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COMMENTS

Implementation of the Bank Holding Company Act Amendments of 1970: The Scope of Banking Activities

There has been a continuing conflict between those who wish to allow banks to diversify their operations beyond the traditionally limited scope of the banking business and those who see such an expansion as a threat to the stability of the economy and a license for unfair competition.1 The most recent in a continuing series of attempts to reconcile this conflict is found in the Bank Holding Company Act Amendments of 19702 and the implementation of these Amendments by the Federal Reserve Board. The original Act, adopted in 1956,3 was the first major attempt4 to bring bank holding companies, a device that had been used by banks to diversify into nonbank activities,5 under regulatory restraints. The original Act


There were two main forces that urged adoption of the 1970 amendments. One group, headed by the Nixon Administration, was primarily concerned that the one-bank holding company movement might lead to the formation of huge industrial-commercial-financial conglomerates. See, e.g., Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 7-11 (1970) [hereinafter 1970 Senate Hearings] (statement of Undersecretary of the Treasury Charles Walker). Businesses that found themselves in competition with affiliates of bank holding companies also wanted to limit the scope of bank holding company activity. See, e.g., 1970 Senate Hearings, supra, at 461, 481 (insurance companies), 509, 534 (data processing companies), 276, 322, 412 (travel agencies). The main opponents of the amendments were banking organizations that took an active role in attempts to protect their interests. See, e.g., 1969 House Hearings, supra note 1, at 900, 1029 (large bank holding companies), 1097 (regulated multibank holding companies), 1176 (small banking organizations).


4. The Banking Act of 1933, ch. 89, 48 Stat. 162 (codified in scattered sections of 12 U.S.C.), imposed limited control on bank holding companies. Controls were applicable when two conditions were met: (1) at least one of the banks in the holding company system was a member of the Federal Reserve System, and (2) the holding company desired to vote its bank stock. Under these circumstances, the company was required to seek a voting permit from the Federal Reserve Board and to submit itself and its subsidiaries to examination by the Board. Ch. 89, § 19, 48 Stat. 166.

Due to the essentially voluntary nature of the second requirement, most bank holding companies were able to avoid regulation. As of 1955, only eighteen companies had submitted to federal regulation. See S. REP. No. 1095, 84th Cong., 1st Sess. 2 (1955).

5. Chase, supra note 1, at 1226-27.
covered only those holding companies that controlled at least two banks. The changes made by the 1970 amendments included extending the coverage of the Act to include companies that control only one bank and modifying the standards used to determine which nonbanking activities bank holding companies will be permitted to carry on.

In the two years since the amendments were enacted, the Federal Reserve Board has indicated the course that it will follow in implementing the provisions relating to nonbanking activities. This Comment will survey that course and evaluate it in the light of the intent of Congress in enacting the 1970 amendments.

I. BACKGROUND TO THE ADOPTION OF THE 1970 AMENDMENTS

The intended impact of the amendments can best be understood in terms of the efforts that have been made by banks to expand into nonbanking activities, for holding companies have been extensively used to circumvent the strict limitations on such expansion. In their operations banks have been restricted to the powers granted in their charters and in the statutes under which they are organized. The powers of national banks are exclusively granted by the federal banking laws. Title twelve of the United States Code expressly authorize certain powers. For example, national banks can carry on traditional banking functions "by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security . . . ." Other grants of powers

6. In addition to the changes discussed in this Comment, the 1970 amendments modified several definitions, excluded certain classes of companies from regulation as bank holding companies, exempted various types of shares from the prohibitions on holding of nonbank stock, modified regulatory procedures, and required all banks affiliated with holding companies to become members of the Federal Deposit Insurance Corporation. For a concise summary of the changes made by the amendments, see 1970 Senate Report, supra note 1, at 23-27.


9. Chase, supra note 1, at 1227.


are restricted to particular purposes, or are subject to conditions or quantitative limitations. Certain powers, such as the power to act in fiduciary capacities or to contribute to charitable organizations, are contingent upon the powers of state institutions in the state of the bank's operations.

In addition to expressly granted powers, national banks are authorized to exercise "[a]ll such incidental powers as shall be necessary to carry on the business of banking . . . ." Once an undertaking has been found to be an approved incidental activity, the bank is allowed considerable discretion in exercising the power; the courts have ruled that the bank may behave as any prudent businessman would under the circumstances. However, the exercise of the incidental power must at all times be focused upon the authorized banking objective. Thus, while a bank may be permitted to operate a business in order to facilitate its sale as a going concern, if it attempts to operate the business in hopes of realizing profits, it exceeds its power.

The limits on state banks are more difficult to describe since each state's approach is somewhat different. Unless a federal statute ex-

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plicitly restricts state bank activity,\textsuperscript{21} state laws and charters granted by the state define the powers of these institutions.\textsuperscript{22} No federal law makes the incidental powers clause of the National Banking Act applicable to state banks. However, a number of states have adopted similar clauses,\textsuperscript{23} which must be applied to the particular powers explicitly granted by those states. Moreover, some states grant powers denied to national banks. The New York and Ohio statutes, for example, permit travel agency operations,\textsuperscript{24} and Indiana permits leasing of real property\textsuperscript{25} and some insurance agency operations.\textsuperscript{26}

These grants, both federal and state, exclude almost all commercial and industrial activities available to other enterprises, including many highly profitable activities. During the 1960's, two major efforts were made to expand the scope of permissible bank activities. First, the Comptroller of the Currency, James J. Saxon, reversed the long-standing policy of the Comptroller's office\textsuperscript{27} and issued rulings expanding the permissible scope of national bank activities. He took a flexible view of the limitations imposed by the national banking laws: “The National Banking Act is not a merchandise mail-order catalog. It is rather, like the Constitution of the United States, a framework under which National Banks may employ their inventiveness and capacity for change to respond to the needs of our growing industry and commerce, both domestic and international.”\textsuperscript{28}

Among the activities that the Comptroller interpreted as within the scope of national bank powers were selling data processing services,\textsuperscript{29} leasing personal property acquired at the specific request of and for the use of a customer,\textsuperscript{30} operating travel agencies,\textsuperscript{31} acting as

\begin{itemize}
\item \textsuperscript{21} The most important federal restrictions placed upon state banks are conditions of membership in the Federal Reserve System. E.g., 12 U.S.C. § 335 (1970) (state banks subject to some limitation on ownership of investment securities as national banks).
\item \textsuperscript{22} “It is a prevailing rule, in Ohio and elsewhere, that banks and trust companies, though organized primarily for private profit, are of a preeminently public nature and have only such powers as are expressly conferred on them by their charters and by statute, or such as may fairly be implied from those expressly given.” Ulmer v. Fulton, 129 Ohio St. 323, 332, 195 N.E. 557, 561 (1935) (emphasis original). See also People v. Cairo-Alexander Bank, 363 Ill. 589, 2 N.E.2d 889 (1936); 4 MICHIE ON BANKS AND BANKING ch. 7, §§ 1, 5 (rev. ed. 1971).
\item \textsuperscript{23} See, e.g., CONN. GEN. STAT. ANN. § 36-57(a) (1969); MINN. STAT. ANN. § 48.15 (1970).
\item \textsuperscript{24} N.Y. BANKING LAW § 96(13) (McKinney 1971); OHIO REV. CODE ANN. § 1307.31 (Page 1968).
\item \textsuperscript{25} IND. ANN. STAT. § 18-1103(7) (Supp. 1972).
\item \textsuperscript{26} IND. ANN. STAT. § 18-1105 (1964).
\item \textsuperscript{27} Beatty, Legal Limits of Bank Services, supra note 18, at 20-22.
\item \textsuperscript{28} 1964 COMPTROLLER OF THE CURRENCY ANN. REP. 248.
\item \textsuperscript{29} 12 C.F.R. § 7.3500 (1975).
\item \textsuperscript{30} 12 C.F.R. § 7.3400 (1975).
\item \textsuperscript{31} 12 C.F.R. § 7.7475 (1975).
\end{itemize}
agent in the sale of credit-related insurance, operating messenger services, providing tax preparation services, underwriting revenue bonds of state and local governments, and operating commingled investment funds. The Comptroller further concluded that the restrictions on stock ownership found in the National Banking Act did not prevent a bank from carrying on any activities through subsidiaries that the bank could have performed itself.

This expansion in the permissible scope of the activities of national banks put great pressure on their state bank competitors, who in turn urged state regulatory agencies and legislators to make similarly expansive modifications in the state regulatory systems. Several very large state banks converted to national bank status to take advantage of these expanded powers. A number of states responded by amending their banking laws to permit state banks to carry on activities within the new national powers. Some states enumerated newly granted powers; others used incidental powers clauses to achieve a similar result, with several explicitly tying the incidental powers to those allowed national banks under federal law.

However, in 1966, the expansive trend under the Comptroller's rulings began to suffer severe setbacks in the courts. In that year the United States District Court for the District of Columbia struck down the Comptroller's interpretation allowing national banks to underwrite revenue bonds. Later suits invalidated the rulings with regard to the sale of insurance incident to banking transac-

35. 28 Fed. Reg. 9916 (1963) (codified at 12 C.F.R. § 1.3(e) (1964-71)).
38. 12 C.F.R. § 7.7506 (1973). This interpretation was important in pressuring state-chartered banks to seek national charters. See, e.g., 1968 CAL. Supt. of Banks Ann. Rep. 26-27. See also text accompanying note 40 infra.
39. For an early summary of the degree of national bank entry into these fields, see Beatty, Legal Limits of Bank Services, supra note 18, at 5-12.
41. See, e.g., N.Y. BANKING LAW § 90(13) (McKinney 1971) (travel agencies); OHIO REV. CODE ANN. § 1107.31 (Page 1968) (travel agencies).
tions,\textsuperscript{44} the operation of mutual investment funds,\textsuperscript{45} and the operation of travel agencies.\textsuperscript{46}

As the Comptroller's rulings came under attack, many banks turned to a second device for expanding the scope of their activities—the one-bank holding company. Banks were barred from engaging in nonbank activities through their own subsidiaries under regulations issued by the Comptroller of the Currency and by the Federal Reserve Board that limited subsidiaries of banks to activities that the banks could perform themselves.\textsuperscript{47} However, these restrictions did not apply to "bank holding companies"—more complicated corporate structures in which the nonbanking companies are subsidiaries not of the bank, but of the holding company, which also controls the bank. Bank holding companies that controlled two or more banks had been regulated since 1956 under the Bank Holding Company Act,\textsuperscript{48} which placed fairly narrow limits on the scope of activities in which affiliated companies could engage.\textsuperscript{49} Under this Act, the Federal Reserve Board performed a variety of regulatory functions, including approving the acquisition of both bank and nonbank subsidiaries by bank holding companies.\textsuperscript{50} The Board's
interpretation of the Act was very strict, and, consequently, holding companies were in some ways more tightly restrained than banks.51

However, holding companies that controlled only one bank were not within the scope of the Act52 nor, therefore, subject to its limitations on nonbank subsidiaries.53 In 1956 and again in 1966, Congress considered placing one-bank holding companies under the Act. Each time the suggestion was rejected on the grounds that such holding companies were causing no serious problems and subjecting them to the requirements of the Act would seriously harm the many small banks that were their primary banking components.54

After 1966, as the courts began to curtail the Comptroller's expansive interpretations, the character of one-bank holding companies changed drastically. The nation's largest banks rushed to form one-bank holding companies,55 many of which engaged in commercial and industrial enterprises not even arguably within banking powers, such as TV broadcasting, furniture manufacturing, and pizza parlors.56 In February 1969, Congress began to consider amendments to the Bank Holding Company Act that would extend it to one-bank holding companies; the resulting amendments became effective on December 31, 1970.57

II. FEATURES OF THE 1970 AMENDMENTS EFFECTING THE SCOPE OF BANKING ACTIVITIES

The main thrust of the 1970 amendments was to expand the coverage of the Act significantly. This was accomplished by modifying several key definitions.

