

# BUSINESS DIVISIONS FROM THE PERSPECTIVE OF THE U.S. BANKING SYSTEM

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### I. INTRODUCTION

The Bank Holding Company Act of 1956 (“Act”),<sup>1</sup> as amended, most recently in 1999 by the Gramm-Leach-Bliley Act<sup>2</sup> (“GLB”) divides all economic activity into five groups. These groups are:

#### 1. Banking;

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1. Bank Holding Company Act of 1956 (“BHCA”), Pub. L. No. 84-511, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841–1850 (2000) & 26 U.S.C. §§ 1101–1103 (2000)).

2. Gramm-Leach-Bliley Financial Modernization Act of 1999 (“GLB”), Pub. L. No. 106-102, 113 Stat. 1338 (codified in scattered sections of 12 and 15 U.S.C.).

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2. Activities closely related to and a proper incident to banking;
3. Activities of a financial nature;
4. Activities complementary to those of a financial nature; and
5. Activities not of a financial nature.<sup>3</sup>

This article will explore these five groups of activities separately. The policies behind the divisions will be analyzed and questioned whether they serve the policies behind the Act. This article will also question whether the divisions make good economic sense and whether they are drawn in a logical manner. Finally, this article examines the effects that the divisions have had on the banking industry, in both the United States and abroad, and looks to what they portend for the future.

The five areas of activity represent the Act as it now stands. The Act has always divided the economic world into discrete groups of activities, but those specific groups have changed as the Act evolved and was amended in response to changing conditions. The GLB, enacted in 1999, was a response to a changed technological world that made banking law unresponsive to economic needs both domestically and, perhaps even more importantly, internationally. Although the changes might have been ground-breaking at one time, contemporary electronic technology, combined with forward-looking regulatory and judicial decisions, may have sufficiently affected the system to make the changes largely irrelevant.<sup>4</sup>

Before the GLB, there was one other significant amendment, which was enacted in 1970.<sup>5</sup> This amendment created the second division listed above (activities “closely related” to and a “proper

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3. See GLB § 103, 12 U.S.C. § 1843(a), (c)(8), (k), (n) (2000).

4. See Eugene M. Katz, *Securities Activities, Merchant Banking and Functional Regulation Under the Gramm-Leach-Bliley Act*, 56 CONSUMER FIN. L.Q. REP. 182 (2002) (stating “the reforms adopted by the GLB Act simply validate what the marketplace already had demanded”); see Peter J. Wallison, Address at the American Enterprise for Public Policy Research (Dec. 19, 2001), <http://aei.org/sp/spwallison011219.htm> (last visited Nov. 9, 2002) (expressing “[t]he sad thing about all this is that it is all so unnecessary”).

5. Bank Holding Company Act Amendments of 1970 (“1970 Amendments”), Pub. L. No. 91-607, 84 Stat. 1760 (1970) (codified as amended in scattered sections of 12 U.S.C. and 31 U.S.C.).

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incident” of banking).<sup>6</sup> That division was an important and fundamental segment of the Act until the GLB reduced it to an insignificance.

It is observed at the outset that the five groups of activities are not even remotely alike in terms of either size or importance. Next to the fourth group (activities complementary to those of a financial nature), which has virtually no content at present, the second group, once so prominent, is now probably the smallest and least important. Conversely, the fifth group (activities not of a financial nature) largely engulfs the remaining four.

## II. Banking

The concept of what is “banking” for purposes of the Bank Holding Company Act<sup>7</sup> is addressed in two ways.

In a case before the Second Circuit Court of Appeals, the Independent Insurance Agents of America challenged an order of the Federal Reserve Board (“Board”) that “permitted two Indiana state banks acquired by the Merchants National Corporation, a bank holding company, to resume specified insurance activities permitted under Indiana law.”<sup>8</sup> In response to the plaintiffs’ assertion that the activities were beyond the legal scope of bank activities permitted under the Act, the Board contended it had no power to inquire into the activities of a bank acquired by a holding company.<sup>9</sup> The Court of Appeals confirmed the Board’s position that one must “leave the scope of permissible activities of bank subsidiaries of a bank holding company subject only to the authority that issued the banks’ charter, without any further restriction from the [Bank Holding Company] Act itself.”<sup>10</sup>

6. GLB § 103; 12 U.S.C. § 1843.

7. Outside the Bank Holding Company Act, the concept of “banking” takes on more refined colorations. In connection with branching, one sees “core” banking functions. See *Clarke v. Sec. Indus. Ass’n*, 479 U.S. 388, 409 (1987) (holding a discount brokerage service is not a core banking function). Related concepts in 12 U.S.C. § 81 deal with the “general business” of banking. See 12 U.S.C. § 81 (2000).

8. *Indep. Ins. Agents of Am., Inc. v. Bd. of Governors*, 890 F.2d 1275, 1277 (2d Cir. 1989).

9. See *id.* at 1278–80 (explaining that the Board believed the Act’s restrictions on permitted activities applied only to activities of the bank holding company itself, not to those of its acquired subsidiary). The Board did recognize, however, that under an exception to the “ownership” clause of the Act, 12 U.S.C. § 1843, a bank holding company may not acquire an entity that claims to be a “bank” but engages mostly in nonbanking activities, noting that such an acquisition would be “primarily, if not solely” for the purpose of enabling the holding company to engage in the target’s nonbanking activities.” *Id.* at 1279. The Second Circuit referred to a prior situation, in which Citicorp, a bank holding company, had attempted such an evasive maneuver in order to invade the insurance business. *Id.*; see *Citicorp (South Dakota)*, 71 FED. RES. BULL. 789, 790 (1985).

10. *Indep. Ins. Agents of Am.*, 890 F.2d at 1279.

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Both the Board and the Court of Appeals based their decisions in part on statements of the United States Supreme Court in *Board of Governors v. Investment Company Institute*.<sup>11</sup> In that case, the Supreme Court considered an interpretive ruling of the Board that permitted “bank holding companies and their nonbanking subsidiaries to act as an investment adviser.”<sup>12</sup> Investment Company Institute argued the Board’s ruling, in effect, gave powers to a bank subsidiary beyond its permissible scope.<sup>13</sup> The Institute also contended that the regulation wrongly authorized banks themselves to engage in these activities.<sup>14</sup> The Supreme Court provided a succinct response: “The simple answer to this argument is that not only does the interpretive ruling confer no authorization to undertake any activities, but also the Board does not have the power to confer such authorization on banks.”<sup>15</sup> The Court found further support for its determination in a quote from the Board’s opinion, which stated, “[t]he authority of national banks or state member banks to furnish investment advisory services does not derive from the Board’s regulation; such authority would exist independently of the Board’s regulation and its scope is to be determined by a particular bank’s primary supervisory agency.”<sup>16</sup>

Once one goes to “a particular bank’s primary supervisory agency” to determine the scope of a bank’s authority to offer investment advisory services, the laws are beyond the reach of, and essentially irrelevant to, this article’s purpose. The National Bank Act<sup>17</sup> and the regulations of the Comptroller<sup>18</sup> control activities of national banks; fifty different sets of state statutes and supporting regulations have similar control over the state bank system.<sup>19</sup> Other statutes, both federal and state, govern savings and loan associations,<sup>20</sup> savings banks<sup>21</sup> and other

11. 450 U.S. 46 (1981); *Indep. Ins. Agents of Am.*, 890 F.2d at 1284; Merchants National Corp., 75 FED. RES. BULL. 388 (1989).

12. *Bd. of Governors*, 450 U.S. at 49.

13. *Id.* at 53 (claiming the Board was not authorized to determine that investment adviser services were “closely related” to banking).

14. *Id.* at 60 n.25.

15. *Id.*

16. *Id.*

17. National Bank Act of 1864, June 3, 1864, ch. 106., 13 Stat. 99 (codified as amended in scattered sections of 12, 19, 31 U.S.C.).

18. See 12 C.F.R. § 1 *et seq.* (2002).

19. See, e.g., TEX. FIN. CODE ANN. § 1.001 *et. seq.* (Vernon 1998 & Supp. 2002)

20. See, e.g., Home Owners’ Loan Act of 1933 (“HOLA”), Pub. L. No. 101-73, 48 Stat. 128 (codified at 12 U.S.C. §§ 1461–1470 (2000)) (governing federal savings and loan associations); TEX. FIN. CODE ANN. §§ 61.001–.007 (Vernon 1998) (setting forth the Texas Savings and Loan Act).

21. See, e.g., 12 U.S.C. § 1464 (2001) (authorizing the “organization, incorporation,

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institutions that one might consider banks. The word “banking” appears throughout this myriad of laws<sup>22</sup> and, as already noted, its various meanings in this context need not concern us.

