows builds from that presented in Langevoort, *Interpreting the McFadden Act: The Politics and Economics of Shared ATM's and Discount Brokerage Houses*, 41 BUS. LAW. 1265 (1986).

150. For discussions of the evolution in branching policy, see E. WHITE, *THE REGULATION AND REFORM OF THE AMERICAN BANKING SYSTEM, 1900-1929* (1983); H. BURNS, *supra* note 81; G. FISCHER, *AMERICAN BANKING STRUCTURE* (1968); Glidden, *Legal Constraints on Bank Expansion: Can They Be Removed Without Destroying the Dual Banking System?*, 1980 U. ILL. L.F. 369; Fischer & Golembe, *The Branch Banking Provisions of the McFadden Act as Amended: Their Rationale and Rationality*, in SUBCOMM. ON FINANCIAL INST. OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH CONG., 2D SESS., *COMPENDIUM OF ISSUES RELATING TO BRANCHING BY FINANCIAL INSTITUTIONS* 1.

151. One of the major sources of current difficulties of banking institutions in the Southwest and the Farm Belt has been excessive reliance on localized lending opportunities by energy and agriculture, respectively. See, e.g., *Texas Banks: Deep in the Heart of Trouble*, *ECONOMIST*, Feb. 22, 1986, at 73. It has been suggested that Canada's banking system was subject to fewer bank failures during the Depression because its pro-branching regulatory policy promoted greater diversification. See White, *A Reinterpretation of the Banking Crisis of 1933*, 44 J. ECON. HIST. 119 (1984).

existing banks.¹⁵²

This policy had two predictable effects. First, the growth of “unit” (*i.e.*, nonbranch) banking increased the frequency of bank failures, with the attendant adverse consequences on local communities in an era prior to deposit insurance. Second, those many unit banks that were able to survive (if not prosper to a point where they wished to expand) formed an extremely powerful political lobby dedicated to preserving and protecting their local markets from entry by outsiders. Initiatives at the federal level to address the first of these developments by permitting national bank branching were defeated by virtue of the second.

At the state level the political results were somewhat more varied, and in the early portion of this century some jurisdictions began to allow their state-chartered banks to branch, occasionally state-wide, but more commonly on a smaller (*e.g.*, county-wide) basis.¹⁵³ Into the 1920s, fear was expressed at the federal level that there might be a loss of regulatory authority to the extent that larger banks switched their charters from federal to state to take advantage of liberalized branching authority. This was particularly of concern with respect to the Federal Reserve System, the newly created vehicle for banking and commercial stability that depended on a sizable national bank membership.¹⁵⁴

At this point, a major battle was joined. The unit banking lobby was anxious to prevent branching as far as possible.¹⁵⁵ Reformers (with substantial support among the federal regulators) pushed for relatively liberal branching powers as a way of addressing the recurring problem of excessive deconcentration in the banking industry, and its resulting fragility. In the middle was the concern about the continuing viability of the Federal Reserve.

The McFadden Act of 1927 was essentially a victory for the unit bankers: Congressman McFadden himself described the bill as an

152. See E. WHITE, *supra* note 150, at 22-23.

153. *Id.* at 156-60.

154. The problem was made more pressing by a ruling of the Supreme Court in 1924, *First Natl. Bank v. Missouri ex rel. Barrett*, 263 U.S. 640 (1924), which strongly suggested that national banks indeed lacked the authority to branch. Some branch banking by national banks was statutorily permitted if the national charter was obtained via conversion from a state charter, and the state bank already had branches. See R. ROBERTSON, *THE COMPTROLLER AND BANK SUPERVISION* 101-02 (1968).

155. Illustrative of this was the so-called Hull Amendment of 1924, legislation — supported at the time by the American Bankers Association — that would have prevented any branching in a state that at the time of the legislation did not authorize state bank branching, even if the state later revised its position. See E. WHITE, *supra* note 150, at 163-64.