First, "bank holding company" was redefined as "any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this Chapter."58 Under this new definition, control of one bank is sufficient to bring a company within the coverage of the Act.

Second, the definition of "company" was expanded. The original

51. See text accompanying notes 244-47 infra.
52. See Bank Holding Company Act of 1956, ch. 240, § 2(a), 70 Stat. 133.
55. Id. at 3.
act included "any corporation, business trust, association or similar organization" and explicitly excepted partnerships and government-owned corporations. The 1970 amendment added partnerships to the definition, thus subjecting them for the first time to the restrictions imposed by the Act.

Third, a new definition of "control" was added. Previously enacted definitions that provided that one company has control over another if it controls at least twenty-five per cent of any class of voting securities or if it controls the election of a majority of the directors or trustees were retained. The amendments provided in addition that control exists if "the Board determines . . . that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company."

Balancing these expansions in the coverage of the Act are other amendments that tend to liberalize the scope of activities in which a bank holding company will be permitted to engage. The Act defines the permissible scope of holding company interest in nonbanking organizations in section 4. The general mandate of the section is that

(a) Except as otherwise provided in this chapter, no bank holding company shall—

(1) . . . acquire direct or indirect ownership or control of any voting shares of any company which is not a bank, or

(2) . . . retain direct or indirect ownership or control of any voting shares of any company which is not a bank or bank holding company or engage in any activities other than (A) those of banking or of managing or controlling banks and other subsidiaries authorized under this chapter or of furnishing services to or performing services for its subsidiaries, and (B) those permitted under paragraph (8) of subsection (c) of this section.

The 1970 amendments made three modifications that affect the im-

pact of this mandate. The first is the so-called “grandfather” clause, a proviso to section 4(a)(2), which provides that “a company covered in 1970 may also engage in those activities in which directly or through a subsidiary (i) it was lawfully engaged on June 30, 1968 . . . and (ii) it has been continuously engaged since June 30, 1968.”

The second modification allows some one-bank holding companies to continue to enjoy the favored status that they held prior to the amendments. This is section 4(d), which exempts certain holding companies that controlled one bank prior to July 1, 1968, and have not acquired another bank since that date. If the Board finds that such action “would not be substantially at variance with the purposes of this chapter,” it may grant exemptions to avoid disrupting long-established business relationships, to avoid forced sales of small locally owned banks, or to allow retention of banks that represent only a small part of the holding company’s total interests and of the banking market. This provision differs from the grandfather clause in that one-bank holding companies exempt under section 4(d) may not only continue such operations as they had in 1968, but may also expand into other nonbank activities unless restricted by the Board’s exemption order or by subsequent Board action.

The third modification is found in section 4(c)(8), which exempts from the requirements of section 4(a) “shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.” This exception applies both to ownership of shares of nonbank companies and to activities carried on directly by the holding company. Congress provided that “[i]n determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects . . . .”

70. While the Act makes no provision for subsequent Board action, the Federal Reserve Board currently reserves the right to take such action in orders issued under the Bank Holding Company Act. See, e.g., Beneficial Corp., 58 Fed. Res. Bull., 849, 850 (1972): “[T]his determination is subject to revocation if the facts upon which it is based change in any material respect.”
72. Section 4(a)(2) provides that the company may not “engage in any activities other than . . . (B) those permitted under section 4(c)(8)).” While 4(c)(8) exempts only the holding of shares of companies engaged in such activities, it is clear that the Board allows the holding company to carry on such activities directly. See, e.g., Cody Agency, Inc., 58 Fed. Res. Bull. 736 (1972).
These three modifications will be the focus of discussion in this Comment. The steps that the Federal Reserve Board has taken to implement each will be surveyed and then evaluated in light of the congressional goals behind the enactment of the amendments.

III. Section 4(a)(2): THE "GRANDFATHER" PRIVILEGES

Under the proviso to section 4(a)(2), bank holding companies that were covered by the Act upon passage of the 1970 amendments may continue those activities in which they were engaged on June 30, 1968, and in which they have been continuously engaged since that date. This clause applies even if the manner in which the activity is performed is restructured. Thus, if a holding company directly operated a drugstore on June 30, 1968, it can transfer that store to a subsidiary, or it can open additional drugstores directly or through subsidiaries. However, the acquisition after June 30, 1968, of a going concern engaged in the nonbanking business is prohibited.

"Grandfather" privileges are subject to termination if the Federal Reserve Board determines "having due regard for the purposes of this chapter that such action is necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices . . . ." With regard to small banks, no time period is set within which the Board must exercise this power of revocation. However, companies controlling banks with assets in excess of 60 million dollars must be evaluated within two years of the effective date of the amendments, or within two years thereafter.

74. See text accompanying note 67 supra for text of statute.

75. The Board has imposed one important restriction on this restructuring. In Whitney Holding Corp., 59 Fed. Reg. Bull. 371 (1973), one of Whitney's nonbank subsidiaries (Berwick) owned land that was leased to farmers. Berwick had acquired the land in 1970 from a bank that had been a subsidiary of Whitney since 1962. The bank had acquired the land in 1953. Despite the fact that Whitney was a "company covered in 1970" and the apparent satisfaction of the requirements of section 4(a)(2), the Board denied grandfather privileges. It did so because "[a]n activity engaged in by a bank is regarded by the Board as not being an activity within the meaning and intent of the grandfather proviso in section 4(a)(2) of the Act." 59 Fed. Reg. Bull. at 371.


after that level of bank assets is reached, whichever is later.\(^78\) The five factors to which the Board is to look in determining whether grandfather privileges are to be terminated are identical to those adverse factors listed in section 4(c)(8).\(^79\) However, unlike section 4(c)(8), the grandfather proviso does not require that positive benefits be demonstrated.\(^80\) Nor need the Board distinguish between those activities that are closely related to banking and those that are not.\(^81\)

The Board has undertaken a review of the rights of bank holding companies to retain grandfather privileges in sixty-seven cases. On September 26, 1972, it tentatively approved the continuation of the activities of twenty-three holding companies.\(^82\) Of that group only one\(^83\) was engaged in activities that would not also have been permitted under section 4, and the tentative approval of that application was subsequently reversed.\(^84\) On the same day that these tentative approvals were issued, the Board announced that it was evaluating additional companies to determine if they should be allowed to retain their grandfather privileges.\(^85\) Many of these were engaged in activities quite remote from banking, such as real estate, farming, manufacturing, and merchandising.\(^86\)

On December 26, 1972, the Board announced its final decisions in thirty of the cases; these thirty companies were found not entitled to grandfather privileges, although some of them could continue their nonbanking activities under other sections of the Act.\(^87\) To date, none of the individual orders that the Board has published with regard to the remaining thirty-seven companies has required a divestiture of activities initially eligible for grandfather privileges.\(^88\)

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81. See Bank Holding Company Act § 4(a)(2), 12 U.S.C. § 1843(a)(2) (1970). But see note 87 infra for an indication that the Board may deny grandfather privileges when the activity qualifies for an exemption under some other provision.
83. Ribso, Inc., was the owner and lessor of some residual mineral rights. 37 Fed. Reg. 21382 (1972).
84. See text accompanying notes 118-19 infra.
88. Divestiture has been required in a number of cases, but always on the grounds that the activity had been commenced after June 30, 1968. See, e.g., Alaska Bancshares, Inc., 59 FED. RES. BULL. 211 (1973); Western & S. Life Ins. Co., 38 Fed. Reg. 6104 (1973).
small scale, although some charitable foundations that are covered by the Act have been allowed to retain holdings in large nonbanking businesses. Future decisions, involving such activities as oil and gas mining and exploration, hotel construction, and air carrier operations, are likely to present harder questions.

When grandfather privileges are allowed the Board frequently places severe limits on the extent to which the bank holding company can expand into the nonbanking activities. Sometimes the limitations are fairly general, such as a prohibition on any substantial changes in the scope of the holding company's activities. In other cases, the Board's restrictions are very specific, such as that a real estate development operation not acquire additional land, or that a finance company operation not expand to any new locations.

The introduction of the grandfather proviso arose from the same concerns that had made Congress reluctant in the past to include one-bank holding companies within the coverage of the Act. It felt that the one-bank holding companies existing at the time set in the clause, most of which were quite small, had not caused great problems and was thus reluctant to require them to undergo the hardships of divestiture, which would be particularly harsh for small banks. The Board's rather strict approach, and its apparent recognition that the dangers are reduced in small enterprises, is consistent with the purpose of the proviso.

In making its determinations under this clause the Board was to consider the listed adverse effects, thus guaranteeing that those

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89. In Estate of James Millikin, 38 Fed. Reg. 1153 (1973), the bank holding company (a charitable trust) owned rental farm and residential property. The respective market shares (in Decatur, Illinois) were .03 per cent and .1 per cent. See also Contract Leasing Corp., 38 Fed. Reg. 1538 (1973); Zions Utah Bancorporation, 38 Fed. Reg. 1310 (1973).


97. See text accompanying note 54 supra.


99. Many of these one-bank holding companies controlled small banks in small communities that did not generate sufficient earnings to attract competent management. Extra earnings produced by affiliated businesses helped to counterbalance this condition. 1969 House Hearings, supra note 1, at 308.