When the Supreme Court determined that a national bank could, within its banking powers, offer annuities to its customers and was not restricted by state insurance limitations in doing so,<sup>23</sup> its decision rested upon three bases. The first basis, and the one for which the Court is most often cited, is that an annuity contract is fundamentally a bank product – an “investment” – rather than “insurance.”<sup>24</sup> The second basis is the principle that when an agency properly assigned to a specific area reasonably interprets a regulation within that area, the courts will affirm the decision.<sup>25</sup> In this instance, the Supreme Court deferred to the Comptroller of the Currency’s decision an annuity was a bank product that could be sold “as part of, or incidental to, the business of banking.”<sup>26</sup> The third basis is that national banks have the power to act as agents in the sale of securities, which, as mentioned above, include annuities.<sup>27</sup> Clearly, the power to act as an agent belongs to national bank power.

The Supreme Court considered the language of the National Bank Act authorizing a national bank “to exercise . . . all such incidental powers as shall be necessary to carry on the business of banking . . . .”<sup>28</sup> On their face, these words embody a considerable discretionary ingredient; specifically, there does not appear to be a clearly defined line marking the power’s limits. The *NationsBank* Court confirmed this view in a famous footnote

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examination, operation, and regulation of . . . Federal savings associations (including Federal savings banks”); TEX. FIN. CODE ANN. §§ 91.001–.007 (Vernon 1998) (setting forth the Texas Savings Bank Act).

22. See, e.g., 12 U.S.C. § 24 (Seventh) (providing a national bank has the power “[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking”); N.Y. BANKING LAW § 96 (McKinney 2001) (providing that every New York bank has the power to “exercise all such incidental powers as shall be necessary to carry on the business of banking”).

23. See *NationsBank of N.C. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 261–64 (1995).

24. *Id.* at 259–61.

25. *Id.* at 256–59.

26. *Id.* at 259–60.

27. *Id.* at 256–58 (discussing the provision of the National Bank Act, 12 U.S.C. § 24 (Seventh), which authorizes national banks to deal in securities). In a later case, the Eleventh Circuit Court of Appeals refused to permit a national bank to sell annuities when the bank was acting as a principal rather than as an agent, and the court distinguished *NationsBank* on this ground. See *Blackfeet Nat’l Bank v. Nelson*, 171 F.3d 1237, 1241–42 (11th Cir. 1999).

28. See *NationsBank*, 513 U.S. at 256 (quoting 12 U.S.C. § 24 Seventh (1988 ed. & Supp. V) (current version at 12 U.S.C. § 24 (2000))).

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where the Court wrote: "We expressly hold that the 'business of banking' is not limited to the enumerated powers in § 24 (Seventh) and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated."<sup>29</sup>

The position taken by the Supreme Court in *NationsBank* was consistent with earlier views on the nature of banking the Comptroller of the Currency espoused. Particularly, in a 1989 Interpretive Letter, the Comptroller opined that it was legally acceptable for national banks to broker financial instruments, including agricultural futures and related options.<sup>30</sup> The Comptroller reasoned this activity fell within the scope of the "business of banking" powers clause under 12 U.S.C. Section 24 (Seventh).<sup>31</sup> The Interpretive Letter referred several times to the five examples of banking power within that provision and clearly stated (consistent with the later *NationsBank* case): "[T]he National Bank Act grants the power to engage in the business of banking which consists of more than only the five specifically listed powers."<sup>32</sup> Thus, the five enumerated powers are simply examples of banking powers and not an exclusive list.<sup>33</sup>

Title 12 of the United States Code is the federal law defining the powers of national banks. State banks have similar authorizations. For example, New York banking laws empower its state banks to "exercise all such incidental powers as shall be necessary to carry on the business of banking."<sup>34</sup> Even if a national or state bank is part of a bank holding company system over which the Board has general regulatory jurisdiction, the Board cannot question the banking power given to the bank by its authorizing law.<sup>35</sup> We will look at that power from another point of view – the concept of banking as a measure of activities that may be conducted by affiliates of the bank in a holding company system – in the following subsection.

29. *Id.* at 258 n.2.

30. Office of the Comptroller of the Currency, Interpretive Letter No. 494, Fed. Banking L. Rep. (CCH) ¶83,083, at 71,203 (Dec. 20, 1989).

31. *Id.*

32. *Id.* at 71,197.

33. *See id.* at 71,198.

34. N.Y. BANKING LAW § 96(1) (McKinney 2001). It is not a coincidence that the federal law reads so similarly to that of New York State, since the former was patterned on the latter.

35. *See* *Indep. Ins. Agents of Am., Inc. v. Bd. of Governors*, 890 F.2d 1275, 1279 (2d Cir. 1989) (noting the Board interpreted the Bank Holding Act as "leav[ing] the scope of permissible activities of bank subsidiaries of a bank holding company subject only to the authority that issued the banks' charter, without any further restriction from the Act itself").

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The Act was enacted in 1956 and substantially amended in 1970.<sup>36</sup> In both iterations, the bank holding company's authority to engage in business through corporate entities other than chartered banks themselves was carefully defined.<sup>37</sup> In both situations, the definitions were based upon the relationship of those entities to banking. However, the concept of banking was different for this purpose in the periods before and after 1970.

Bank holding companies that had been controlled by the Act before the 1970 amendment<sup>38</sup> were tightly constrained in the permissible nonbank businesses they could conduct outside of their bank(s). The ability to engage in any business outside the bank itself required prior Board approval.<sup>39</sup> The Act permitted affiliates of banks covered by the Act and within a holding company structure to engage in businesses of a "financial, fiduciary, or insurance nature . . . which the Board . . . determined to be so closely related to the business of banking . . . as to be a proper incident thereto . . . ."<sup>40</sup> The Board interpreted "business of banking" to mean such banking business as banks actually conducted in the same holding company system as the applicant.<sup>41</sup> The Board wrote in 1959:

The fact that insurance may be considered as *generally* related to the banking business and in many respects similar to that business would not alone be sufficient to justify an exemption under Section 4(c)(6) of the Holding Company Act. In view of the language of the statute and of the Board's Regulation Y, it is essential that the activities of the company involved—the contemplated insurance activities of Agencies, Inc. in the present case—must have some direct and significant connection with the business of banking

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36. BHCA, 12 U.S.C. §§ 1841–50 (2000); 1970 Amendments, Pub. L. No. 91-607, 84 Stat. 1760.

37. BHCA § 4, 12 U.S.C. § 1843; 1970 Amendments § 103, 12 U.S.C. § 1843(a)(2) (2000).

38. See *infra* notes 44–47 and accompanying text for the discussion pertaining to how bank holding companies that controlled only one bank were not regulated by the Act until 1971.

39. See BHCA § 4(c)(6), 70 Stat. at 137 (1956) (allowing Board to approve such activities by order, only "after due notice and hearing, and on the basis of the record made at such hearing . . .").

40. *Id.*

41. See First Bank Stock Corporation, 45 FED. RES. BULL. 917, 930 (1959).

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or of managing and controlling banks as conducted by the Applicant or its banking subsidiaries.<sup>42</sup>

Thus, before 1970, for purposes of the Act, one meaning of “banking” was the banking business as conducted by the bank in the particular holding company. It was of no consequence whether other banks outside the holding company also engaged in the activity. This is essentially the concept of banking that is addressed in this subdivision of the article. Finding out what “banking” meant was a much simpler exercise before 1970. One only had to look at the actual holding company being considered and see what activities its subsidiary bank(s) took part in.

This first concept of banking under the Act – an activity that cannot be regulated by the Board – remains a cogent subject today. The legal doctrine has remained essentially unchanged through the life of the Bank Holding Company Act. As we will see in the next subdivision, however, the second concept of banking has lost most of its significance since the Gramm-Leach-Bliley Act of 1999 was enacted.

The second concept of banking, a more difficult concept than the first, is the group of activities considered “closely related to banking” under Section 4 of the Act as amended in 1970.<sup>43</sup> The concept of “closely related to banking” did not figure into the Act at all until the amendment. The 1970 Amendment derived from experience with one-bank holding companies. Before 1970, a bank holding company that controlled only a single bank was not a “bank holding company” as defined in the Act and, consequently, was not regulated by the Act.<sup>44</sup> Essentially, in addition to controlling its one bank, this form of holding company could engage in any type of activity.<sup>45</sup> By Act of Congress approved December 31, 1970, the Bank Holding Company Act was expanded to cover one-bank holding companies.<sup>46</sup> By the

42. *Id.*

43. 1970 Amendments § 103, 12 U.S.C. § 1843(c)(8) (amending BHCA § 4).