"anti-branch banking measure" ¹⁵⁶ A formal restriction on branching not only for national banks but also for state chartered members of the Federal Reserve was written into federal law. The one element of compromise allowed national and member banks to branch in their own towns and cities if such authority was granted to state-chartered banks. That element of the legislation was designed to foster some limited "competitive equality" between national and state banks so as to protect the Federal Reserve System. ¹⁵⁷

This was not much reform, and the next five years witnessed the adverse economic effects of deconcentration as the United States entered the Depression. The incidence of bank failures, usually of small-town unit banks, increased substantially. At this point, the legislative histories of the McFadden Act and the Glass-Steagall Act join, for Carter Glass took the lead in pressing for further branching authority for national and member banks in the same draft legislative package in 1931 that first proposed the divorce of commercial and investment banking. ¹⁵⁸ Though Glass said that he came to support branch banking "reluctantly," ¹⁵⁹ his actions are consistent with the two strong concerns that motivated him generally — promotion of the availability of credit to farmers and businessmen, and protection of the Federal Reserve System. ¹⁶⁰

The unit bankers opposed liberalization. They were championed by Senator Huey Long of Louisiana (who threatened a filibuster over the issue), as well as by some large city banks (including at one point the Chase National Bank) that wanted to protect their profitable correspondent banking relationships with the unit bankers. ¹⁶¹ Glass' influence, however, was enough to place in the final version of the Banking Act of 1933 a provision permitting national and state member banks to branch anywhere within the state where they were located if state law permitted state-chartered banks to branch. ¹⁶² This standard — fairly complete competitive equality — was less than Glass wanted but all that was politically feasible, even in 1933. And even that much liberalization was probably obtained only as a compromise to gain what the unit bankers' representatives wanted most — federal deposit

156. 68 CONG. REC. 2166 (1927).

157. This was not an end in itself. See Fischer & Golembe, *supra* note 150, at 21.

158. See H. WILLIS & J. CHAPMAN, *supra* note 71, at 80-82.

159. S. KENNEDY, *supra* note 68, at 207.

160. See Part II.A.1. *supra*.

161. See H. BURNS, *supra* note 88, at 58-59.

162. Banking Act of 1933, ch. 89, § 23, 48 Stat. 162 (1933) (current version at 12 U.S.C. § 36 (1982)).

insurance.¹⁶³

What does this say about the congressional intent underlying the McFadden Act? On balance, the unit bankers had won the political victory, shifting the arena for debate over branching from Congress to the state legislatures — where they also had substantial power. The only condition was that national banks not be disadvantaged competitively if a state chose to permit branching. In this sense, the Act represented the judgment of Congress that in general it was appropriate as a matter of regulatory policy to limit geographic expansion. The reasons for this determination vary; no doubt special-interest pressure for home market protection was a (probably the) dominant factor. But the legislative history expresses facially legitimate — though not necessarily persuasive — “public-regarding” concerns as well, and it is likely that these in fact played an honest role in the formulation of the law. Foremost among them was the channeling objective: promoting local reinvestment of deposits by preserving local control over banking institutions, thus avoiding the drain of funds from remote regions to the money centers that was feared if authority over use of the funds was placed in a distant bank headquarters.¹⁶⁴ Closely related was the desire to avoid concentrating too much economic power in money-center banking institutions, quite apart from where the money was used.¹⁶⁵ Closing local markets to expansion by growth-oriented banks would indirectly accomplish this. Statutory interpretation of the McFadden Act that seeks to adhere to the legislative intent could legitimately use these considerations as touchstones of legislative purpose.¹⁶⁶

B. Judicial Reformulation

The first Supreme Court decision to construe the McFadden Act's definition of branch, *First National Bank in Plant City v. Dickinson*,¹⁶⁷ is strikingly similar to the *Camp* decision under Glass-Steagall in at least four respects. Both involve interpretive issues of first impression

163. See Golembe, *supra* note 80, at 198-99 (citing 77 CONG. REC. 5897 (1933) (remarks of Rep. Goldsborough)).

164. See Part I.B.3. *supra*. McFadden referred to this as absentee control over community money, an “unsound and un-American” practice. 65 CONG. REC. 11,297 (1924).

165. See Part I.B.2. *supra*.

166. See Langevoort, *supra* note 149, at 1268-69; Comment, *Customer-Bank Communication Terminals and the McFadden Act Definition of a “Branch Bank,”* 42 U. CHI. L. REV. 362, 384-86 (1975). This is not to say, once again, that these are persuasive arguments — simply that they were honestly held by at least some of the drafters. For a discussion of some of the costs and benefits of geographic expansion and its regulation, see King, *Interstate Banking: Issues and Evidence*, ECON. REV., Apr. 1984, at 36.