100. See text accompanying note 77 supra.
holding companies that were causing serious problems would not es­
cape the full rigor of the Act.\textsuperscript{101} The approach taken by the Board
has been to approve the continuation of the business if no serious
negative factors are present, without consideration of potential public benefits.\textsuperscript{102}

It is not yet clear whether the Board will ever weigh positive fac­
tors when disadvantages are found to exist. In the only cases to date
in which serious problems were found, the Board did not consider
positive factors.\textsuperscript{103} The proviso itself leaves the question unclear, re­
quiring only that the Board act if it determines “having due regard
for the purposes of this chapter that such action is necessary to pre­
vent” a listed adverse effect.\textsuperscript{104} A requirement that benefits be con­
sidered may be derived from the language “having due regard for
the purposes of this chapter.” This inference is not unreasonable, as
Congress intended that companies eligible for grandfather privileges
be given more lenient treatment than companies entering similar
nonbanking activities after June 30, 1968, and it would be odd if
public benefits could justify a harmful acquisition under the “closely
related to banking” provision,\textsuperscript{105} but not under the grandfather pro­
vision.

Closer examination reveals, however, that a refusal to weigh ben­
efits against injuries does not unreasonably put companies seeking
grandfather privileges at a disadvantage. The grandfather exemption
is premised on the congressional finding that the companies covered
cause no serious harm.\textsuperscript{106} Once this conclusion is shown to be incor­
rect in a particular case, the entire justification for grandfather priv­
ileges disappears. In any event, if the benefits that an activity gives
rise to outweigh the injuries, the holding company can argue that the
activity is closely related to banking and thus exempt under section
4(c)(8).

In the absence of adverse factors, however, a company that has
carried on an activity closely related to banking since June 30, 1968,
and can thus use the grandfather clause, has an advantage over a com­
pany that began such activities more recently. Under section 4(c)(8),
an application may not be approved without an affirmative showing

\textsuperscript{101} House Managers’ Statement, \textit{supra} note 75, at 26-27.

\textsuperscript{102} See, e.g., Minnesota Small Loan Co., 38 Fed. Reg. 1308 (1973); Delta Loan &

\textsuperscript{103} In \textit{D.H. Baldwin Co.}, 38 Fed. Reg. 16279 (1973), the Board disapproved of the
holding company’s former practice of directing its subsidiary bank to maintain corre­
spondent balances in banks with which the holding company maintained lines of credit.
However, the Board did not look to benefits and relied upon the company’s assurances
that the practice would not be resumed. \textit{See also} Alaska Bancshares, Inc., 59 FED. RES. BULL. 211 (1973).


\textsuperscript{105} See text accompanying notes 237-41 \textit{infra}.

\textsuperscript{106} 1970 SENATE REPORT, \textit{supra} note 1, at 4.
that public benefits exceed harms; the grandfather clause, on the other hand, allows entirely benign retentions to continue.

The Board has not yet considered whether any holding companies with less than 60 million dollars in bank assets should be permitted to exercise grandfather privileges. However, given the congressional policy behind the proviso, one would expect the Board to be more willing to permit holding companies controlling small banks to continue nonbanking activities.107 In addition, it is not yet clear whether the Board will adhere to the principle, expressed by Congress,108 that the fact that a company has grandfather privileges does not create a presumption that the privileges should continue, although the strict conditions imposed by Board decisions109 indicate a willingness to terminate for fairly minor changes in circumstances. The Board should be especially careful to avoid this presumption in those cases in which mandatory review is not required, although the heavy workload of the Board110 will probably preclude close consideration of many of those cases.

The committee reports indicate that Congress intended to make the grandfather clause applicable only to one-bank holding companies.111 However, multibank companies may be covered by the literal language of the proviso in two situations. First, some “companies covered in 1970” that had previously been lawfully engaged in activities impermissible under the Act, as amended, were in fact multibank holding companies before the amendments. They might be covered either under the new control test,112 or as partnerships, which the 1970 amendments included for the first time in the definition of “company.”113 If Smith, Jones & Co., a partnership, owned two banks and a steel company on June 30, 1968 (and has continuously operated the steel company since that date), the requirements of the proviso to section 4(a)(2) are met, and apparently the firm would be entitled to grandfather privileges. If the partnership in question is relatively small, as it is likely to be, this result is appropriate, for the hardships of divestiture would be at least as great as in the case of a one-bank company.

108. House Managers’ Statement, supra note 75, at 27.
109. See text accompanying notes 94-96 supra.
111. House Managers’ Statement, supra note 75, at 26: “The principal justification for providing a grandfather clause was to protect the traditional small town bank holding company.” But see id. at 27.
However, two Board decisions dealing with one-bank holding companies indicate that it is unlikely that a multibank holding company will be brought under the coverage of the proviso through the application of the new control test. The proviso applies only to "a company covered in 1970," defined in section 2(b) as "a company which becomes a bank holding company as a result of the enactment of the Bank Holding Company Act Amendments of 1970 and which would have been a bank holding company on June 30, 1968, if these amendments had been enacted on that date." The Board has interpreted the latter requirement very strictly. In *Perpetual Corp.*, the bank holding company owned 24.86 per cent of one bank on June 30, 1968 (and acquired additional shares thereafter). The Board concluded that the company would not have been a bank holding company on June 30, 1968, if the 1970 amendments had been in effect at that date, since 25 per cent ownership would have been required to establish control. It totally failed to consider whether either of the other two control tests had been met. If the 25 per cent test conclusively establishes that control exists, ownership of 24.86 per cent would seem to suggest an inquiry into the other possible means of establishing whether or not a company has control.

But the Board expressly refused to apply the new control test to determine if a company qualified for the grandfather proviso in *Ribso, Inc.* The holding company owned 20.82 per cent of the voting shares of a bank on June 30, 1968, and thereafter acquired additional shares, raising its ownership to over 25 per cent. *Ribso* contended that it exercised a "controlling influence" over the bank as of June 30, 1968—thus meeting the definition of a "company covered in 1970"—but the Board refused to consider this claim. It said that decisions as to the existence of a controlling influence must be made by the Board after notice and opportunity for hearing, operate only prospectively, and cannot relate back to a time prior to the date of

116. Bank Holding Company Act § 2(a)(2), 12 U.S.C. § 1841(a)(2) (1970): "Any company has control over a bank or over any company if—(A) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company . . . ."
117. Bank Holding Company Act § 2(a)(2), 12 U.S.C. § 1841(a)(2) (1970): "Any company has control over a bank or over any company if—. . . (B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or (C) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company." Section 2(a)(2)(B) was part of the original Act; section 2(a)(2)(C) was added by the 1970 amendments. See text accompanying notes 62-64 supra.
the Board's determination.\textsuperscript{119} Ribso indicates an extremely narrow interpretation of the reach of the grandfather provision. If the 1970 amendments had been in effect on June 30, 1968 (as section 4(a)(2) asks us to suppose), Ribso's status as a bank holding company could have been established by a finding that it "exercise[d] a controlling influence over the management" of the bank. The Board, however, was unwilling to undertake such an inquiry.

This strict interpretation of the eligibility requirements indicates that the Board will not be generous with grandfather privileges. This is in accord with the congressional objective of alleviating hardship in a special class of cases (small banks that are causing no serious adverse effects) and with the congressional fear that permitting continuation in some cases would undermine the purposes of the act.\textsuperscript{120}

A second situation in which a multibank holding company would fall under the literal provisions of the grandfather clause could arise as follows: Ace Realty, a real estate brokerage company, owned the First State Bank on June 30, 1968. During 1971, Ace sought and received Board approval of its acquisition of the Second State Bank. Under these facts, Ace would be a "company covered in 1970" which was, and has been continuously, engaged in the real estate business, yet is not a one-bank holding company. In the interest of fairness, Ace should be as entitled to grandfather privileges as any one-bank holding company. Any adverse effects created by the expansion could be weighed in the course of determining whether the privileges should be allowed to continue. The Board's position, however, is still uncertain.\textsuperscript{121}

If multibank holding companies are covered by the grandfather clause, a problem arises with regard to the 60 million dollar limit on bank assets that triggers mandatory Board review. The statute requires this review "in the case of any such company controlling a bank having bank assets in excess of $60,000,000 on or after December 31, 1970."\textsuperscript{122} If a partnership owns ten banks, each with assets of 50 million dollars, as well as other, nonbanking companies, it would

\textsuperscript{119} This ruling by the Board represents an abrupt shift from the practice adopted in Trust Co. of N.J., 58 Fed. Res. Bull. 717, 719-21 (1972), in which the Board undertook a detailed retrospective analysis of an alleged controlling influence relationship.

\textsuperscript{120} House Managers' Statement, \textit{supra} note 75, at 26.

\textsuperscript{121} In October 1971, the Board issued a proposed regulation that would have denied grandfather privileges to bank holding companies otherwise entitled to such privileges that had acquired another bank, unless the order approving acquisition of the additional bank specified otherwise. 36 Fed. Reg. 20779 (1971). Then, in April 1972, the Board withdrew the proposal and announced that each application would be considered individually. 37 Fed. Reg. 9044 (1972).

not be subject to mandatory review under a literal reading of the amendment. However, since the conference report indicates that it was the amount of bank assets controlled by the holding company that Congress considered important, this provision should be read to refer to the total bank assets controlled by the company rather than to the assets of the largest bank.

The Board has not yet reached a decision on this question. However, the matter has been virtually settled, for the two-year period since the enactment of the amendments has already passed, and the Board has yet to decide a case in which the 60 million dollar limit was measured by totaling the assets of several subsidiary banks. This suggests either that the situation suggested above does not actually exist or that the Board has chosen to interpret the language of section 4(a)(2) literally.

IV. SECTION 4(d): EXEMPTION OF CERTAIN ONE-BANK HOLDING COMPANIES

Under section 4(d), the Federal Reserve Board can exempt from the limitations on nonbanking activities imposed by section 4(a) certain companies that controlled one bank on July 1, 1968, and have not subsequently acquired another bank. Unless to do so would be at variance with the purposes of the Act, the Board is authorized to grant such exemptions to promote any one of three objectives:

(1) to avoid disrupting business relationships that have existed over a long period of years without adversely affecting the banks or communities involved, or (2) to avoid forced sales of small locally owned banks to purchasers not similarly representative of community interests, or (3) to allow retention of banks that are so small in relation to the holding company's total interests and so small in relation to the banking market to be served as to minimize the likelihood that the bank's powers to grant or deny credit may be influenced by a desire to further the holding company's other interests.