44. BHCA § 2(a), 70 Stat. at 133 (1956) (defining a “bank holding company” as “any company (1) which directly or indirectly own, controls, or holds with power to vote, 25 per centum or more of the voting shares of each of two or more banks . . .”).

45. In general, these bank holding companies were ordinary stock corporations, which are empowered by their controlling laws to engage in any activity, subject to certain limited exceptions like banking or insurance. One of the authors of this article was employed by a one-bank holding company during those untroubled days. It owned a greeting card company, a department store, an X-Ray manufacturing company, an investment advisor and more. It considered itself a well-balanced conglomerate and nicely insulated from market risk. With the 1970 Amendments, of course, it was required to divest itself of that protection.

46. See 1970 Amendments § 101 (deleting the “two or more banks” language).



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1970 amendment, Congress structured the Act so that both one-bank and multi-bank holding companies were covered and allowed to engage in a wide variety of nonbank activities.<sup>47</sup>

Congress first amended Section 4(c)(8) of the Act (under which bank holding companies may acquire interests in nonbanking activities), then continued to give the Board supervision over all decisions, and finally made any Board approval subject to certain restrictions and conditions.<sup>48</sup> Under that section, as amended, the Board was empowered to issue orders and promulgate regulations generally permitting the acquisition of companies whose activities were “so closely related to banking or managing or controlling banks as to be a proper incident thereto.”<sup>49</sup> Insofar as the concept of banking is concerned, the main effect of the amendment was to turn the previous “business of banking” into just “banking.”

In its first public action under the new provision, by order of the Board of Governors, the Federal Reserve Board publicly released on January 21, 1971, less than a month after approval of the amendment, a proposal that ten activities be considered “closely related to banking or managing or controlling banks.”<sup>50</sup> The release clarified that the Board was concerned mainly with “banking” rather than “managing or controlling banks.”<sup>51</sup> After a hearing on April 14, 1971, in which Board members heard all issues raised by the proposals, the Board approved seven of the ten proposed activities.<sup>52</sup>

Efforts to discover what the Board used as a standard for banking in evaluating what activities should be “closely related to banking” have been less than satisfying. The “hearing” held on April 14, 1971, where members of the Board considered “all issues raised by the proposals,” did not rise to the level of a “meeting.” No minutes were taken, or at least none remain. There was, however, a reference to “the record of the hearing,”<sup>53</sup>

47. See § 103, Stat. at 1763–64 (1970).

48. See § 103.

49. § 103(4).

50. Bank Holding Companies Interests in Nonbanking Activities, 36 Fed. Reg. 1430, 1430–31 (Jan. 29, 1971) (to be codified at 12 C.F.R. pt. 222).

51. *Id.* On the second page of the January 29, 1971 Federal Register release, the Board observed that it must consider whether activities are “closely related to banking” without ever referring to the “managing or controlling banks” language. See 36 Fed. Reg. at 1431. That approach has dominated the Board throughout its administration of the Act.

52. Nonbanking Activities of Bank Holding Companies, 36 Fed. Reg. 10777 (June 3, 1971) (to be codified at 12 C.F.R. pt. 222).

53. See *id.* at 1077.

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which probably means that a transcript was created and is now available from the Board under the Freedom of Information Act.

The Board seemingly did not feel it necessary to find a clear and specific concept of banking to which the activities presented to it for approval would be related. Should banking mean an activity conducted by this bank, by all banks, by some banks, by most banks, by many banks? One senses that an activity assigned to a bank in Montana, for example, and performed only for a single day would not be banking, as the Board comprehends the term. Something more seems required, but one could not be sure in 1971 what it was.

Throughout the next few years, the Board continued deciding what was “closely related to banking” without actually defining the term “banking.” However, a sense that something beyond a casual act or activity of a single bank seemed to hover over its decisions. For example, in 1974 an applicant was reported to have presented an activity to the Board as being “traditionally [] performed by banks, and . . . in Applicant’s opinion, [and presumably at least partly for that reason] closely related to banking.”<sup>54</sup> Later the same year, the Board decided underwriting mortgage guaranty insurance was “similar to those [credit decisions] made by banks in their regular course of business.”<sup>55</sup> In deciding what a bank holding company may do as related to the issue of whether an activity is closely related to banking, this somewhat indistinct test seemingly assumed that the activities of a bank holding company, a federally regulated entity, should not vary from state to state based upon what the local banks may do. We find no decision, however, that deems “banking” to be what a single bank can do or even what banks in a particular geographic area may do.

Approximately four years after the Board made its initial determination of what constituted activities “closely related to banking,” the District of Columbia Circuit Court of Appeals in *National Courier Ass’n v. Board of Governors*, became the first appellate court to give some formal guidance as to the meaning of “banking.”<sup>56</sup> *National Courier* remains the seminal decision interpreting when an activity should be deemed “closely related” to banking for purposes of the Bank Holding Company Act 1970

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54. Bank Holding Companies, 39 Fed. Reg. 13,007 (Apr. 10, 1974) (to be codified at 12 C.F.R. pt. 225).

55. Bank Holding Companies Nonbanking Activities of Bank Holding Companies, 39 Fed. Reg. 33,712, 33,712 (Sept. 19, 1974) (to be codified at 12 C.F.R. pt. 225). The activity was, however, rejected for other reasons.

56. *Nat’l Courier Ass’n v. Bd. of Governors*, 516 F.2d 1229 (D.C. Cir. 1975).

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Amendments. Despite its significance, however, the case was less thorough than it could have been. Given the opportunity to analyze what Congress contemplated as “banking” following the 1970 Amendments, the court largely declined the invitation<sup>57</sup> beyond analyzing the legislative history of the words.<sup>58</sup> Most of the court’s contributions to the subject now at issue, however, came indirectly or by assumption.

The court properly quoted the operative words in the Bank Holding Company Act – “banking or managing or controlling banks” – and subsequently eliminated all but the word “banking” as if “managing or controlling banks” added nothing,<sup>59</sup> as perhaps they do not. It then determined that “[t]he Board must . . . articulate the ways in which banking activities and the proposed activities are assertedly connected, and must determine, not arbitrarily or capriciously, that the connections are close.”<sup>60</sup> Explaining this statement, the court required a bank’s proposed services to have been provided by banks “generally” in order for there to be a connection.<sup>61</sup> This word had not previously appeared in the published discussions of the Act.

The court’s holding that an activity must be engaged in by banks generally to constitute banking for purposes of Section 4 of the Bank Holding Company Act, and not by a single bank or even a limited group of banks, was adopted by subsequent decisions and has become a foundation of the Act.<sup>62</sup> Thus, if the legislature of the State of Nevada had empowered its banks to offer as a banking activity the business of gambling, it would be considered banking in Nevada for purposes of subsection 1 above; and, since banks could conduct the activity, it would be regulated by the

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57. See *id.* at 1237 (stating, “[r]ather than define [‘closely related to banking’] with any precision . . . we simply require that the Board go about making its ‘closely related’ decision in a reasoned fashion consistent with the legislative intent”). The court first addressed the concept before the 1970 Amendments, “closely related to the business of banking.” *Id.* at 1236. Next the *Nat’l Courier Ass’n* court determined that Congress intended an entirely new test according to the changed language. *Id.* at 1236–37. However, other than indicating that a broader set of activities was to be included than just those engaged in by the affiliate bank, the court did not pursue the issue of how those activities were to be identified. *Id.*

58. See *id.* at 1236.

59. See *id.* at 1236–37.

60. *Id.* at 1237. Thus, once the Board established what “banking” constituted, its next task was to determine whether the activity presented to it was “closely related.” *Id.* See discussion *infra* Part III.

61. *Id.* at 1232–33.

62. See, e.g., *Ass’n of Data Processing Serv. Orgs., Inc. v. Bd. of Governors*, 745 F.2d 677, 686 (D.C. Cir. 1984); *Ala. Ass’n of Ins. Agents v. Bd. of Governors*, 533 F.2d 224, 240–41 (5th Cir. 1976), *vacated in part*, 558 F.2d 729 (5th Cir. 1977). But see *Sec. Indus. Ass’n v. Bd. of Governors*, 716 F.2d 92, 103 (2d Cir. 1983), *aff’d*, 468 U.S. 207 (1984) (refusing to read this requirement into the language of the Act).

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state banking commission and, absent fraud in the Citicorp-South Dakota sense,<sup>63</sup> could not be authorized, prohibited or controlled by the Board. However, gambling would not be “banking” in the sense of this subsection because it would not be offered by banks generally; and, as a consequence, an activity closely related to gambling could not be engaged in by a non-bank affiliate, not even in Nevada.