167. 396 U.S. 122 (1969).

nearly forty years after statutory enactment, on the eve of marketplace transition. Both overturn a decision of the Comptroller of the Currency, giving little deference to administrative expertise. Both purport to give broad, purposive readings to the restrictive statutes in question. And both formulate interpretive approaches that, while well-intentioned, miss the point of actual legislative intent, thereby creating the potential to skew subsequent case law.

Plant City involved a challenge to a decision of the Comptroller, who had held that the McFadden Act did not bar a national bank from establishing a receptacle in a shopping center that bank customers could use to make deposits, or an armored car that would travel to various customers to take their deposits. If such facilities were considered branches, they would have been impermissible under Florida law. The Comptroller held that they were not branches, on the ground that as a technical matter the deposits were not legally effective until delivered back to the bank by bank personnel.

In overturning the Comptroller's decision, the Supreme Court reviewed the legislative history of the Act and found that the dominant congressional intent was to establish "competitive equality" between state and national banks.¹⁶⁸ Therefore, the proper test for whether a facility is a branch is whether its existence could give the establishing bank an advantage in competition for customers or funds over state-chartered banks that might not be able to expand their reach in the same fashion. Under that test, both the receptacle and the armored car were branches.

The Court's analysis assumes, wrongly, that the drafters saw competitive equality as an important end in itself, a way of promoting federalism and the dual system of banking. Instead, the rule of equality was merely an element of compromise in legislation designed primarily to express a congressional preference for protecting local banking markets from entry by larger, more economically powerful banks.¹⁶⁹ The more precise test, then, would have been whether the existence of

168. 396 U.S. at 133. The Court derived its competitive equality principle from *First Natl. Bank v. Walker Bank & Trust Co.*, 385 U.S. 252 (1966), which dealt with the extent to which a bank may branch under the Act. There, competitive equality was clearly the proper test.

169. See *Fischer & Golembe*, *supra* note 150, at 21; *Glidden*, *supra* note 150, at 379-80. For a discussion of the error in considering competitive equality a separate goal in banking regulation generally, see *Scott*, *supra* note 5, at 41-42. The harm in the Court's approach is evidenced in subsequent lower court cases that have held such facilities to be branches, *St. Louis County Natl. Bank v. Mercantile Trust Co.*, 548 F.2d 716 (8th Cir. 1976), *cert. denied*, 433 U.S. 909 (1977), even though these do not really have the potential to cause a serious outflow of local deposits. In the Supreme Court's most recent McFadden Act decision, *Clarke v. Securities Indus. Assn.*, 107 S. Ct. 750 (1987), discussed in note 187 *infra*, the principle of competitive equality was limited to equality in core banking functions, effectively precluding this result.

the facility could reduce local control over local funds, threatening the possibility of funds flowing out of the locality to remote locations notwithstanding a state-enunciated policy to the contrary. As with *Camp*, however, this is a quibbling criticism in the context of the facts before the Court. Either approach leads to a determination that the facilities in question were branches.

Naturally, the *Plant City* decision established the framework for deciding the more significant branching issues that soon followed. Far and away the most important of these was the status of automated teller machines (ATMs), the banking industry's effort to reduce costs and increase convenience in everyday transactions with depositors.¹⁷⁰ Once again, the Comptroller was permissive, ruling that ATMs were not branches, and thus could be established at remote locations by national banks without regard to state branching laws.

Given the substance-over-form approach set forth in *Plant City*, the Comptroller's ruling was certainly open to question. Predictably, it was rejected in a number of cases, most notably by the District of Columbia Circuit in *Independent Bankers Association of America v. Smith*.¹⁷¹ The court found that an ATM realistically is a place where deposits are made, checks paid, and money lent;¹⁷² hence, it is a branch. The opinion is a belabored one, perhaps reflecting the court's discomfort with the result as a policy matter, given the clear consumer benefits of this feature of the transition toward electronic banking. But it found no alternative given the Supreme Court's competitive equality test, and left to Congress or the states the task of policy modification.¹⁷³

C. Transitional Jurisprudence: Shared ATMs

Smith did not thwart marketplace evolution toward wide-scale electronic branching. The response, growing out of efforts to provide small community banks with ATM facilities when they could not afford the large start-up costs to establish their own, was to restructure

170. For an excellent analysis, see Comment, *supra* note 166.

171. 534 F.2d 921 (D.C. Cir.), *cert. denied*, 429 U.S. 862 (1976); *see also* State Bank v. Merchants Natl. Bank & Trust Co., 593 F.2d 341 (8th Cir. 1979); Colorado *ex rel.* State Banking Bd. v. First Natl. Bank, 540 F.2d 497 (10th Cir. 1976), *cert. denied*, 429 U.S. 1091 (1977).