In permitting these exemptions Congress sought "to cover situations existing with respect to one bank holding companies that have controlled over a long period of years one small bank, usually in a small town where some particular hardship may be created if the holding company were forced to divest itself of its bank." The Board decisions have scrupulously followed the command of the statute by holding that any one of the three statutory objectives is sufficient to

123. "With respect to bank holding companies which control bank assets in excess of $60 million, the Board is required under the Act to reach a determination within two years ..." House Managers' Statement, supra note 75, at 28 (emphasis added).
125. House Managers' Statement, note 75, supra, at 23.
qualify a bank for exemption. An exemption has been denied only where none of the three grounds was present.\textsuperscript{126}

The Board has ruled on nine applications for section 4(d) exemptions; eight of these were approved. In five of these cases the holding company was a large diversified corporation,\textsuperscript{127} which opened its bank as a matter of convenience to the employees of one of its subsidiaries located in an area with inadequate banking facilities. In no case did the assets of the bank exceed three per cent of the assets of the conglomerate, so the size factor suggested exemption. All five applications were approved, despite the lack of findings that forced sales would be harmful. In four of the cases, where the banks had been acquired during the 1920's and 1930's, their long-standing business relationships, as well as the size factor, suggested exemption.\textsuperscript{128} The fifth case, \textit{Minnesota Mining & Manufacturing Co.},\textsuperscript{129} where the holding company had only operated the bank since 1958, was decided on the basis of size alone. The Board found in all five cases that there was sufficient competition with other banks so that misuse of bank ownership was unlikely and that there was no evidence of past misuse of bank credit. A sixth case,\textsuperscript{130} decided exclusively on the basis of the size factor,\textsuperscript{131} suggests that the size requirement may not be as strict as it would appear from the five cases discussed above. In 1965, the holding company, the largest commercial printer in the United States, had participated in the organization of a bank near its largest facility. At the time of the application the assets of the bank represented almost ten per cent of the holding company's assets, although its net income was only three tenths of one per cent of that of the holding company.

In two other cases the size factor was not present, but exemptions were granted on the basis of the long-standing business relationships and the likelihood that forced sales would be to interests less concerned with the communities. In \textit{Milton Hershey School & Trust}\textsuperscript{132} the holding company was not an operating industrial enterprise, so the size factor was not considered relevant. The Trust had held the bank since 1930, most of the bank's customers were employees of

\textsuperscript{126} See text accompanying notes 135-37 infra.


\textsuperscript{131} 38 Fed. Reg. at 13584.

another subsidiary of the holding company, and most of its loans were to people living in the Hershey, Pennsylvania, community. Requiring divestiture, the Board stressed, would be likely to lead to a sale of the bank to interests less concerned with the community, who would use the bank's resources for more profitable investments elsewhere. The holding company in *Heldenfels Brothers* was a construction contractor (total assets of 10.7 million dollars) that had begun operations in Rockport, Texas, in 1917 and had controlled the First National Bank of Rockport for thirty-seven years. The Board found that, although Heldenfels Brothers had made efforts to broaden ownership of the bank among local residents, a forced sale would necessarily be to an outside purchaser less interested in local needs.

A ninth application was denied because none of the three grounds were present. The business relationship was not of long standing, for the holding company had acquired the bank in 1963, and there was no evidence of a unique relationship between the bank and the community. Nor did the size of the bank relative to the holding company and the market indicate that an exemption would be appropriate. The bank's assets formed forty-six per cent of the assets of the holding company, which operated a chain of grocery and drug stores, and the deposits held by the bank were twenty per cent of those in its market. In the absence of the three factors the application was rejected despite the lack of any finding of misuse of ownership of the bank.

V. *Section 4(c)(8)*

A. *Activities “Closely Related to Banking”*

Section 4(c)(8), as amended in 1970, allows a bank holding company to retain or acquire shares in a company that engages in non-banking activities "so closely related to banking . . . as to be a proper incident thereto." In determining what activities are properly incident to banking the Board is to consider if there might be "benefits to the public . . . that outweigh possible adverse effects . . . ." There are three different ways in which the Federal Reserve Board has determined which activities are "closely related to banking." First, it has issued a series of regulations delineating the

basic activities that are so regarded.\textsuperscript{140} Second, in response to inquiries, the Board has issued interpretations of its regulations.\textsuperscript{141} Finally, the Board considers individual applications by bank holding companies to engage in particular activities. Some of these applications request a determination that the activities in question fall within the Board's regulations or interpretations,\textsuperscript{142} while others seek to have a new activity declared to be "closely related."\textsuperscript{143} To date, ten categories of activities have been listed in the regulations as being "closely related to banking" under section 4(c)(8):\textsuperscript{144}

(1) Making or acquiring, for [the bank holding company's] own account or for the account of others, loans and other extensions of credit (including issuing letters of credit and accepting drafts), such as would be made, for example, by a mortgage, finance, credit card, or factoring company;\textsuperscript{145}

\textsuperscript{140} The rules issued regarding bank holding companies comprise Federal Reserve Board Regulation Y, which is codified in 12 C.F.R. §§ 225.1-5 (1973). Activities that have been determined to be closely related to banking are found in 12 C.F.R. § 225.4(e) (1973).

\textsuperscript{141} The interpretations relating to activities determined to be closely related to banking are also part of Regulation Y and are contained in 12 C.F.R. §§ 225.123, .125-.128 (1973).


\textsuperscript{144} 12 C.F.R. § 225.4(a) (1973). Two proposed changes in the regulations are currently under consideration. One proposal would add "Performing or carrying on armored car or courier services" to the list of closely related activities. Proposed Reg. Y § 225.4(a)(11), 36 Fed. Reg. 21897 (1971). The other would revise the leasing paragraph of Regulation Y (12 C.F.R. § 225.4(a)(6) (1973)) so as to include leasing of both personal and real property. Proposed Amendment to Reg. Y § 225.4(a)(6), 37 Fed. Reg. 26534 (1972). See notes 181-84 infra and accompanying text for discussion of the specific provisions of this proposal. At the request of several bank holding companies, the Board has also requested comments on a proposal to add the underwriting of mortgage guaranty insurance to the list of closely related activities. See 38 Fed. Reg. 13572 (1973).

The Board has also issued an interpretation that specifies activities it has found are not closely related to banking: insurance premium funding (i.e., the combined sale of insurance and mutual funds), underwriting life insurance that is not sold in connection with a credit transaction, real estate brokerage, land development, real estate syndication, management consulting, property management, operation of savings and loan associations. 12 C.F.R. § 225.126 (1973). This interpretation was adopted May 4, 1972, see 37 Fed. Reg. 9022 (1972), and was expanded to its present scope on September 20, 1972, see 37 Fed. Reg. 20329 (1972). It is largely based on cases that the Board had previously decided. See, e.g., cases discussed in note 145 infra and in text accompanying notes 157-59, 170-73 infra.

\textsuperscript{145} The Board has ruled that this regulation does not sanction a real estate brokerage operated in connection with a mortgage company, Boatmen's Bankshares, Inc., 58 FED. RES. BULL. 427 (1972), or a land development operation, also connected with a mortgage company, that purchased, improved, and sold land to builders and acted as a joint venturer in real estate developments. UB Fin. Corp., 58 FED. RES. BULL. 428 (1972). See also 12 C.F.R. §§ 225.126(c), (d) (1973), discussed in note 144 supra.
(2) Operating as an industrial bank, Morris Plan bank, or industrial loan company, in the manner authorized by State law so long as the institution does not both accept demand deposits and make commercial loans;\textsuperscript{146}

(3) Servicing loans and other extensions of credit for any person;\textsuperscript{147}

(4) Performing or carrying on any one or more of the functions or activities that may be performed or carried on by a trust company (including activities of a fiduciary, agency, or custodian nature), in the manner authorized by State law so long as the institution does not both accept demand deposits and make commercial loans;\textsuperscript{148}

(5) Acting as investment or financial adviser to the extent of (i) serving as the advisory company for a mortgage or a real estate investment trust; (ii) serving as investment adviser, as defined in section 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act; (iii) providing portfolio investment advice to any other person; (iv) furnishing general economic information and advice, general economic statistical forecasting services and industry studies; and (v) providing financial advice to State and local governments, such as with respect to the issuance of their securities;\textsuperscript{149}

(6) Leasing personal property and equipment, or acting as agent, broker, or adviser in leasing of such property, where at the inception of the initial lease the expectation is that the effect of the transaction and reasonably anticipated future transactions with the same lessee as to the same property will be to compensate the lessor for not less than the lessor’s full investment in the property;\textsuperscript{150}

(7) Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas;\textsuperscript{151}

(8) (i) Providing bookkeeping or data processing services for the internal operations of the holding company and its subsidiaries and (ii) storing and processing other banking, financial, or related eco-

\textsuperscript{146} While the Board has approved applications under this provision, see, e.g., Zions Utah Bancorporation, 58 Fed. Res. Bull. 72 (1972), it has never interpreted precisely what is meant by “industrial bank, Morris Plan bank, or industrial loan company.”

\textsuperscript{147} If the industrial bank both accepts demand deposits and makes commercial loans, it is a “bank” under section 2(c), 12 U.S.C. § 1841(c) (1970), and its acquisition by a bank holding company is subject to Board approval under section 3, 12 U.S.C. § 1842 (1970).

\textsuperscript{148} This provision has come before the Board most frequently in the context of the acquisition of mortgage companies. These decisions, however, do not indicate what the limits of the permissible activities may be. See, e.g., Central Natl. Chicago Corp., 58 Fed. Res. Bull. 69 (1972); UB Fin. Corp., 58 Fed. Res. Bull. 428 (1972).

\textsuperscript{149} The Board’s only decision concerned with the scope of this regulation permitted the provision of land escrow services. Wells, Fargo & Co., 58 Fed. Reg. 1226 (1978). Other applications that have been approved include Nortrust Corp., 58 Fed. Res. Bull. 67 (1972); NCNB Corp., 58 Fed. Res. Bull. 844, 847 (1972).

\textsuperscript{150} This provision is discussed in text accompanying notes 155-73 infra.

\textsuperscript{151} This provision is discussed in text accompanying notes 174-84 infra.
nomic data, such as performing payroll, accounts receivable or payable, or billing services.\textsuperscript{152}

(9) Acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:

(i) Any insurance for the holding company and its subsidiaries;

(ii) Any insurance that (a) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (b) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (c) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(c) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);

(iii) Any insurance sold in a community that (a) has a population not exceeding 5,000, or (b) the holding company demonstrates has inadequate insurance agency facilities;\textsuperscript{153}

(10) Acting as underwriter for credit life insurance and credit accident and health insurance which is directly related to extensions of credit by the bank holding company system.\textsuperscript{154}

\textsuperscript{152} The Board's interpretation of this regulation allows for considerable flexibility. It permits holding companies to engage in those activities in which banks have engaged in the past in carrying on their internal operations and accommodating customers. 12 C.F.R. § 225.123(g) (1973). The Board intended to limit development of programs to those in which the data was of a financial nature. 12 C.F.R. § 225.123(g) (1973). In addition, the Board said that three activities incidental to such operations are also permissible:

(1) Making excess computer time available to anyone so long as the only involvement by the holding company system is furnishing the facility and necessary operating personnel; (2) selling a byproduct of the development of a program for a permissible data processing activity; and (3) furnishing any data processing service upon request of a customer if such data processing service is not otherwise reasonably available in the relevant market area.