Following the *National Courier* case, the term “generally” appeared regularly when the Board applied the “closely-related” test. For instance, in a 1976 opinion considering the relationship of the travel agency business to banking, the Board looked to whether banks “generally have provided the proposed service.”<sup>64</sup> Finding that one percent of all commercial banks in the United States conducted this particular business and that these banks account for less than two percent of all travel agencies, the Board held that the travel agency business was not “closely related” to banking.<sup>65</sup>

In addition, in 1976, the Board found automobile leasing to be “closely related” to banking, based in large part upon “a strictly factual test of whether banks generally have provided and do provide the proposed service.”<sup>66</sup> Specifically, the Board determined automobile leasing had spread nationwide during the preceding twelve to fifteen years and was engaged in by 680 banks during the early 1970’s.<sup>67</sup>

In considering the relationship of municipal securities dealerships to banking, the Board decided it was premature to render a final decision on whether the two were “closely related” because the Municipal Securities Rulemaking Board, created in 1975, was itself considering regulations covering such dealerships.<sup>68</sup> The Board stated, however, that it “believes that there is support for a determination that the activity is ‘closely related to banking’” and “that an activity generally engaged in by banks directly would seem to qualify as ‘closely related’ to banking or managing or controlling banks within the meaning of the statute.”<sup>69</sup>

If the National Bank Act specifically permits a national bank to engage in a particular type of activity, is this enough to be

63. See Citicorp (South Dakota), 71 FED. RES. BULL. 789, 790.

64. Bank Holding Companies Nonbanking Activities, 41 Fed. Reg. 5134, 5135 (Feb. 4, 1976) (to be codified at 12 C.F.R. pt. 225).

65. *Id.*

66. Bank Holding Companies, 62 FED. RES. BULL. 928, 931 (1976).

67. *Id.*

68. See Bank Holding Companies Nonbanking Activities, 41 Fed. Reg. 47,083, 47,083 (Oct. 27, 1976) (to be codified at 12 C.F.R. pt. 225).

69. *Id.*

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considered banking “generally?” After all, in 1971, approximately 4,600 national banks<sup>70</sup> existed that were located in all states. Would more be required to meet the “generally” test? The Fifth Circuit Court of Appeals in *Alabama Ass’n of Insurance Agents, Inc. v. Board of Governors* was presented with the opportunity to address this question.<sup>71</sup> The case focused on a specific provision of the National Bank Act that granted national banks authority to act as an agent for the sale of insurance in any place with a population that does not exceed 5,000.<sup>72</sup> The Board had built a regulation upon this provision that granted certain authorities to non-bank affiliates within a holding company system.<sup>73</sup> The regulation was challenged and the Court of Appeals for the Fifth Circuit ruled that the Board had extended the fundamental banking authority too broadly.<sup>74</sup> The court did not deny, indeed, could not deny, that acting as an agent in any place with a population of 5,000 or less was part of a national bank’s authority.<sup>75</sup> It analyzed Congress’ rationale for granting national banks this power and found the statute’s purpose “was to give small town banks, which had difficulty in deriving a sufficient profit from banking, an additional source of revenue.”<sup>76</sup> It also noted, “Congress thus did not indicate that the sale of insurance in small towns was part of ‘banking’ . . . .”<sup>77</sup> Finally, the court expressed the view that this limited authority should not be expanded through the holding company route to form a base for general bank holding company activity:

No one doubts that subsidiaries of holding companies which are national banks located in small towns have the authority to broker insurance. But to hold that other holding company subsidiaries which are not banks have such authority as a result of 12 U.S.C. § 92 would not only violate the Bank Holding Company Act, but would warp the Congressional intention underlying the 1916 enactment as well.<sup>78</sup>

70. 1971 COMPTROLLER OF THE CURRENCY ANN. REP. Table 4.

71. *Ala. Ass’n of Ins. Agents, Inc. v. Bd. of Governors*, 533 F.2d 224 (5th Cir. 1976), vacated in part, 558 F.2d 729 (5th Cir. 1977).

72. *See id.* at 243–44 (discussing 12 U.S.C. § 92 (1970)).

73. *Id.* at 243 (discussing 12 C.F.R. § 225.4 (a)(9)(iii) (1976)).

74. *See id.* at 243–44.

75. *See id.* at 243 (noting Congress had permitted since 1916 such activity for national banks).

76. *Id.*

77. *Id.*

78. *Id.*; see also discussion *infra* Part III.

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The principle that “banking” includes all activities of the National Bank Act could potentially be derived from *Securities Industry Association v. Comptroller of the Currency* (“SIA”).<sup>79</sup> Although this case did not concern the Bank Holding Company Act, the court did hold that national banks had the power to act as an agent in the sale of securities by virtue of the Glass-Steagall amendment to the National Bank Act.<sup>80</sup> Can one consider this activity to be in the general business of banking upon which a “closely related to banking” decision could be made, or must it first be established that banks generally do conduct the particular activity?

In another case decided during the same period, the Board<sup>81</sup> and ultimately the Supreme Court,<sup>82</sup> decided that the brokerage business was “closely related” to banking and, consequently, permissible for bank affiliates within a holding company system, without going through the drill of establishing how many banks engaged in the activity. That is, the Board and the Supreme Court seemed to decide implicitly, perhaps assume, a finding that banks “generally” engage in the activity might not be necessary when that activity was authorized for national banks.

The Supreme Court, however, in the course of affirming the Board’s opinion that securities brokerage was “closely related” to banking, observed:

The Board found that banks currently offer, as an accommodation to their customers, brokerage services that are virtually identical to the services offered by Schwab. . . . Moreover, the Board cited a 1977 study by the Securities and Exchange Commission that found that ‘bank trust department trading desks, at least at the largest banks, perform the same functions, utilize the same execution techniques, employ personnel with the same general training and expertise, and use the same facilities . . . that brokers do.’ Finally, the Board concluded that the use by banks of

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79. 577 F. Supp. 252 (D.C. Cir. 1983), *aff’d*, 758 F.2d 739 (D.C. Cir. 1985), *aff’d in part, rev’d in part*, 479 U.S. 388 (1987). Likewise, the Board would have no power over the activity if it were offered by a non-affiliated bank with no connection to the Bank Holding Company Act.

80. *See id.* at 257.

81. *See BankAmerica Corp.*, 69 FED. RESERVE BULL. 105, 107–09 (1983).

82. *See Sec. Indus. Ass’n v. Bd. of Governors*, 468 U.S. 207, 221 (1984) (affirming the decision of the Board).

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‘sophisticated techniques and resources’ to execute purchase and sell orders for the account of their customers was sufficiently widespread to justify a finding that banks generally are equipped to offer the type of retail brokerage services provided by Schwab.<sup>83</sup>

In other words, although the Court did not say that it was specifically investigating whether the service was “generally” offered, it discovered it was offered and observed that it was offered by banks with some degree of consequence and in some depth.<sup>84</sup>

One would expect that there exists a fairly broad set of activities offered by some banks, but not by banks generally, and that such activities would not constitute “banking” for purposes of the “closely related” test. A logical place to look for such activities is in the state bank system where, because banking authority is granted by the separate states, one can easily conceive of activities conducted by banks in only one or a few states. If this situation existed, however, it was most likely before 1991. In the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), Congress generally prohibited insured state banks from engaging in activities as principals that were not allowed for national banks.<sup>85</sup> The actual situation is, however, less clear. During the time the FDICIA became effective, the Conference of State Bank Supervisors published a list of various activities that, despite being prohibited to national banks, were nonetheless engaged in by state banks.<sup>86</sup> Furthermore, the FDICIA authorizes the FDIC to permit such activities if it finds that “the activity would pose no significant risk to the appropriate deposit insurance fund.”<sup>87</sup> To the extent that state banks can engage in activities prohibited to national banks, to what extent would those activities be considered “banking” under the Bank Holding Company Act?

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83. *Id.* at 211–12.

84. *Id.*

85. Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), Pub. L. No. 102-242, § 303, 105 Stat. 2236, 2349–53 (1991). One of the authors has written elsewhere that, in taking this opportunity for independent action away from state banks, Congress effectively ended the dual banking system. *See* CARL FELSENFELD, *BANKING REGULATION IN THE UNITED STATES* 32.3–.4 (2000).

86. *See State Powers: FDIC Maps Exceptions to FDICIA Restrictions on State Bank Powers*, 12 No. 3 BANKING POL’Y REP. 12, 12 (Feb. 1993) (listing various activities fitting this description).