172. That a deposit can be made at an ATM is clear; the other statutorily enumerated functions are somewhat less obvious. According to the court, the substance-over-form approach compelled a finding that a check is paid when money is withdrawn from the machines, 534 F.2d at 942-45, and that money is lent when a withdrawal results in an overdraft, 534 F.2d at 945-48.

173. A large number of states did revise their laws to permit ATMs to be used more widely than traditional brick and mortar branches. *See* Recent Development, *The Future of Shared Automatic Teller Networks in the Wake of Marine Midland Bank: A Call for Federal Legislation*, 38 VAND. L. REV. 1621, 1626-29 (1985).

the ownership interests in such devices via a pooling arrangement. "Shared ATMs," as they came to be called, became accepted devices whereby an independent firm (or perhaps a joint venture among a group of banks) would establish and own a network of ATMs in a given location, inviting local banks to participate pursuant to contractual arrangement. The participating banks' depositors would be given debit cards enabling them to access the system to make deposits and receive cash. Transaction fees would be charged to the banks. Through switching devices, customer use of the machines would be identical to use of machines actually owned by the bank; accounts would be debited or credited immediately. This type of arrangement soon became a means by which banks of all sizes could join nationwide ATM networks, giving their customers remote multistate access to deposit facilities and cash.¹⁷⁴

The Comptroller declared that these facilities were not branches, first through informal rulings, later in formal regulation, on the grounds that branches must be "owned or rented" by the bank in question in order to be "established" by that bank.¹⁷⁵ After initially being struck down by a district court,¹⁷⁶ the Second Circuit upheld the Comptroller's position in *Independent Bankers Association v. Marine Midland Bank*.¹⁷⁷

While one decision (particularly of a court of appeals, even if followed by a denial of certiorari by the Supreme Court) cannot by itself signal a change in judicial thinking on a given statute, *Marine Midland* bears such a close similarity in style and structure to the transitional decisions under Glass-Steagall that such an inference is warranted. The court's determination that the word "establish" in the McFadden Act requires a property interest (ownership or leasehold) in the facility in question is an extremely narrow construction of the term. The court did not arrive at it purposively through analysis of the competitive impact of shared ATMs; had it done so, a contrary result would have been called for, since from a consumer perspective the attractive-

174. See McMahon & Peck, *Recent Federal Litigation Relating to Customer-Bank Communication Terminals ("CBCTs") and The McFadden Act*, 32 BUS. LAW. 1657 (1977); *Status of ATM's Under State Branching Laws: Hearings on S. 2898 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 98th Cong., 2d Sess. (1984).

175. See 12 C.F.R. § 5.31(b) (1984). This concept was derived from dicta in the *Smith* case, 534 F.2d at 951-52.

176. *Independent Bankers Assn. v. Marine Midland Bank*, 583 F. Supp. 1042 (W.D.N.Y. 1984). The case itself involved a challenge to the use by out-of-town banks of the ATM facility owned and operated by a large upstate New York supermarket chain, Wegman's.

177. 757 F.2d 453 (2d Cir. 1985), *cert. denied*, 106 S. Ct. 2926 (1986). See generally Hawke, *2nd Circuit Expands Powers of National Banks*, *Legal Times*, Mar. 18, 1985, at 18, col. 2; *Recent Development*, *supra* note 173.

ness of the devices (or the chance that they will be utilized) has little to do with whose property the machines are or whose logo appears on them. Moreover, by reference to the actual intent of the Act, shared ATMs have the potential to upset the competitive balance between large expansion-oriented banks and local community-oriented ones, and to cause a geographic reallocation of savings capital. That, indeed, was why the community bankers of New York were bringing the suit.