\textsuperscript{153} The Board has recently issued an extensive interpretation of this provision. See 12 C.F.R. § 225.123 (1973). The interpretation, among other things, emphasizes that the provision regarding sales of otherwise unqualified insurance as a matter of convenience to the customer is not intended to allow entry into a general insurance agency business. 12 C.F.R. § 128(1)(b) (1973). A suit has been filed challenging the interpretations as an attempt to make substantive regulations without the required notice or procedure. National Assn. of Ins. Agents, Inc. v. Board of Govs., CCH Fed. Banking L. REP. ¶ 95,809 (Petition for Review No. 72-1938, D.C. Cir., filed Oct. 5, 1972).

The Board decision in Fidelity Corp. of Pennsylvania, 38 Fed. Reg. 14795 (1973), further restricts the scope of permitted insurance activities by holding that sale of "level term" life insurance (coverage remains constant despite decreasing loan balance) in connection with credit transactions is not closely related to banking.

\textsuperscript{154} See Virginia Natl. Bankshares, Inc., 38 Fed. Reg. 12169 (1973). The bank holding company showed that its customers would gain a projected ten to fifteen per cent premium saving as compared with the costs of other available insurance. Such a showing meets the Board's criteria set out in a footnote to the regulation. See 12 C.F.R. § 225.4(a)(10) n.3 (1973).

The Board has determined that underwriting level term life insurance (see note
Three of these categories (Regulations 5, 6, and 7) have caused certain interpretative difficulties. They will be discussed in detail below, along with the relevant interpretations and decisions.

The fifth regulation has been amended twice.\(^{155}\) The most important interpretation of clause (i)\(^{156}\) is in *BankAmerica Corp.*,\(^{157}\) which held that a subsidiary that would "organize, structure, place, manage, and supervise real estate syndications . . . as the sole general partner . . . and sell limited partnership interests to individuals" was not closely related to banking.\(^{158}\) "[S]uch activities," the Board concluded, "go beyond the functions performed by an advisory company to a real estate investment trust."\(^{159}\)

The proper scope of clause (ii) has been the subject of an extensive interpretative ruling,\(^{160}\) in which the Board attempted to restrict bank holding companies to the limits set for banks by the Banking Act of 1933,\(^{161}\) as interpreted by the Supreme Court in *Investment Company Institute v. Camp.*\(^{162}\) The Board's ruling reads *Investment Company Institute* as forbidding a "bank holding company to sponsor, organize or control a mutual fund,"\(^{163}\) but does not apply this restriction "to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities."\(^{164}\) The bank holding company must insulate itself as much as possible from the closed-end funds that it advises. The funds must have names dissimilar to those of the bank holding company and its subsidiary banks.\(^{165}\) The holding company must not extend credit to the investment company or hold its securities (even in a fiduciary capacity or as collateral for loans).\(^{166}\) Nor is the holding company allowed to participate in the promotion or sale of the investment company's securities.\(^{167}\) These rules are

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156. 12 C.F.R. § 225.4(c)(5)(i) (1973). This provision is set out in the text accompanying note 149 *supra*.
158. CCH FED. BANKING L. REP. ¶ 95,656.
159. CCH FED. BANKING L. REP. ¶ 95,656. See also 12 C.F.R. § 225.126(e) (1973), discussed in note 144 *supra*.
162. 401 U.S. 617 (1971).
166. 12 C.F.R. § 225.125(g) (1973).
designed to avoid the danger, feared by the Supreme Court, that the public will associate the poor performance of an investment company associated with a bank with the soundness of the bank.

"Portfolio investment advice," permitted under clause (iii), refers to advice on "the investment of funds in a 'security' as defined in section 2(1) of the Securities Act of 1933 (15 U.S.C. sec. 77a) or in real property interests, except where the real property is to be used in the trade or business of the person being advised . . . ." 169

Two Board decisions under clause (iv) have distinguished the providing of financial and economic information, which is permitted, from "management consulting," which is not. 170 "Management consulting" includes, but is not limited to, analysis and advice regarding a firm's purchasing, production, marketing, planning, personnel, internal, or research operations. 171 Such advice, the Board found, could lead to serious conflicts of interest. If an affiliated bank should be a creditor of an advised company (a not unlikely situation), the advising company may be torn between advice that would best protect the bank's claim and advice that would be best for the client. 172 The Board has applied this reasoning to one case in which the affiliated consulting firm's business was limited to advising banks and bank holding companies. 173 However, when banks are the clients of the consulting firm, conflicts between the interests of the client and those of affiliated banks are much less likely to occur. Because of the unique guarantees insuring the stability of banks, loans from banks affiliated with the consulting firm are less likely to be in jeopardy and thus less likely to influence the firm's advice. The Board may feel that it is important to avoid potential conflicts of interest between the client banks and the affiliate banks, but if that is its position, it should be specified more clearly.

The scope of clause (v), which permits advisory services to state and local governments, has yet to be defined.

Under the sixth regulation a bank holding company can engage in the leasing of personalty only if "at the inception of the initial lease the expectation is that the effect of the transaction will be to compensate the lessor for not less than the lessor's full investment in
the property." Interpretative problems have arisen most frequently with respect to the phrase "full investment in the property." In general, leasing is permissible if it is "the functional equivalent of an extension of credit to the lessee." This condition has been found to exist if, at the time of the acquisition of the property by the lessor, there is a lease agreement that will yield a return from rentals, salvage value, and estimated tax benefits equivalent to the lessor's cost. A leasing operation is not disqualified by an otherwise nonqualifying lease with a municipal government lessee that cannot enter into a lease of more than one year's duration so long as there is a reasonable anticipation of renewals resulting in full compensation. Short-term "bridge" leasing, which fills a gap until permanent financing is arranged, is also allowed. In BankAmerica Corp., the holding company argued that this regulation allowed the operation of a computer leasing subsidiary when "industrial experience" indicated that it could anticipate renewals of otherwise nonqualifying leases or future leases of the same equipment to other parties sufficient to return its investment. The Board held that this was not a permissible activity. It noted that the initial leases would not be on a "full payout" basis and that, given the rapid changes in computer technology, renewals were unlikely. The Board did not specifically deal with the claim that future leases of the same equipment would be sufficient to recoup the initial investment, thus leaving open the possibility that in a case involving a more stable industry it will consider "industrial experience" in determining if a lease is the functional equivalent of an extension of credit.

The Board is currently considering a proposal that would revise the leasing paragraph to include real property. This would retain the requirement that the lease be the "functional equivalent of an extension of credit." In addition, it would incorporate the requirement, now found only in the interpretative rulings, that the lessor's return fully compensate him for his investment.

180. CCH FED. BANKING L. REP. ¶ 95,716. The Board also found that the risk involved in the proposed activity meant that there were negative public benefits.
182. Id. § 225.4(a)(6)(i).
The seventh regulation permits investment in activities "designed primarily to improve community welfare." Under the Board's interpretation of this regulation, investments in community development corporations established pursuant to state or local laws are permissible, as are investments in low- and moderate-income housing that receive financial assistance or mortgage insurance from a governmental authority. To encourage flexibility in approaching social problems other permissible categories are only defined generally:

1. Projects for the construction or rehabilitation of housing for the benefit of persons of low- or moderate-income,
2. Projects for the construction and rehabilitation of ancillary local commercial facilities necessary to provide goods or services principally to persons residing in low- or moderate-income housing,
3. Projects designed explicitly to create improved job opportunities for low- or moderate-income groups.

In the one application considered under this regulation, the Board stressed that community welfare must be the main thrust of the project and not just a collateral effect. The application in that case was denied for that reason, even though the Board found that the office and commercial center proposed would stimulate the economy of the area in which it was to be constructed. In determining that community welfare was not the primary purpose of the project the Board examined the commercial nature of the venture and the expected rate of return on the investment. It noted that any commercial enterprise would benefit the community in some way.

B. The Public Benefits Factors

In addition to the "closely related" language discussed above, section 4(c)(8) provides:

In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can

addition, the proposal would add the requirement that "[t]he property to be leased be acquired specifically for the leasing transaction under consideration." Id. § 225.4(a)(6)(ii). It would also provide time limits for disposing of the property when the lease expires (as soon as practical, maximum of two years), set the maximum term for a permissible lease (including renewals) at 20 years, and require that the lease be on a nonoperating basis. Id. §§ 225(a)(6)(v),(vi),(iii).

185. 12 C.F.R. § 225.127(b) (1973). This provision is set out in the text accompanying note 151 supra.
186. 12 C.F.R. § 225.127(c) (1973).
reasonably be expected to produce benefits to the public, such as
greater convenience, increased competition, or gains in efficiency,
that outweigh possible adverse effects, such as undue concentration
of resources, decreased or unfair competition, conflicts of interest, or
unsound banking practices.191

Of the five negative factors listed in the statute, only decreased
competition in the line of business of the firm sought to be acquired
has received much attention from the Board. In determining whether
this danger exists the Board considers the effect of an acquisition on
both present and potential competition.