87. FDICIA § 303(a), 12 U.S.C. § 1831(a)(1)(A) (2000).

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A prime example of such an activity might be the general insurance agency business. Other than under 12 U.S.C. Section 92,<sup>88</sup> this activity is prohibited to national banks. One might expect to find a broad scattering of authorizations to state banks before the passage of FDICIA, and even subsequent to FDICIA, because this legislation affects only those state bank activities conducted by a state bank acting as principal and not as an agent.<sup>89</sup> The issue was, however, never joined because from the start, in 1971, insurance agency activities for bank holding companies were carefully structured to relate to a credit offering by the related bank or holding company.<sup>90</sup> These provisions were generally looked to as setting the appropriate area and the standard for the bank holding companies, rather than the activities of the banking system at large.<sup>91</sup> It is difficult to identify any activity outside insurance, after 1971, that might have been offered widely by state banks but was prohibited to national banks and might, thereby, have set a test for a definition of "banking."

Another speculation about the definition of "banking" relates to core banking functions. In *Clarke v. Securities Industry Ass'n*, the Supreme Court held that to constitute a national bank branch, a "core banking function" had to be involved, and the Court further held that the brokerage business, at issue in the case, did not rise to that level.<sup>92</sup> One wonders whether it is sensible to conclude that the brokerage business can constitute the general business of banking<sup>93</sup> while at the same time holding that the location at which the business is conducted causes the bank to not be a bank branch. The *Clarke* case was, however, decided after the *SIA* case and was not concerned with whether an activity was "closely related" to banking or, for that matter, whether it was generally engaged in by banks.

In sum, it is probably fair to say that, in reality, any activity found permissible for a national bank will probably be deemed

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88. 12 U.S.C. § 92 (allowing national banks in places with a population not exceeding five thousand to act as an insurance agent or broker).

89. FDICIA § 303(a), 12 U.S.C. § 1831(a).

90. See Thomas E. Wilson, *Separation Between Banking and Commerce Under the Bank Holding Company Act—A Statutory Objective Under Attack*, 33 CATH. U. L. REV. 163, 167–68 (1983) (noting that, in order to be permissible, the Board only required insurance be sold by the bank holding company in a manner bearing a direct relationship to the extension of credit by bank or bank related holding company affiliates).

91. The system was overhauled by the Garn-St. Germain Depository Institutions Act of 1982, P.L. 97-320, 96 Stat. 1469 (1982) (codified as amended in scattered sections of 12 U.S.C.).

92. *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388, 404, 409 (1987).

93. See *Sec. Indus. Ass'n v. Bd. of Governors*, 468 U.S. 207, 211, 214–15 (1984).



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“generally” engaged in by banks because of the number of national banks subject to the same authorizing statute. The question of whether a branch is involved must simply be seen as a separate issue and not dependent upon interpretations of the Bank Holding Company Act.

The Supreme Court observed in the *SIA* case “that Congress vested the Board with considerable discretion to consider and weigh a variety of factors in determining whether an activity is ‘closely related’ to banking.”<sup>94</sup> Clearly, that discretion applies to the “closely related” aspect of the test. Whether the Board’s discretion applies to the concept of “banking” itself, and how the Supreme Court regards this issue, is less clear.

This second concept of banking has lost virtually all of its significance since the Gramm-Leach-Bliley Act of 1999. GLB authorizes two types of bank holding companies. The first is the traditional bank holding company originally authorized under the 1970 Amendments to the Bank Holding Company Act.<sup>95</sup> If the holding company continues after passage of GLB in 1999, the activities that the bank-affiliated companies may conduct are those that were deemed acceptable by the Board one day before the effective date of GLB.<sup>96</sup> While those activities were established based upon whether they were “closely related to banking,” and while, for that purpose, banking was a significant factor, they were fully determined by the time of GLB.<sup>97</sup> Thus, the meaning of “banking” for that purpose no longer has any particular impact. The reduction of restrictions upon what holding companies may do showcases a pattern for operation of the Bank Holding Company Act. We will see a constant reduction in those restrictions from the 1956 enactment date of the Bank Holding Company Act through the 1970 Amendments and GLB to the present and an indication that the restrictions will continue to lessen in the future, harbinging a new age of banking.

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94. *Id.* at 214; see also Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 80,384, 80,385 (Dec. 21, 2000) (to be codified at 12 C.F.R. pt. 225) (stating “[t]he Gramm-Leach-Bliley Act broadened . . . the authority of the Board to determine the scope of activities permissible for [holding companies]”).

95. See 12 U.S.C. § 1841(a) (2000) (defining “bank holding company”).

96. GLB § 102(a), 12 U.S.C. § 1843(c)(8) (2000).

97. However, section 103 of GLB does permit the Board to modify those determinations. § 103(a), 12 U.S.C. § 1843(c)(8) (2000).

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## III. ACTIVITIES “CLOSELY RELATED” TO AND A “PROPER INCIDENT” TO BANKING

Activities that are “closely related” to and a “proper incident” to banking is the second of the five major categories into which the Bank Holding Company Act now divides all commercial activities.<sup>98</sup> This category came into existence with the 1970 Amendments to the Act and was part of a two-fold legislative objective: (1) to include all bank holding companies under the Act (particularly the one-bank holding companies that had previously been excluded from coverage), and (2) to expand the type of activity in which affiliates of a bank inside a holding company could engage.<sup>99</sup>

As a result of GLB, this group of activities has become the least important of the five divisions. Essentially, it is frozen in place as of November 11, 1999,<sup>100</sup> for companies that do not move forward under GLB and become financial holding companies. The Board approvals granted as of that date remain in place, unchanged, “subject to such terms and conditions contained in such regulation or order, unless modified by the Board.”<sup>101</sup> This does not freeze the particular activities of a given bank holding company; it means that new activities for that company must be activities previously approved, even if not approved for that bank holding company. As already observed, one-bank holding companies were not covered by the pre-1970 Act.<sup>102</sup> As a result, they could engage in any activity permitted by their general corporate (and, of course, bank) charters despite the fact they were affiliated with banks inside a holding company.<sup>103</sup> No regulatory approval was required and their activities ranged

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98. See BHCA § 102(a), 12 U.S.C. § 1843(c)(8) (2000).

99. See S. REP. NO. 91-1084 (1970) (stating that the purpose of the amendments was to bring companies controlling one bank, as well as more than one, under control of the Act, but to allow flexibility in the range of permissible activities).

100. November 11, 1999 was one day before enactment of the GLB. 12 U.S.C. § 1843(k)(4)(G) (2000).

101. *Id.* An example of the Board modifying a previous order occurred in its action on December 21, 2000, which it expanded “from 30 to 49 percent the amount of revenues that may be derived from nonfinancial data processing,” with the data processing still considered to be “closely related to banking.” Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 80,384, 80,385 (Dec. 21, 2000) (to be codified at 12 C.F.R. pt. 225).

102. See BHCA § 2(a), 70 Stat. at 133 (1956).

103. Bernard Shull & Lawrence J. White, *The Right Corporate Structure for Expanded Bank Activities*, 115 BANKING L.J. 446, 454 (1998) (explaining how the pre-1970 Act lead banks to reorganize into one-bank holding companies so they could escape regulation).

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across the spectrum of business activities.<sup>104</sup> On the other hand, affiliates of banks in multi-bank holding companies were tightly restrained by the Act and essentially could engage only in activities permitted to their affiliated banks.<sup>105</sup> The 1970 Bank Holding Company Act Amendments sought a middle ground between these two extremes. One-bank holding companies would be covered; at the same time, all affiliates of banks would be permitted to engage in a wider range of businesses, provided they were “closely related” to banking and a “proper incident” thereto.<sup>106</sup>

This new test appeared in the famous Section 4(c)(8) and was significant enough to become a word in the banking vocabulary - *forseeate*.<sup>107</sup> The test reads as follows: “activities of which had been determined by the Board by regulation or order . . . to be so closely related to banking as to be a proper incident thereto.”<sup>108</sup>

A significant element of the test, one still a part of bank holding company law, is the clear exclusion from activities that could be performed inside a bank holding company of activities of a non-financial nature.<sup>109</sup> For example, a bank affiliate could not manufacture cars or sell hamburgers. In 1970, a separation was established between banking and “commerce” as it is commonly called.<sup>110</sup> This separation quickly became a foundation of the Act and an accepted principle of banking law. The Federal Reserve System and its charismatic Chairman at the time, Arthur Burns, successfully conveyed this ideology of separation.<sup>111</sup> Regardless of the demonstrable fact that banks had been deeply involved in “commerce,” by owning canals, supplying water, steam, gas and light, operating turnpikes and in other early enterprises,<sup>112</sup>

104. See Carter H. Golembe, *From Saxon to Ludwig: The National Bank Charter in a Changing Environment*, 17 BANKING POL'Y REPORT, Apr. 20, 1998, at 1.