Instead, though admitting that it was "arbitrary,"¹⁷⁸ the court chose the narrow construction largely because it said it could find no other bright-line way — invoking a predictability value reminiscent of Glass-Steagall's *ICI II* decision — to distinguish between shared ATMs and other remote transaction devices, like banking by telephone, home computers, or merchant-owned point-of-sale facilities.¹⁷⁹ In its view, apparently, the logical extension of the *Plant City* competitive-impact test proved too much, and some sort of pruning was thus necessary.

The court's point has a superficial appeal. The competitive-impact test is flawed in that, logically, any out-of-office activity undertaken by a bank to extend its presence could be declared a branch, since virtually everything a bank does in terms of product or marketing innovation is designed to gain a competitive advantage.¹⁸⁰ A credit card imprint device used by a merchant causes, for all practical purposes, a loan to be made to the cardholder; depositors can use home computer banking to transfer money from one account to another (a deposit function) and cause payments to third parties. Some limiting principle is indeed appropriate. But there was an intuitively attractive alternative limiting principle open to the court that would have worked acceptably and not done any real violence to the purposive definitional test of *Plant City* and *Smith*. This was an "agency" test, which asks whether (as with shared ATM's) the device is operated, pursuant to contractual obligation, primarily for the benefit of participating banks, or whether instead (as with home computers and point-of-sale facilities) the device is really for the benefit of the merchant or consumer, without any legal agency-like obligation to any bank.¹⁸¹ The court's

178. 757 F.2d at 462.

179. 757 F.2d at 459-60. This same problem had bothered the *Smith* court, leading to the "own or rent" dicta.

180. See Ginsburg, *Interstate Banking*, 9 HOFSTRA L. REV. 1133, 1220 (1981).

181. See Langevoort, *supra* note 149, at 1275-76. With the shared ATM, the owner of the devices is by contract obligated to act on the bank's behalf in assuring that the deposit and cash-dispensing functions are performed. Indeed, the owner has *no* interest in the devices apart from this representative role. By contrast, the other devices are owned and operated by persons with

choice of the narrow rule rather than this one strongly indicates the affirmative desire to restrict the contemporary impact of the McFadden Act.

Predictably, the other major justification given by the court for its holding was deference to the Comptroller's administrative expertise.¹⁸² The court's long discourse on deference notes the difficulties for industry members that would be caused by upsetting their reliance on the agency's interpretation of the Act; it does not explain why deference is more appropriate here than in the overturning holdings in *Plant City* and *Smith*, the two controlling precedents.¹⁸³

As with the nature of its reasoning, the effect of the court's decision is plainly accommodationist. Permitting widespread use of shared ATMs — not to mention other mechanisms for geographic expansion that need not be owned or rented by the bank¹⁸⁴ — increases consumer convenience and options, and lowers the cost to the banks of delivering financial services on a remote basis. It avoids placing national banks at a potential disadvantage vis-à-vis state banks not subject to McFadden with respect to interstate ATM utilization.¹⁸⁵ As to the historic objective underlying the Act, the transitional marketplace is characterized by rapid low-cost movement of funds among geographic locations, thus frustrating any reasonable expectation that localism can be an achievable public policy.¹⁸⁶ Adhering to a broad

either no contractual obligation to the bank to act on its behalf or obligations that are incidental to its own proprietary interest in facilitating consumer transactions.

182. 757 F.2d at 461-62.

183. This is especially the case in light of action by Congress in the Depository Institution Deregulations and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 188 (1980), to deprive the Comptroller of rulemaking authority under the McFadden Act. See 12 U.S.C. § 93a (1985). The same restriction is imposed with respect to the Glass-Steagall Act.

184. On future technological impact, see Bergen, *What's Really Happening in Bank Automation*, BANKERS MONTHLY, Apr. 15, 1986, at 16. One problem unaddressed by the court is the status of ATMs that are owned by an affiliate of the bank in a holding company structure. Prior administrative law suggested that so long as the ATM was operated for the benefit of the bank, it would be a branch. See Order Approving Acquisition of Bank, Michigan Natl. Corp., 64 FED. RES. BULL. 127 (1978). Another expansion device might be the use of deposit brokers — broker-dealer firms that solicit their customers for deposits on behalf of participating banks — a practice which has been challenged on branching grounds. See *Iowa v. Shearson-American Express*, No. 81-514A (S.D. Iowa filed Oct. 16, 1981). In general, sufficient development of nonbranch expansion techniques will place such stress on the prevailing regulatory structure of the banking system that substantial modification of the "dual system of banking" is inevitable. See note 45 *supra* and accompanying text. The *Marine Midland* decision accelerates that development.