In determining whether present competition will be reduced the
Board typically follows a three-step analysis. First, it specifies the
particular market involved. The definitions of markets tend to be
fairly narrow; the Board looks primarily to the particular product
involved.192

The Board also describes the market geographically. Its practice
is to specify the area of overlapping services,193 rather than to define
a market area in the abstract. Although this specific approach is
legitimate, as applied by the Board it may be overbroad and occasion­
ally produces misleading expressions of market shares. For
example, a bank holding company and the company that it seeks to
acquire may both operate throughout a state. Neither may have a
significant share of the “state market,” but they may both have a
much larger share (or perhaps be the only competitors) in a smaller
geographic area. The smaller market, in such a case, may be the most
appropriate for determining the acquisition’s impact on present
competition.194 However, when the firm in question is in the business

192. For example, mortgage banking is divided into three submarkets: residential,
commercial, and construction. See, e.g., First Natl. Bancorporation, Inc., 58 FED RES.
Bull. 597 (1972); First Tulsa Bancorporation, Inc., 58 FED RES. BULL. 517 (1972). Dis­
tinctions are also made between specialization in holding second mortgages and first
mortgages, see, e.g., Dominion Bankshares Corp., 58 FED RES. BULL. 567 (1972), and
in making mortgage loans for one’s own account and for resale to institutional inves­
tors. See, e.g., Central Natl. Chicago Corp., 58 FED RES. BULL. 69 (1972). In addition,
the Board has distinguished between classes of loans. See, e.g., First Bank Sys., Inc.,
58 FED. RES. BULL. 172 (1972) (home improvement loans and other consumer loans);
Bank of Va. Co., 58 FED RES. BULL. 954 (1972) (loans secured by used cars and less
riskier loans); Colorado Bankshares, Inc., 58 FED RES. BULL. 422, 426 (1972) (loans to
temporary residents and less risky loans).
194. For an illustration of this difficulty, see Marine Bancorporation (Order Approv­
ing Retention of Coast Mortgage), 58 FED RES. BULL. 504, 505 (1972). The Board
majority says that the combined proportion of mortgages originated by the holding
company and the disputed subsidiary in a seven-county area of overlapping service is
8.1 per cent, 58 FED. RES. BULL. at 506. The dissenting statement of Governors Robert­
son and Sheehan argues that the appropriate market is a smaller unit (the Seattle
area) and that together the companies originate 11.5 per cent of the mortgages in
that area, 58 FED RES. BULL. at 507. The minority view finds some support in United
of placing loans with investors, it may be necessary to regard the appropriate market as covering a large region, even the entire nation. Typically, none of the companies will have a sufficient share of such a broad market to require an analysis of the competitive effects of the acquisition.

The second step in evaluating the effect of the proposed acquisition on present competition is the determination of the share of the market held by the holding company and the share held by the company to be acquired. Three applications to acquire mortgage companies that were denied solely on the basis of loss of present competition indicate what the Board considers to be an excessive share of the market. The combined shares of the holding company system and the proposed subsidiary were, respectively, 20 per cent of mortgages in the Spokane market, 11.8 per cent of the one-to-four-family residential mortgage market in Tulsa, and 13.6 per cent of the one-to-four-family residential market in the Augusta, Georgia, area. From these decisions and others approving acquisitions it appears that, as the market share after acquisition approaches 10 per cent, the Board regards the loss of competition as

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a lower court finding that the appropriate market for two merging banks was the entire northeastern part of the United States. In doing so, the Court stated: “The proper question to be asked in this case is not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger will be direct and immediate.” 374 U.S. at 357.


200. First R.R. & Banking Co., 59 Fed. Res. Bull. 25, 26 (1973). In this case the combined share of the construction loan market was 15.5 per cent.

201. In Marine Bancorporation, 58 Fed. Res. Bull. 505, 506 (1972), the Board said that an 8.1 per cent market share was serious but approved the application. The dissenters argued that the share was actually 11.5 per cent. See text accompanying notes 237-42 infra for a more detailed treatment of this case.


The Clayton Act proscribes mergers or acquisitions “where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly.” 15 U.S.C. § 18 (1970).

In United States v. Von’s Grocery Co., 384 U.S. 270 (1966), there were thousands of small firms in the Los Angeles retail food business, the market in question. The Court found congressional intent to promote such enterprises in the 1950 amendments to the Clayton Act (Act of Dec. 23, 1950, ch. 1184, 64 Stat. 1120). 384 U.S. at 276-77. It concluded that creation of one firm with a 7.5 per cent market share (which would have
significant. Within a fairly wide range around that figure, approval may be granted if appropriate mitigating factors are found.

In the third step of its analysis, the Board investigates any such mitigating features. For example, if the proposed subsidiary itself has only a small share of the present market, the Board will look more favorably upon its acquisition, even if the total market share of the subsidiary and the holding company system combined is considerable. In such situations the acquired company is presumably not a significant competitive force. The Board may also consider in mitigation the degree of concentration in a market. If there are many competitors in a market, none of which have a particularly large share, acquisitions are more likely to be approved on the theory that the existing competition is adequate and will continue after the acquisition. In one such case the Board approved an acquisition made it the second largest firm in the market and was therefore impermissible.

The Clayton Act does not require the balancing of adverse effects with potential benefits. The Bank Merger Act, however, does provide for such a procedure:

5. The responsible agency shall not approve—

(a) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.


(b) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

12 U.S.C. § 1828(c)(7)(B) (1970). Actions challenging proposed mergers are still brought under the antitrust laws; however, a finding that a substantial decrease in competition is possible will not necessarily prevent the merger if the anticompetitive effects are clearly outweighed by its benefits in meeting the convenience and needs of the community. See United States v. First City Natl. Bank, 386 U.S. 361 (1967).

The approach followed by the Board under the Bank Holding Company Act seems consistent with the Supreme Court's application of the Bank Merger Act. It should be noted that the provisions of the Bank Holding Company Act governing the acquisition of banks by holding companies are identical to those found in the Bank Merger Act. See 12 U.S.C. § 1842(c) (1970). See also 12 U.S.C. § 1849(b) (1970). The Board has applied the market-shares doctrine quite strictly, perhaps in consideration of Congress' desire to use the Bank Holding Company Act to stimulate competition and encourage de novo entries. See House Managers' Statement, supra note 75, at 17-18.


203. E.g., First Chicago Corp., 58 Fed. Res. Bull. 175, 176 (1972). In certain markets this reasoning would be unsatisfactory, for it would permit eventual elimination of small firms. (While no single small company would be a significant force, the presence of a large number of small firms may be important. Cf. United States v. Von's Grocery Co., 384 U.S. 270 (1966), discussed in note 201 supra.) However, in response to a similar argument raised in a hearing on an application for a merger of two bank holding companies under section 3(a)(5) of the Bank Holding Company Act, 12 U.S.C. § 1842(a)(6) (1970), the Board refused to consider such long-range possibilities. Each application, it said, is to be analyzed on the basis of the facts existing at the time of Board consideration." First Fla. Bancorporation, 59 Fed. Res. Bull. 183, 184 (1973).
that resulted in a combined market share of 12.5 per cent because there were many other competitors in the market, several of which were large national firms.\textsuperscript{204} On the other hand, where a few large companies dominate the market, the Board may still approve an acquisition if the holding company and the proposed subsidiary are not major factors in order to enable the subsidiary to compete more effectively with the dominant firms.\textsuperscript{205}

The Board has been concerned about loss of potential competition, as well as present competition. If the holding company is capable of entering a market directly or by opening a new subsidiary, its entry by acquisition of an existing business is regarded as undesirable. Therefore, in ruling on an application, the Board examines the holding company’s capacity to enter the proposed subsidiary’s business on a de novo basis, considering such factors as skill, capital, contacts in the business, and the legality of the entry.

Firms doing a substantial business in one segment of the mortgage banking field, for example, are considered capable of expanding into other submarkets,\textsuperscript{206} and a bank holding company with a mortgage company subsidiary is regarded as better able to enter a new geographic market of the mortgage banking business than a holding company without such a subsidiary.\textsuperscript{207} On the other hand, the skill barrier has been regarded as too great to make bank holding companies likely entrants into such specialized businesses as factoring.\textsuperscript{208} A legal bar to de novo entry has been an important factor in cases involving applications to acquire finance companies that specialize in second mortgages.\textsuperscript{209} The Board has approved such applications, concluding that, since federal law requires that real estate loans by national banks be secured by first liens,\textsuperscript{210} the national bank subsidiaries of the holding companies are unlikely to enter the market in the future. This analysis is faulty, however, in that it is the ability of the holding company (directly or through a subsidiary) to enter into competition with the finance company that must be evaluated, not the ability of a particular bank subsidiary to do so.

Once the Board finds that the holding company applicant has the

\textsuperscript{204} First Ark. Bankstock Corp., 59 Fed. Res. Bull. 28, 29 (1973). In First Pa. Corp., 58 Fed. Reg. 917 (1973), the Board allowed acquisition of a finance company that led to a combined market share of nearly nine per cent of the small consumer loan business in the Houma, Louisiana, market because there were over 30 other competing firms, many potential entrants, and relative ease of entry.


capacity to make a de novo entry into the market served by the potential subsidiary it next determines if circumstances obviate the undesirable loss of potential competition that would result. For example, in some cases the Board has found that the holding company, although capable of a de novo entry, is unlikely to enter the market de novo; \(^{211}\) consequently, little would be lost by permitting an acquisition and thus removing all possibility of a future entry by the holding company. In other cases, the Board has concluded that the proposed subsidiary is so small that its acquisition would have an impact equivalent to a de novo entry. \(^{212}\)

\(^{211}\) The loss of potential competition may also be obviated by the existence of many other potential entrants; \(^{213}\) in such a case the loss of one may not be too serious. Acquisitions by holding companies capable of de novo entry have also been approved when a large number of firms are already competing in the market. \(^{214}\) Presumably, the loss of potential competition is less important where the market is already highly competitive.

The four other potential adverse effects to be weighed in assessing net public benefits have not been as important in Board decisions as the possibility of decreased competition. Of these, the most emphasis has been placed on concentration of resources. However, the Board has failed to provide any clear standards as to what constitutes an undesirable concentration. \(^{215}\) The decision in Crocker National


\(^{213}\) E.g., First Natl. Holding Corp., 58 Fed. Res. Bull. 502, 502 (1972). See also First Natl. Union Corp., 58 Fed. Res. Bull. 72 (1972) (company controlling nation’s ninth largest mortgage company allowed to acquire largest mortgage banking firm in Mississippi although mortgage company was operating only one state removed from Mississippi, because other firms were capable of entering market).


The Board’s willingness to approve acquisitions that apparently reduce potential competition is analogous to the reluctance of the courts to intervene with bank mergers because of loss of potential competition. See, e.g., United States v. First Natl. Bancorporation, 379 F. Supp. 1009 (D. Colo. 1971), aff’d by an equally divided court, 41 U.S.L.W. 4358 (U.S., Feb. 28, 1973).