105. See BHCA § 4(a), 70 Stat. at 135-37.

106. See GLB §§ 101, 103, 12 U.S.C. §§ 1841(a), 1843 (2000).

107. 1970 Amendments § 103, 12 U.S.C. § 1843(c)(8) (2000).

108. §1843(c)(8) (setting forth the famous 4(c)(8) test). The Act lists other permissible activities for bank affiliates, but by far the most significant are those passing the 4(c)(8) test.

109. §1843(c)(8); Alan E. Sorcher & Satish M. Kini, *Does the Term “Bank Broker-Dealer” Still Have Meaning*, 6 N.C. BANKING INST. 227, 242 (2002) (noting the continuing distinction between banking and commercial activities).

110. 1970 Amendments § 103.

111. See Carter H. Golembe, *Separation of Banking and Commerce: A Myth That's Ripe for Debate*, 16 NO. 2 BANKING POL'Y REP. 1, 16 (1997); Alfred C. Aman, Jr., *Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board*, 74 IOWA L. REV. 837, 867 (1989).

112. See Carl Felsenfeld, *The Bank Holding Company Act: Has it Lived its Life?*, 38 VILL. L. REV. 1, 41-42 (1993); see generally Joseph H. Sommer, *The Birth of the American*

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Congress had never seriously questioned this principle. In balancing the competing risks, whatever additional risk the prohibition of the reasonable diversification of its activities imposed on the banking system was outweighed by the danger of bank entry into commerce. Therefore, banks have been prevented from taking the most fundamental investment advice, diversifying your risk, and engage in lending money, the riskiest activity of all for banks.

The 4(c)(8) test is composed of two components, which require separate consideration. The first component is whether the activity is closely related to banking, and the second component is whether it is a proper incident to banking.<sup>113</sup> As to the first, *National Courier Ass'n v. Board of Governors* attempted to decipher the legislative intention and observed the following possibilities: "Is it an intentionally vague phrase by which Congress very largely left it up to the Board to decide what kinds and degrees of relationships are sufficiently close? Or is there some more specific connection that the Board must find exists between banking and the assertedly related activity?"<sup>114</sup> The Nat'l Courier Ass'n court refined the definition of closely related and interpreted it to mean that an activity is closely related to banking if:

1. Banks generally have in fact provided the proposed services.
2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.<sup>115</sup>

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*Business Corporation: Of Banks, Corporate Governance, and Social Responsibility*, 49 BUFF. L. REV. 1011 (2001) (discussing early American banking and commerce); Edward L. Symons, Jr., *The Business of Banking in Historical Perspective*, 51 GEO. WASH. L. REV. 676, 687-88 (1983).

113. 12 U.S.C. § 1843(c)(8).

114. *Nat'l Courier Ass'n v. Bd. of Governors*, 516 F.2d 1229, 1236 (1975). The District of Columbia Court of Appeals examined the development of the 1970 change and concluded greater flexibility for banking activities beyond the pre-1970 law was intended. *Id.* at 1236.

115. *Id.* at 1237.

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Determinations of whether a certain activity was closely related to banking did not generally present difficulties to the Fed. Indeed, one noted commentator in the banking field wrote that the Fed's analysis only entailed whether banks performed the activity, and whether the activity was "closely related," or was not part of the test.<sup>116</sup>

In the early years under the 1970 Amendments, the Federal Reserve Board acted conservatively in the administration of its new powers. Activities were approved as closely related to banking with care and circumspection. Bank holding companies planning to expand into their new powers discovered immediately that Board concerns, justified or not, had to be satisfied before a new activity was approved.<sup>117</sup> This regulatory attitude is reflective of the usual position not only of the regulators, but also of Congress in dealing with banks: restriction and prohibition. Concerns with risk have always dominated possibilities of advancement in powers. As a result, this precautionary approach was ultimately proven unnecessary and the Board, in recognizing its needless paranoia, nearly went to the other extreme.

Insurance, as a holding company affiliate activity, represents a separate legal thread from the 1970 Amendments to GLB in 1999.<sup>118</sup> Upon the 1970 changes and the introduction of "closely related to banking" and "a proper incident thereto" requirements, insurance first took its place with all other non-banking activity.<sup>119</sup> Specifically, insofar as the holding company was concerned, it had to pass the 4(c)(8) tests in order to be *allowed*. Given the interest of banks and their affiliates in offering insurance on the one hand and the entrenched position of the national independent insurance agents on the other, fierce contests ensued over the legitimacy of insurance for bank holding companies after 1970.<sup>120</sup> The Court of Appeals decision in *Alabama Ass'n of Insurance Agents v. Board of Governors* exemplifies the conflict during this time period.<sup>121</sup> The case

116. Peter Wallison, *Reader's Turn*, 2000-9 GOLEMBE REPORTS 5.

117. See generally *Sec. Indus. Ass'n v. Bd. of Governors*, 468 U.S. 207 (1984).

118. See Jonathan R. Macey, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 J. CORP. L. 691, 709-10 (2000) (discussing the distinct character of insurance).

119. Lisa L. Broome & Jerry W. Markham, *Banking and Insurance: Before and After the Gramm-Leach-Bliley Act*, 25 IOWA J. CORP. L. 723, 746 (2000).

120. *Ala. Ass'n of Ins. Agents v. Bd. of Governors*, 533 F.2d 224, 230-31 (5th Cir. 1976).

121. See *Ala. Ass'n of Ins. Agents v. Bd. of Governors*, 533 F.2d 224, 231 (5th Cir. 1976), *vacated in part* by 558 F.2d 729 (5th Cir. 1977) (claiming the case at hand represents numerous other episodes in the battle between the bank holding company

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examined Federal Reserve regulations and whether the insurance activities two bankholding companies engaged in satisfied the 1970 statutory test.<sup>122</sup> The Court held that a portion of the insurance activities were “closely related” to banking;<sup>123</sup> and that some were a “proper incident thereto.”<sup>124</sup> In hindsight, one is surprised by the Court’s antique arguments on these points and the fine distinctions it created. Given the broad “financially related” activities the GLB created in 1999, it is hard not to question the *Alabama Ass’n* decision.

In 1982, as part of the Garn-St.Germain Depository Institutions Act (“Garn-St. Germain”), Congress drastically changed the relationship between insurance and bank holding companies.<sup>125</sup> Garn-St. Germain provided: “[I]t is not closely related to banking . . . for a bank holding company to provide insurance as a principal, agent, or broker . . . .”<sup>126</sup>

Before Garn-St. Germain, bank holding companies had offered insurance both as principal and as an agent in a variety of forms.<sup>127</sup> Garn-St. Germain was a major victory for the independent agents and a defeat for the banks. However, the banks still had enough legislative influence to recover a generous piece of potentially lost ground. This influence is evidenced by the number of exceptions from Congress’ new test engrafted onto the statute.<sup>128</sup> For example, the ban did not apply to the following activities:

1. acting in connection with credit life or credit accident and health insurance;
2. acting as an agent for physical damage insurance covering collateral used to secure loans made by finance company nonbank affiliates in a bank holding company system where the amount financed is at least \$10,000

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industry and the insurance industry).

122. *Id.* at 242–44 (explaining that courier services and brokering of convenience insurance are not incidental to banking, but property damage insurance sales are an activity which is incident to banking).

123. *Id.* at 241–42, 244 (approving physical damage insurance on collateral taken for bank loans and disallowing insurance offered as a matter of convenience).

124. *Id.* at 245–246.

125. See Garn-St. Germain Depository Institutions Act of 1982 (“Garn-St. Germain”), Pub. L. No. 97-320, 96 Stat. 1469.

126. Garn-St. Germain § 601.

127. Barry A. Abbott et al., *Banks and Insurance: An Update*, 43 BUS. LAW. 1005, 1006–07 (1988).

128. Garn-St. Germain § 601.

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- (except that the ceiling is \$25,000 where manufactured or mobile homes are the collateral);
3. insurance offered in communities of 5,000 or less, or where it can be demonstrated that there are inadequate insurance facilities;
  4. certain not insubstantial grandfather rights were granted to companies already offering insurance under the Fed's existing authorizations; or
  5. insurance offerings in small (under \$50 million) bank holding companies.<sup>129</sup>

In summary, while many activities continued to be allowed, others were no longer "closely related to banking" and were, therefore, no longer permissible.

A new chapter arrived with GLB in 2000.<sup>130</sup> As described in greater detail in the next subdivision, GLB has authorized the newly formed financial services holding company to engage in both insuring as a principal and acting as an agent or broker.<sup>131</sup> This exercise particularly highlighted how politicized the insurance conflict had become. One is at a loss to explain how it can be "closely related to banking" for insurance to be written on a \$9,000 loan, but not "closely related" on an \$11,000 loan. It appears, in this area, words mean whatever Congress wants them to mean.