185. The court used this to justify its result. 757 F.2d at 460-61. However, the absolute prohibition on interstate branching found in the McFadden Act is a conscious legislative choice, which naturally can operate to the disadvantage of national banks. It is not a reason for disregarding the Act's overriding objective. This point was made in the *Smith* case, 534 F.2d at 949-50.

186. See Part I.B.3. *supra*; see also Felsenfeld, *Electronic Banking and Its Effects on Interstate Branching Restrictions — An Analytic Approach*, 54 FORDHAM L. REV. 1019 (1986).

interpretation of the branching prohibition with respect to shared ATMs would therefore have done little to further any of the legitimate goals that Congress once had in mind for the banking system — certainly not enough to outweigh the cost savings and the convenience to the public. To the extent that the court understood the nature of the marketplace transition in this regard, its holding is quite circumspect.¹⁸⁷

IV. CONCLUSION: STATUTORY INTERPRETATION AND POLITICAL VALUES

The McFadden Act experience reinforces the tentative conclusion reached about the evolution of Glass-Steagall. The tendency of courts interpreting these two statutes to depart from the expansive pursuit of historic legislative goals, and instead to accommodate the new assumptions of the transitional banking marketplace, suggests as a strong possibility the conscious judicial pruning of two apparently obsolete statutes.

At this point, it is necessary to consider an alternative explanation for the shifts in direction taken by the courts under these two statutes. The emphasis on “plain English” literalism may simply reflect the adoption of this canon, *a priori*, as the neutral principle of interpretation best suited to the judiciary’s institutional role in the enforcement of statutes — quite apart from the outcomes it produces. This possibility cannot easily be dismissed; a number of current Justices of the Supreme Court have emphasized the value of strict constructionism, and it appears at first glance to have independent jurisprudential appeal.¹⁸⁸ Two responses are in order. One is that the canon of literalism, divorced from contextual reference to actual intent, is normatively hard to justify — indeed, internally inconsistent to the

187. See Note, *ATM Networks Under the McFadden Act*: Independent Bankers Association of New York v. Marine Midland Bank, N.A., 35 AM. U. L. REV. 271 (1985). The Supreme Court’s most recent McFadden Act decision reflects to a considerable degree the transitional style of judicial reasoning, although on close analysis it is probably also correctly decided in terms of actual legislative intent as well. In *Clarke v. Securities Indus. Assn.*, 107 S. Ct. 750 (1987), the Court held that discount brokerage offices of national banks were not branches for purposes of the McFadden Act. It deferred to the view of the Comptroller, supported by considerable legislative history, that the policy of competitive equality developed in prior decisions should be promoted through the Act only with respect to “core” banking functions. The result is accommodationist, of course, since it removes a potential barrier to product expansion in the banking industry. On this issue generally, see Langevoort, *supra* note 149, at 1277-78; Note, *Interstate Banking Restrictions Under the McFadden Act*, 72 VA. L. REV. 1119, 1134-37 (1986).

188. For an argument that the Supreme Court’s change in interpretive technique in favor of literalism masks a substantive preference for *laissez-faire*, see Note, *Intent, Clear Statements and the Common Law: Statutory Interpretation in the Supreme Court*, 95 HARV. L. REV. 892, 911-12 (1982). A distrust of governmental intrusion and a desire to update can merge in a way that makes actual motivation difficult to discern.

extent that its own justification is intent-based (*i.e.*, that the drafters would "want" strict interpretation). While it is no doubt true that in many instances words in statutes are carefully chosen and ought be given effect to the letter — and that carefully crafted language may reflect the give and take of legislative compromise much more accurately than general statements of purpose¹⁸⁹ — it can just as easily be the case that words or phrases are chosen in the press of legislative business without the time or ability to consider carefully any choice of locution. Any interpretation divorced from evidence of actual intent has the potential, at least, to frustrate legislative purpose.¹⁹⁰ The second point is that courts do not adhere to a maxim of literalism with enough consistency to grant it any sort of overriding legitimacy as a neutral principle. Certainly the experience in the early stages of the statutory life cycle indicates that purposive construction endures as a maxim of equal persuasive power, illustrating the observation that for every canon of construction there is an equal and opposite canon.¹⁹¹ The popularity of literalism today may in fact simply reflect its usefulness as a pruning tool at a time when there are so many aging statutes.