\(^{215}\) In BNTB Corp., 58 Fed. Res. Bull. 70 (1972), the bank holding company controlled 25 per cent of the bank deposits in the Birmingham, Alabama, area, and the proposed acquisition, the 20th largest mortgage company in the United States, had total assets of $32 million dollars (234 million of which were in the Birmingham area). The Board rejected the acquisition application because “the proposed acquisition is one that would eliminate potential competition.” 58 Fed. Res. Bull. at 71. In addition, the
Corp.\textsuperscript{216} suggests that this may be due to a Board split on the question of whether the absolute size of a company or its size relative to the market is the critical factor. In that case, three of the four members of the Board majority said that the concentration of 6 billion dollars in assets and 877 million dollars in mortgage servicing portfolios in a California bank holding company was too great.\textsuperscript{217} However, the other member of the majority concurred in denying the application only on the ground of loss of potential competition.\textsuperscript{218} The three dissenting governors concluded that there was no significant concentration when the size of the market (California) was considered.\textsuperscript{219}

The other three adverse factors have been largely ignored by the Board.\textsuperscript{220} At least one of these, unfair competition,\textsuperscript{221} deserves more attention, especially with regard to the possibility that credit from bank subsidiaries of the holding company will become less available to the competitors of the nonbank business that the holding company wishes to acquire. For example, in \textit{United Jersey Banks},\textsuperscript{222} the Board approved the acquisition of a New York City commercial finance company even though the largest bank in the holding company system supplied credit to several of the finance company’s competitors. The Board found that the danger of unfair competition was negligible for two reasons: First, the acquired company was a very weak competitor in a large financial market.\textsuperscript{223} Second, the availabil-

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\textsuperscript{216} Board stated that it was “concerned also about the concentration of economic resources” that would result. 58 \textit{Fed. Res. Bull.} at 71.


\textsuperscript{218} ibid. 420.

\textsuperscript{219} ibid. 420-21 (Burns, Chm., concurring).

\textsuperscript{220} ibid. 421-22 (Mitchell, Daane, & Sheehan, Govs., dissenting).

\textsuperscript{221} Unsound banking, conflicts of interest, and unfair competition are the other three factors. Neither unsound banking nor conflicts of interest problems have been discussed by the Board in considering the public benefits that would result from an acquisition. The only mention of these factors is in paragraphs summarily listing nonexistent potential harmful effects. \textit{See, e.g.}, Guaranty Loan \& Inv. Corp., 58 \textit{Fed. Res. Bull.} 738, 739 (1972); Dacotah Bank Holding Co., 58 \textit{Fed. Res. Bull.} 740 (1972).

\textsuperscript{222} However, conflicts of interest problems were discussed in connection with the determination as to whether management consulting was closely related to banking. \textit{See text accompanying notes 170-73 supra}. Fear of unsound banking practices seems to have been important in the determinations that computer leasing, \textit{see text accompanying notes 179-80 supra}, and real estate syndication, \textit{see text accompanying notes 157-59 supra}, were not closely related to banking.

\textsuperscript{223} The conference report lists as examples: “(a) intimidation of customers to cause them to refrain from buying a competitor's products; (b) commercial espionage . . . ; (c) inducing breach of contract; (d) enticing away competitor's employees in order to cripple his business; (e) price discrimination; (f) selling a service below cost . . . , in order to obtain a business for another subsidiary; (g) harassing practices . . . .” House Managers' Statement, \textit{supra} note 75, at 19.


\textsuperscript{225} The acquired firm’s assets were less than three per cent of those of its largest competitor. \textit{See 57 Fed. Reg. at 23384}. 
ity of many alternative sources of credit made it unlikely that competitors would be deprived of funds as a result of the acquisition. However, this analysis ignores the possibility that the other potential credit suppliers may also be affiliated with commercial finance companies. In that case, obtaining credit from them would not be a realistic alternative. Moreover, the Board did not consider whether, if the subsidiary bank continued to make loans to the competitors of its affiliates, there was any danger of misuse of confidential credit information.

Even when banks presently affiliated with the holding company have made no loans to the competitors of their nonbank affiliates, the decreased availability of credit may be a problem in the long run. If operating a nonbanking subsidiary within a holding company system has advantages, such as bringing more customers into the bank or reducing the costs of the nonbank subsidiary (as, for example, by reducing the cost of credit), other banks in the market and unaffiliated nonbank businesses will feel competitive pressures to join bank holding companies or create such systems themselves. Accelerating this process is the tendency of banks in a given market to keep in step with each other in expanding into nonbanking lines. At some point the remaining independent nonbank businesses may be left without banking institutions that are not affiliated with their competitors, and the diminished availability of credit will became apparent. Considerable foresight is required to avoid this problem. Otherwise, the Board may be compelled to cease approving all applications submitted after the danger has become clear. This would perpetuate the advantaged position of those holding companies who submitted their applications first, even though others may be more deserving of approval. However, the Board's only alternative in such a situation would be to revoke previous approv-


225. See House Managers' Statement, supra note 75, at 19.


228. 1969 House Hearings, supra note 1, at 811 (statement of Peter H. Grimes, Pres., Assn. of Retail Travel Agents).

229. Id. See also G. Hall, supra note 227, at 21; note 203 supra.
als. This is hardly a desirable solution given congressional concern over the hardships caused by divestiture.

Once the Board has determined that these potential adverse effects exist, the language of section 4(c)(8) requires it to see if these negative factors are outweighed by any positive effects. The types of benefits that the Board has accepted as indicating that an acquisition may be justified include an expansion of the acquired company's activities made possible by the availability of more resources, an increase in the lines of service of a new or old subsidiary, an increase in competition with the dominant firms in a market, and the making of funds available to the subsidiary at lower cost.

However, the Board has seldom found that the benefits in a given case overcome the adverse effects. Although in each approval the Board briefly indicates the possible public benefits, Marine Bancorporation is the only decision in which benefits have tipped the balance in the face of serious adverse effects. In that case, in which the bank holding company asked to retain a mortgage company subsidiary, the Board found that the competitive factors taken alone would have justified rejection but that the benefits that could

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230. Unlike the grandfather clause, section 4(c)(8) contains no provision for terminating a holding company's rights to engage in nonbanking activities after initial approval. Instead, the Board's authority to terminate, as in the case of section 4(d) exemptions, see note 70 supra, is based on a reservation of such a power in the order approving the applications. See, e.g., First Va. Bankshares Corp., 59 Fed. Reg. Bull. 202, 203 (1973): "This determination is subject to the Board's authority to require such modification or termination of the activities ... as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder . . . ."

231. Such concern is shown by the congressional decision to allow companies which became bank holding companies as a result of the 1970 amendments up to ten years to dispose of their unauthorized holdings. Bank Holding Company Act § 4(a)(2), 12 U.S.C. § 1843(a)(2) (1970).


236. See, e.g., Bank of Va. Co., 58 Fed. Reg. Bull. 924-35 (1972): "Approval of each acquisition will make available to Richmond Finance Corporation and Hanover the financial resources of Applicant and enable both companies to better serve their customers and provide more effective competition to their competitors in the market area. The resulting benefits in terms of public needs and convenience, and increased competition would, in the Board's judgment, outweigh any possible adverse effect on competition."


238. 58 Fed. Reg. Bull. at 506. The company had originated 4.7 per cent of the
have been anticipated and that were actually produced since the acquisition overcame these undesirable effects. These benefits had resulted from the depressed conditions in the Seattle area at the time of the acquisition (1968). As the Board explained, affiliation improved

Coast's [the acquired subsidiary's] ability to accept from financially distressed builders and other mortgage debtors land and other improvements for orderly liquidation, thereby preventing foreclosure, forced sales and deficiency judgments which would, in most cases, have resulted in financial disaster to the mortgage debtors. Another reasonable expectation, and proven fact, was that the affiliation would also improve the ability of Coast to expand the scope of its mortgage lending and expand its services into new lines, such as college housing and public housing projects for minority, elderly, and low-income groups.239

This approach raises some interesting questions regarding the equality of treatment between applicants that seek to retain an existing affiliate and those that seek to acquire a new enterprise.240 The former may have tangible benefits to show to the Board, while the latter can present at the most only promises and predictions. In Marine Bancorporation, the Board, after listing the "proven facts," concluded that, "these potential public benefits outweigh the adverse effect on competition resulting from the affiliation."241 However, as the two dissenting governors suggest,242 it is difficult to believe that the majority disregarded the actual post-acquisition benefits.

The balancing analysis required by the "public benefits" language cannot be made on a categorical basis,243 for the Board must determine which of the listed positive and negative factors potentially exist in a given case before it can weigh them against each other, and the presence of most of the adverse factors listed in the

mortgages in the Seattle market, and Coast Mortgage (the acquired subsidiary) had originated 6.8 per cent. 58 Fed. Res. Bull. at 507 (Robertson & Sheehan, Govs., dissenting). Compare this with the discussion of excessive market shares in text accompanying notes 198-200 supra.


243. The Board has made one attempt to define a public benefit. In 12 C.F.R. § 225.4(a)(10 n.3 (1973), the Board indicates it will normally approve applications by holding companies seeking to underwrite credit insurance only on a showing that approval would reduce rates (or increase benefits). See note 154 supra and accompanying text.
statute can only be determined in the context of a particular application. For example, in order to determine whether the entry of a given bank holding company into a certain type of activity will increase or decrease competition, the Board must consider, among other things, whether the entry is de novo or by acquisition, the size of the firm acquired, and the competitive structure of the market. Similarly, whether undue concentration of resources will result depends not so much on the type of activity, as on the relative economic power and size of the resulting bank holding company system. Since it cannot be said that a given type of activity will invariably produce net benefits or net harm, regulations of general scope, such as those issued under the "closely related" language, will not be of much help in applying the "public benefits" language. Instead, the Board must make case-by-case determinations.

C. Relationship Between the "Closely Related" Language and the "Public Benefits" Language

The congressional intent underlying the 1970 amendments may shed some further light on the purpose of section 4(c)(8) and, specifically, the relationship between the "closely related" requirement and the "public benefits" requirement. Prior to the 1970 amendments, section 4(c) provided:

The prohibitions in this section . . . shall not, with respect to any other bank holding company, apply to—

. . . .

(8) shares of any company all the activities of which are or are to be of a financial, fiduciary, or insurance nature and which the Board after due notice and hearing, and on the basis of the record made at such hearing, by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto . . . .

The Federal Reserve Board interpreted this section to require "a direct and significant connection between the proposed activities of the company to be acquired and the business of banking, or of managing and controlling banks, as conducted by the bank holding company or its banking subsidiaries." It was not sufficient, in the Board's view, that the activities of the proposed subsidiary were very similar to those conducted by banks generally. There had to be a "direct functional integration" of the activities of the proposed


245. 1969 House Hearings, supra note 1, at 199 (statement of Federal Reserve Board Chairman Martin) (emphasis added).

subsidiary with those of the specific bank holding company making the application.\textsuperscript{247}

The 1970 Amendments made two major changes in section 4(c)(8).\textsuperscript{248} The first was to delete the words "business of," preceding the phrase "banking or managing or controlling banks." One effect of this change seems clear: The Board is no longer to require a direct connection between the business of the proposed subsidiary and that of the bank member of the holding company. Henceforth, such business need only be related to banking generally.\textsuperscript{249}

The second major change was to add the "public benefits" language described above.\textsuperscript{250} There is disagreement over whether this language introduces a requirement separate from the "closely related to banking" language. If so, a proposed activity must meet the old "closely related to banking" test (as modified) and, in addition, meet a "public benefits" test. If not, the Board is to determine whether a proposed activity is closely related to banking principally on the basis of the public benefits or detriments it would produce.