Perhaps the greatest problem that arose concerning the power of bank affiliates in a holding company structure relates to the underwriting of securities.<sup>132</sup> While bank holding companies were actively trying to get power to underwrite and the Board

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129. Garn-St. Germain § 601.

130. Some vestiges remained with the bank holding companies that did not become financial holding companies as they are forced to follow bank holding company law as it was "as of the day before the date of the enactment ..." GLB § 102(a), 12 U.S.C. § 1843(c)(8) (2000).

131. See GLB § 103, 12 U.S.C. § 1843(k)(4)(B).

132. In general, banks themselves could not underwrite corporate securities. National banks were prohibited under the Glass-Steagall Act, 12 U.S.C. § 378 (2000). State banks were, after 1992, prohibited due to section 24 of the Federal Deposit Insurance Corporation Act as amended by the Federal Deposit Insurance Corporation Improvement Act of 1991, which restricted state banks to act as principals only in such activities as were authorized to national banks. 12 U.S.C. § 1831(a).

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was rejecting their applications, the source of the problem was not the Bank Holding Company Act and §4(c)(8). Instead, the prohibitions contained in the Glass-Steagall Act created the problems.<sup>133</sup> The underwriting of securities was easily held to be “closely related” to banking.<sup>134</sup>

The new liberalized approach of the 1970 Amendments found its expression in the 1997 Regulatory amendments.<sup>135</sup> In many ways, the Board streamlined the process of determining whether an activity was “closely related” to banking. It summarized its objectives in the Summary to the 1996 Proposed Rules:

The Board is proposing a comprehensive amendment of Regulation Y that is intended to improve the competitiveness of bank holding companies by eliminating unnecessary regulatory burden and operating restrictions, and by streamlining the application/notice process. Among other proposed revisions, the Board proposes to establish a streamlined and expedited review process for bank and nonbanking proposals by well-run bank holding companies. The Board also proposes to reorganize and expand the regulatory list of nonbanking activities and to remove a number of restrictions on those activities that are outmoded, have been superseded by Board order or do not apply to insured banks that conduct the same activity.<sup>136</sup>

For the first time, the Board seems to have placed bank competitiveness ahead of fears for bank safety. Applications for “closely-related-to-banking” status could now be made in “an expedited and nearly red-tape free approval process” for bank holding companies that meet certain basic prudential standards, supported by only “a simple, short letter and only 15 days advance notice.”<sup>137</sup> The Board was seeking to permit approvals

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133. 12 U.S.C. § 378 (2000).

134. J.P. Morgan & Co. Inc., 73 FED. RESERVE BULL. 473, 487 (1987) (rationalizing because banks provide services similar to securities underwriting, they are “well equipped to provide such services”).

135. Bank Holding Companies and Change in Bank Control (Regulation Y), 62 Fed. Reg. 9,290 (Feb. 28, 1997), (to be codified at 12 C.F.R. pt. 225 (1997)).

136. Bank Holding Companies and Change in Bank Control (Regulation Y), 61 Fed. Reg. 47242 (proposed Sep. 6, 1996) (to be codified at 12 C.F.R. pt. 225).

137. *Id.* at 47242–43.



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“to the fullest extent permissible under the [Bank Holding Company] Act”<sup>138</sup> and to make approvals virtually automatic leaving the discovery of potential (or even real) problems not to the application process, but to the regular course of regulatory investigation and supervision.<sup>139</sup>

For bank holding companies satisfying the basic standards,<sup>140</sup> simplified application procedures were made available in 1997 and are currently available as well. Replies from the Board are normally due within twelve business days.<sup>141</sup> This entire process of expanded permissiveness and simplified procedures leads naturally into the Gramm-Leach-Bliley period, which we will comment upon in the next sub-chapter. For now, it is sufficient to observe that the more receptive Board attitude continues to dominate.

On the second factor of the test, that the activity be a “proper incident to banking,” the Act provides useful interpretation. It provides:

In connection with a notice under this subsection, the Board shall consider whether performance of the activity by a bank holding company or a subsidiary of such company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.<sup>142</sup>

Following the 1970 amendment to the Bank Holding Company Act, the District of Columbia Court of Appeals in the *National Courier Association* case established that the “closely related to banking” test and the “proper incident” test as two separate legal tests requiring separate consideration:

The parties are agreed that there are two distinct issues raised by a bank holding company’s seeking

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138. *Id.* at 47243.

139. We are not aware of any Board action modifying any permission previously given.

140. 12 C.F.R. § 225.23(b)–(c) (setting forth the guidelines for the expedited procedure).

141. 12 C.F.R. § 225.23(b).

142. 12 U.S.C. § 1843(j)(2) (2000).

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to hold shares in a company engaged in non-banking activities . . . . The first is whether those activities are “closely related to banking.” . . . The second or so-called “public benefits” issue, derived from the 1970 amendments to the Act, is one which normally must be resolved upon specific facts.<sup>143</sup>

The first issue is normally thought of as the more crucial, while the second issue is often perceived as largely passed over because of a belief that anything new or additional almost necessarily confers public benefits as a new development. However, the public benefits test has had a scattered and occasionally significant presence in Federal Reserve decisions. One commentator wrote:

[T]he public benefits test gave the Board enormous power to define the scope of permissible bank holding company activities. The Board wielded this power liberally, imposing any number of conditions and restrictions designed to conform bank holding company activities to the Board’s notion of what was appropriate. The test enabled the Board to address every conceivable regulatory concern from customer confusion to the commingling of banking and commerce to tying and other antitrust issues.<sup>144</sup>

Whether the “proper incidents” test was this strong a factor between the 1970 amendments that brought it into existence and the 1999 amendments that largely eliminated it<sup>145</sup> is subject to dispute. Undoubtedly, it was a strong weapon in the Board’s hands. It was, however, rarely used to deny an acquisition. There was continuing discussion in Board decisions<sup>146</sup> dealing with the requirement in the years following 1970. Over the last

143. Nat’l Courier Ass’n v. Bd. of Governors 516 F.2d 1229, 1232–33.

144. Pauline B. Heller & Melanie L. Fein, *FEDERAL BANK HOLDING COMPANY LAW* § 4.04[2] (2002).

145. 12 U.S.C. § 1843(j) (showing the few remaining portions of the proper incident consideration that the GLB tests failed to eliminate).

146. See *BTNB Corp.*, 58 FED. RESERVE BULL. 70, 71 (1972); see also *U.S. Bancorp.*, 58 FED. RESERVE BULL. 177, 178 (1972); *First Tulsa Bancorporation, Inc.*, 58 FED. RESERVE BULL. 317, 318 (1972). See *Nortrust Corp.*, 58 FED. RESERVE BULL. 67, 68 (1972); see also *First Bank Sys., Inc.*, 58 FED. RESERVE BULL. 172, 174 (1972); see also *First Chicago Corp.*, 58 FED. RESERVE BULL. 175, 176 (1972).

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decade, with little variation,<sup>147</sup> it was mentioned only to indicate that its tests were satisfied. This was a result of numerous causes, including infusions of new capital that could be relied upon to bring public benefits,<sup>148</sup> the acquisition of new systems,<sup>149</sup> new cash investments resulting in consumer benefits,<sup>150</sup> convenience and needs factors meetings,<sup>151</sup> and improvements in customer service.<sup>152</sup>

Bank holding companies had long wanted to acquire thrift institutions, including S&Ls. These types of institutions were set out in the Bank Holding Company Act as an exception to the definition of banks,<sup>153</sup> thus they had to be acquired under the provisions of Section 4(c)(8). This means that for a bank holding company to acquire a thrift institution, the Board had to find them as both “closely related” to banking and a “proper incident” to banking. The first test did not pose a particular problem in order to be satisfied. S&Ls had such similar characteristics to banks as to be virtually indistinguishable. Among other functions, both took deposits and made loans. However, under the second test, the Board found no public benefit in bank holding companies absorbing them. In becoming closely associated with commercial banks, S&Ls would be removed from the special market niche in which the law had positioned them and the public might lose that benefit. The Board therefore denied their approval under the public benefits test,<sup>154</sup> at least until a public benefit presented itself in 1982 with the great S&L financial crisis. The public benefit was that a bank holding company, in acquiring a floundering S&L, could save the S&L from dissolution.<sup>155</sup> In the GLB revisions of 1999, the “proper incident” test was discarded entirely.<sup>156</sup> For twenty-nine years, the combination of “closely-related-to-banking” and “proper-incident-to-banking” test was the basic door to allowing a company in a bank holding company system to engage in an activity other than banking itself. The prior combination of tests

147. Metro Armored Courier, Inc., 79 FED. RESERVE BULL. 352, 354–55 (1993) (demonstrating a situation in which an armored car service was seen to undermine a company’s financial condition with little attendant benefit).