Just as hard to justify from a neutral perspective, and applied with even less consistency, is the other principal maxim used to effect the doctrinal transition — deference to an agency's interpretation of a statute committed to its administration. There is little reason to believe that an agency will give to a statutory provision a construction that is a historically accurate reflection of legislative intent. In fact there is substantial reason to believe that legislators choose explicit statutory commands, rather than delegating to an agency rulemaking authority over a particular issue, precisely to avoid subsequent administrative revision of a carefully worked out legislative outcome.¹⁹²

If the shift under the two statutes is not wholly by reference to separately justifiable neutral principles of interpretation, then the updating hypothesis becomes more compelling. But the normative prob-

189. See *Board of Governors v. Dimension Fin. Corp.*, 106 S. Ct. 681 (1986).

190. See Posner, *Statutory Interpretation*, *supra* note 1, at 807-08. In the interpretation of private contracts, the courts have long departed from the "plain English" approach as the dominant interpretative technique. While such an approach (just like the Statute of Frauds and the "four corners" variation of the Parol Evidence Rule) may operate as a useful cautionary device forcing parties to be careful and explicit in promissory formulation, it has given way to the primacy of actual intent, so as to protect the true expectations of the parties. See *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968). The same point can readily be made with respect to statutory interpretation.

191. See Posner, *Statutory Interpretation*, *supra* note 1, at 806 (citing K. LLEWELLYN, *THE COMMON LAW TRADITION* 521-35 (1960)).

192. See Posner, *Statutory Interpretation*, *supra* note 1, at 810-12; Macey, *An Interest Group Model*, *supra* note 64, at 263-64. On the question of consistency, see note 145 *supra*.

lem then reappears. Have the courts any business engaging in such efforts? The traditionalist answer, noted at the article's outset, is that they do not. Posner has argued that the judicial function must be limited to determining and carrying out legislative intent, either actual or reconstructed: a judge "should try to think his way as best he can into the minds of the enacting legislators and imagine how they would have wanted the statute applied to the case at bar" without any reference whatsoever to contemporary values.¹⁹³ Any other approach to statutory interpretation is inconsistent with the fundamental separation of powers, a countermajoritarian revision of the original "bargain" arrived at by the legislature.¹⁹⁴ In a similar vein, Judge Abner Mikva argues that public assertion of an unrestrained "updating" power could easily undermine the independence of the judiciary from the political process.¹⁹⁵

To these concerns about the legitimacy of the updating hypothesis, there is no answer other than Calabresi's. It asks much of judges to be satisfied with the role of agent for legislators, long dead, whose expressed beliefs, assumptions, and policy predictions seem no longer capable of contributing much toward the public good. A more active and creative role, one that accepts the responsibility for assessing whether a statutory rule is "out of phase" with reality and for limiting its scope unless it is reaffirmed by the legislature, seems far more satisfying. This role would be of equal dignity to the common-law powers historically granted to the judiciary.¹⁹⁶

Is this necessarily countermajoritarian (or the frustration of legislative initiative based on the political preferences of some judges for *laissez-faire*, as in the notion of economic due process in the thirties)? Not if one looks at judicial behavior over the entire course of the statutory life cycle. According to the updating hypothesis, courts will give expansive purpose-based scope to words or phrases so long as the prevailing conditions and assumptions of the time of enactment hold substantially true. After that, however, manifest intent — in terms of the

193. Posner, *Statutory Interpretation*, *supra* note 1, at 817, 818.

194. Posner, *Reading of Statutes*, *supra* note 1, at 290. Posner urges concentration on intent (what the legislature expected to accomplish) as opposed to motive (why it acted the way it did). *Id.* at 272; see also R. DICKERSON, *THE INTERPRETATION AND APPLICATION OF STATUTES* 98-101 (1975); MacCallum, *Legislative Intent*, 75 *YALE L.J.* 754 (1966).