The second, one-test, interpretation was favored by those who wanted the 1970 amendments to expand the scope of permissible bank holding company activity. The proponents of such expansion originally attempted to eliminate the "closely related" language and substitute an exemption for activities "functionally related to banking in such a way that their performance by an affiliate of a bank holding company can reasonably be expected to produce benefits to the public that outweigh possible adverse effects . . . ."\textsuperscript{251} Both houses initially adopted versions of the bill containing such "functionally related" language, although the House bill also contained a list of activities that bank holding companies were prohibited from carrying on.\textsuperscript{252} The conference committee agreed to retain the "closely related" language and delete the House's prohibitions.

The members of the committee split sharply over the proper


\textsuperscript{248} Several other minor changes were also made. See House Managers' Statement, supra note 75, at 14-16.

\textsuperscript{249} Id. at 16; Senate Managers' Statement, supra note 75, at 42-424.

\textsuperscript{250} See text accompanying note 191 supra.


\textsuperscript{252} H.R. 6778, § 1(6), passed by the House of Representatives, Nov. 5, 1969, in 1970 Senate Hearings, supra note 2, at 111, 116-19 (selling securities or insurance, providing travel, auditing or data processing services, and leasing property). The version of the Act originally passed by the Senate also contained the "functionally related" language. House Managers' Statement, supra note 75, at 13.
interpretation to be given this action. The majority (four of seven) of the House conferees argued that the retention of the old "closely related" language meant that the attempts to expand the scope of permissible activities had been rejected. The new "public benefits" language, they felt, merely added another test, further restricting the activities in which bank holding companies could engage. The Senate conferees disagreed:

It [the bill] frees the Board of the restrictive precedents established under the present act . . . . Furthermore, it defines "a proper incident" to banking in very broad terms of various benefits to the public as opposed to possible adverse effects.

The House managers' statement regarding the meaning of section 4(c)(8) is in my opinion a misconstruction of fact. It is hard for me to conceive of any way that an objective person present at the conference could interpret section 4(c)(8) as was done in that statement.

[Section 4(c)(8) as amended] retains [from the original Senate bill] maximum flexibility for the Federal Reserve Board to determine the activities in which a bank holding company and its subsidiaries may engage.

Since the conferees disagree so dramatically, it is necessary to look elsewhere to determine what was meant by this particular provision. Perhaps most helpful is the drafting history of the conference bill. At the conference the House conferees proposed exemption for activities that are "so closely related to [the business of] banking or [of] managing or controlling banks as to be a proper incident thereto and can reasonably be expected to produce benefits to the public . . . ." When asked to comment on the above language, Federal Reserve Board Chairman Arthur F. Burns expressed his concern that it implied that the "public benefits" provision was to be a separate test. To avoid this implication he suggested that the word "and" be deleted and that the sentence "In determining whether a particular activity is a proper incident to banking . . . . the Board shall consider . . . [the net public benefits]" be substituted for the last phrase. Since the final version of the bill embodied

254. Senate Managers' Statement, supra note 75, at 42424.
256. Id.
258. Letter from Arthur F. Burns to Wright Patman, Nov. 23, 1970, in Senate Managers' Statement, supra note 75, at 42423. Mr. Burns also suggested the deletion of language bracketed in the House conferees' proposal. See text accompanying notes 248-49 supra.
this change, it would seem that the "public benefits" provision is not a separate and distinct test.

The one-test interpretation finds further support in the fact that Mr. Burns supported an approach with two tests—the "closely related" test and a "proper incident to banking" test. (The public benefits provision would apply only to the latter test under his formulation.) To effectuate this result, he suggested changing the words "as to be" to "and are." 259 The fact that this change was not adopted is another indication that the present language, unlike the House conferees' proposal or Burns' proposal, provides only one test—"so closely related to banking . . . as to be a proper incident thereto"—with the public benefits language to be used in determining whether an activity is properly incident to banking.

Under this interpretation the discretion of the Federal Reserve Board in determining what nonbank activities are permissible is greatly expanded. The House conferees' view of the changes made by the amendments is too restrictive. Looking behind their statements to the actual drafting process there appears to be essentially one test. In most cases, when evaluating an activity under this test, the Board is to look to whether it will produce net public benefits. The "closely related" language retained from the earlier provision does have a limited function in and of itself: It serves as an initial check on activities that are clearly not related to banking, such as operating a railroad or auto repair shop. Such activities would not be permitted even if it could be demonstrated that they would produce net benefits. However, if an activity could be considered related to banking in any way, the Board must look primarily to public benefit factors. This analysis suggests that the role of the regulations defining what is "closely related" will be somewhat limited. The more difficult cases will be decided in the context of particular fact situations, for that is where public benefits can be best evaluated.

This has, in fact, been the approach adopted by the Board. Close analysis indicates that the list of activities in the regulations was never intended to be a definitive guide as to whether a particular entry will be permitted. The Board has in no way restricted its approvals to the listed activities. For example, the Board has approved the proposed operation of a "pooled reserve" plan 260 for banks through a nonbank subsidiary of a holding company, even though


this activity was not covered by the Board's regulations. As the hearing examiner, whose findings and conclusions were adopted by the Board, said, "the listing of the categories does not preclude the existence of other activities which might be shown to meet the test of section 4(c)(8)." The relevant factors in determining that such an activity was permitted under section 4(c)(8) were its similarity to the established practice of loan participation between banks and the hope that it would produce public benefits by improving the capacity of small member banks to make commercial loans.

In two other decisions, a peculiar legal situation led the Board to approve the operation of savings and loan associations, explicitly excluded from the regulations, in the interest of promoting fairer and increased competition. Rhode Island law allows mutual savings banks and certain credit unions to offer checking accounts through commercial bank subsidiaries, thus giving the competitors of the applicant's bank subsidiaries the power to combine these operations. The Board permitted Rhode Island bank holding companies to operate both a savings and loan association and a commercial bank in order to equalize their competitive position vis-à-vis other financial institutions. Finally, in a number of cases the Board has concluded that activities are not closely related to banking because the adverse effects outweighed the benefits.

Thus, the Board has taken a flexible and expansive approach to the application of section 4(c)(8). First, it appears that the Board

263. Old Colony Cooperative Bank, 58 FED. RES. BULL. 417 (1972); Newport Sav. & Loan Assn., 58 FED. RES. BULL. 313 (1972).
264. 12 C.F.R. § 225.4(a)(1) n.* (1973). The Board had not yet adopted 12 C.F.R. § 225.126(h) (1973), which includes operation of savings and loan associations in the category of activities found not closely related to banking. When the Board issued that ruling, it emphasized that it did not affect the Rhode Island decisions. 58 FED. RES. BULL. 717 (1972).
does not consider the regulations to be all-inclusive. Second, peculiar circumstances may make given activity permissible under section 4(c)(8) in one location or situation, but not in another. Similarly, an activity on the regulation’s list will not be approved if public benefits do not outweigh potential harms.269

The fact that an activity is declared to be “closely related” under the regulations does have one tangible effect. The Board has provided a simpler application procedure for de novo entry into activities that have been determined to be closely related to banking under the regulations than for acquisition of a going concern or de novo entry into activities not determined to be closely related.270 Under the simplified procedure, the holding company is required to publish notice of its proposal in newspapers of general circulation in the communities to be served.271 Within thirty days the company must notify the Federal Reserve Bank for its district of the proposal; the activities may be commenced forty-five days later unless the company is notified to the contrary by the Bank.272

When the entry is to be by acquisition of a going concern,273 or if the entry is de novo but into an activity that has not been found to be closely related to banking under the regulations,274 notice must be filed with the Federal Reserve Bank and a copy of the notice

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270. 12 C.F.R. § 225.4(a)-(b) (1973).
272. The Reserve Bank may direct that the company await specific approval or that the procedure used for acquisitions be followed if “adverse comments of a substantial nature” are received within thirty days of the published notice or if it otherwise appears appropriate in a particular case. 12 C.F.R. § 225.4(b)(1) (1973).
274. 12 C.F.R. § 225.4(a) (1973) (requires same procedures as used for acquisitions).
published in the communities to be served. The Board then publishes notice of the application in the Federal Register, and interested persons are given an opportunity to express their views on the public benefits issue. These procedures, however, appear to be primarily designed to facilitate de novo entries. In that respect they follow the command of the statute: "In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern," and the intent expressed in the committee report:

One of the asserted justifications for permitting bank holding companies to engage in activities that the Board has determined independently to be closely related to banking, is to permit the introduction of new innovative and competitive vigor into those markets which could benefit therefrom. Where a bank holding company enters a market through acquisition of a major going concern, it may not have the incentive to compete vigorously, thereby bringing the possible benefits into play, as it would immediately succeed to what it might consider its fair share of the market.

The requirement that the proposed activities be deemed to be "closely related" under the regulations is merely a screening device to ensure that clear cases are not allowed to slip by. It should be noted that even the simplified procedures allow the Board to halt the entry if an analysis of the public benefits seems appropriate. The regulations, once again, are not the final word.

Although the implementation of the 1970 amendments of the Bank Holding Company Act is not yet complete, the Federal Reserve Board has taken a progressive, if not radical, approach to the entry of bank affiliates into nonbank activities. The Board has refused to set forth definitive categories of activities that are or are not permissible. Rather, it has followed the mandate of the statute and looked to see if the specific entry in question will have any detrimental or beneficial effects. It is on this basis that a decision will be made on any given application.

275. 12 C.F.R. § 225.4(b)(2) (1973). The regulation allows the Board to hold hearings "where appropriate." Section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8) (1970), requires that determinations as to what activities are closely related to banking shall be made "after due notice and opportunity for hearing."

Section 225.4(a) allows decisions on the "closely related" issue to be made using the procedures under section 225.4(b)(2). Since the latter regulation does not provide for the right of interested persons to be heard on the relatedness issue, it is arguably incompatible with the statute. However, it appears that under such circumstances the Board in fact permits interested parties to be heard on the relatedness issue. See Bank-America Corp., 38 Fed. Reg. 4816 (1973).


277. House Managers' Statement, supra note 75, at 17.