195. Mikva, *The Shifting Sands of Legal Topography* (Book Review), 96 *HARV. L. REV.* 534, 542-43 (1982).

196. See G. CALABRESI, *supra* note 2, at 164. Professor Macey has offered a different approach to statutory construction. Based on a conception of the institutional role of the judiciary as a check on factional pressure, he would emphasize ostensible or expressed intent, to the derogation of hidden motivations that are often the product of special-interest pressure. See Macey, *An Interest Group Model*, *supra* note 64, at 249-50.

accomplishment of the goals specified in the legislation or its history — becomes meaningless. There is no way of knowing whether the legislature would have wished to pursue the same goals under the new circumstances. While the letter of the law must still be enforced until the statute is repealed or modified, it hardly usurps the legislative prerogative to conclude that situations not clearly covered are to be left to more general statutory controls or simply to marketplace discipline.¹⁹⁷

On the question of legitimacy, there is also an important mitigating factor hidden within the second (and perhaps more powerful) of the mechanisms for updating, the canon of deference. The very fact that in each of the transitional cases an administrative agency had determined that the conduct in question was lawful means that the court did not act alone in the revisionist process. Through the agency's action the proposal had been subject to something of a political process¹⁹⁸ — a value, it is worth noting, strongly advocated by Supreme Court Justice Scalia.¹⁹⁹ While this is hardly the equivalent of legislative action, it diminishes the concern about judicial usurpation precisely because it involves a check-and-balance procedure. In effect, the judicial process is simply operating as an endorsement of the regulatory dialectic.

More study is necessary, taking into account a far greater number of statutes than considered here, before the updating hypothesis can truly be convincing. But the idea is appealing. One certainly wishes, with Calabresi, that the process could be more candid if a new canon

197. This principle, a cousin at least to the maxim that application of a rule should cease when the reasons for its enactment are no longer valid, is similar to one advanced by Frank Easterbrook, who urges a presumption of statutory inapplicability absent clear evidence to the contrary. While accepting the view that a court's only function is to carry out the will of the enacting legislature, he believes that the presumption best assures that the legislature's careful cost-benefit judgments are not upset by judicial misapplication. Easterbrook argues that (assuming no cost of formulation or enforcement) a rational legislator would prefer such a presumption; hence, the principle is not necessarily inconsistent with a commitment to fidelity. See Easterbrook, *Statutes' Domains*, *supra* note 1, at 552. This article differs from Easterbrook in suggesting that a restrictive approach to the application of statutes is not invoked until there is a determination that the prevailing landscape has changed sufficiently to warrant an end to expansive construction.

198. Whether or not that value should be a controlling one with respect to judicial review generally, see Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 505, 510-12 (1985), it is appealing when changed circumstances raise questions about the appropriateness of fidelity to historic legislative purpose.

199. See Scalia, *Rulemaking as Politics*, 34 ADMIN. L. REV. v, x-xi (1982). Consistent with this, Scalia's decisions while on the court of appeals emphasized deference in the banking law context. See, e.g., *Association of Data Processing Serv. Orgs. v. Board of Governors*, 745 F.2d 677 (D.C. Cir. 1984) (regarding the Bank Holding Company Act); *Securities Indus. Assn. v. Comptroller*, 765 F.2d 1196 (D.C. Cir. 1985) (dissenting on denial of petition for rehearing) (regarding the McFadden Act). Scalia was on the panel, but not the author of the opinion, in *Investment Co. Inst. v. Conover*, 790 F.2d 925 (D.C. Cir. 1986), a transitionalist Glass-Steagall case permitting marketing of securities-based IRA accounts, discussed at Part II.C.2. *supra*.

of construction is indeed what the courts are invoking.²⁰⁰ The risk otherwise is incoherence, to the extent that other judges (not to mention the legal community) misconstrue hidden transitional signals. In light of concerns about the legitimacy of any explicit assumption of an updating power and the strength of the rhetorical tradition of fidelity, however, a request for such candor probably asks too much of the judicial system. The evolution of the law of banking regulation will undoubtedly continue in tension, attempting at the same time to have the appearance of both consistency and currency.

At the very least, the transitional law of banking regulation is today more sophisticated intellectually than were its predecessor stages in statutory evolution. The weight of disinterested academic commentary suggests that it is more sensible as well. Hopefully, Congress will sooner rather than later do its own revision of the obsolete banking statutes. Until then, however, there may be something to say for even today's subtle, restrained process of judicial updating.

200. See also Shapiro, *In Defense of Judicial Candor*, 100 HARV. L. REV. 731 (1987).