148. Banc One Corp., 81 FED. RESERVE BULL. 492, 498 (1995).

149. Norwest Corp., 82 FED. RESERVE BULL. 683, 684 (1996).

150. Money Stations, Inc. v. Bd. of Governors, 81 F.3d 1128, 1134–35 (D.C. Cir. 1996), *vacated by* 94 F.3d 658 (D.C. Cir. 1996) (quoting the Board’s statement).

151. Chem. Banking Corp., 82 FED. RESERVE BULL. 239, 257 (1996) (reviewing the convenience and needs factors under the banking statutes).

152. Travelers Group, Inc., 84 FED. RESERVE BULL. 985, 1008 (1998).

153. 12 U.S.C. § 1841(c)(2)(B) (2000).

154. *See, e.g.*, D.H. Baldwin Co., 63 FED. RESERVE BULL. 280, 283 (1977).

155. *See* Interstate Financial Corp., 68 FED. RESERVE BULL. 316, 316–318 (1982).

156. 12 U.S.C. § 1843(k)(3) (2000).

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was replaced in GLB by a new and broader test applicable to bank holding companies that achieved “financial holding company” status.<sup>157</sup> However, for those that did not attain that status, whether by choice or necessity, the 4(c) (8) determinations as they existed “as of the day before [the date of the enactment of GLB]” would continue in effect.<sup>158</sup> Thus, while the concepts of banking, of “closely related” to banking, and of a “proper incident” to banking all remained of some significance as divisions under the Bank Holding Company Act, they no longer held the crucial places they had previously occupied. The basic test for a bank holding company activity under the GLB Act, financially related, was clearly broader and subject to less technicalities. As discussed *infra*, the new test reflected a continued reduction in anxiety on behalf of the Board and an advancement by banks and their affiliates into the new world of banking.

## IV. ACTIVITIES “FINANCIAL IN NATURE”

The term “financial in nature,” a new segment of assets the GLB crafted in 1999, had been used before the enactment of GLB by the U.S. regulatory agencies as well as by courts to define various financial products and services.<sup>159</sup> One example is in the delineation of activities that bank holding company non-bank affiliates could engage in before the 1970 Amendments. Activities were allowed if they were “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 . . . .”<sup>160</sup> The test was broadened in 1970 to include “activities of which had been determined by the Board . . . to be so closely related to banking . . . .”<sup>161</sup> In *Alabama Ass’n of Insurance Agents v. the Board of Governors of the Federal Reserve*, the court construed the elimination of the “financial” requirement as indicative of “a modest broadening of the Board’s discretion.”<sup>162</sup>

157. GLB § 103(a), 12 U.S.C. § 1843(k) (2000).

158. GLB § 102(a), 12 U.S.C. § 1843(c)(8) (2000) (showing that the rigidity of this test was modified in GLB with the addition of the words “unless modified by the Board”).

159. See *Washington Post Co. v. U.S. Dep’t of Health and Human Serv.*, 865 F.2d 320, 324 (D.C. Cir. 1989).

160. BHCA § 4(c)(6), 70 Stat. 133, 137 (showing original Bank Holding Co. Act language prior to amendment by Pub. L. No. 91-607 (1970)).

161. 12 U.S.C. § 1843(c)(8). See also Act of July 1, 1966, Pub. L. No. 89-485, 80 Stat. 236, 238 (setting forth BHCA prior to the broadening of the test applied to interests in non-banking organizations).

162. *Alabama Ass’n of Ins. Agents v. Bd. of Governors*, 533 F.2d 224, 238 (5th Cir. 1976).

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Prior to the GLB, the wording “financial in nature,” as defining the Board’s discretion with respect to holding company activities, never had a unique or clear meaning. Since the *Alabama Ass’n of Insurance Agents* case, changes have occurred in the banking industry. The enactment of GLB, in particular, was an attempt to define not only the concept of “financial in nature” activities, but to establish the legal structure for the creation of the “new” form of BHC, the financial holding companies (“FHC”). In addition, GLB established a new regulatory power to be shared between the Board and the Treasury through the Office of the Comptroller of the Currency (“OCC”).<sup>163</sup>

Under GLB,<sup>164</sup> a BHC may elect to become a FHC and thereby engage, directly or through a nonbank subsidiary, in any activity that is “financial in nature.”<sup>165</sup> Unless it elects to become an FHC, a BHC is limited to activities the Act and other relevant banking acts already permit.<sup>166</sup> GLB specified the major banking activities that are “financial in nature.”<sup>167</sup> Subject to the concurrence of the Department of the Treasury (as a practical matter, the Office of the Comptroller of the Currency within the Treasury), the Board is permitted to authorize by regulation or order activities other than the ones already so defined that it deems to be “financial in nature.”<sup>168</sup>

GLB requires that in order to become a FHC, the electing BHC must certify that its depository institution subsidiaries are “well-capitalized” and “well-managed,” and that they have at

163. See Michael P. Malloy, *Banking in the Twenty-First Century*, 25 J. CORP. L. 787, 820 (2000).

164. Signed into law by President Clinton on November 12, 1999, GLB represents the culmination of Congressional financial reform efforts spanning more than twenty years. Charles M. Horn & Brian W. Smith, *Financial Modernization in the New Millennium: Implementation of the Gramm-Leach-Bliley Act*, 116 BANKING L.J. 689, 689 (1999). GLB made sweeping changes to federal statutes governing the scope of permissible activities and the supervision of banks, bank holding companies, and their affiliates. In particular, GLB substantially lowers, but does not eliminate, the barriers the Banking Act of 1933 erected between the banking and securities industries and the 1982 Garn-St. Germain Depository Institutions Act erected between the banking and the insurance industries. Adam Nguyen & Matt Watkins, *Recent Legislation: Financial Services Reform*, 37 HARV. J. ON LEGIS. 579, 579 (2000). GLB transformed federal banking legislation dating back to the Great Depression. Gary Silverman, *Level Playing Field Still Elusive: US Regulation*, FIN. TIMES, Feb. 22, 2002, at 4.

165. See Michael P. Malloy, *International Financial Services: An Agenda for the Twenty-First Century*, 15 TRANSNAT’L LAW. 55, 57 (2002).

166. See Sarah A. Miller, *Financial Modernization: The Gramm-Leach-Bliley Act Summary*, 1 A.L.I.-A.B.A. CONTINUING EDUC. 53, 63 (2000).

167. GLB § 103(a), 12 U.S.C. § 1843(k)(4).

168. GLB § 103, 12 U.S.C. § 1843(k)(2).

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least a “satisfactory” Community Reinvestment Act (“CRA”) rating.<sup>169</sup> The Board has promulgated regulations defining the concepts of “well-capitalized” and “well-managed.” “Well-capitalized” is defined in terms of the Federal Deposit Insurance Corporation concept of appropriate capital.<sup>170</sup> Essentially, this concept means that the bank must have a Tier One capital of at least six percent, and a total capital of at least ten percent of its risk adjusted assets under the Basel formula, and also meet the leverage test of three percent Tier One capital to total assets.<sup>171</sup> The Board’s definition of “well-managed”<sup>172</sup> requires the bank have had at least “satisfactory” composite rating at its most recent examination from the Board.<sup>173</sup> FHC election becomes effective on the 31st day after the company files a notice with the Board, but the Board can accelerate it.<sup>174</sup>

If an FHC falls out of compliance with the “well-capitalized” or “well-managed” requirements, it will have a six-month period to cure the violation.<sup>175</sup> Otherwise, it will be forced to divest either its bank subsidiaries or its new financial activities.<sup>176</sup> Also, if a subsidiary bank falls out of compliance with the CRA requirement, the FHC will be barred from making any acquisitions or commencing new activities.<sup>177</sup>

The scope of activities permitted to FHCs as “financial in nature” is meant to be broader<sup>178</sup> than the scope of activities

169. GLB § 103(a), 112 U.S.C. § 1843(k)(4).

170. 12 C.F.R. § 225.2(r) (2001).

171. See Stacie E. McGinn, *After the Gramm-Leach-Bliley Act-A Road Map for Insurance Companies, Impact of the Gramm-Leach-Bliley Act on the Insurance Industry* at 113, 121 (PLI Corp. Law & Practice Course, Handbook Series No. 130-00QU, 2000).

172. 12 C.F.R. § 225.2(s).

173. See William J. Sweet, Jr., *After the Gramm-Leach-Bliley Act-A Road Map for Banks, Securities Firms and Investment Managers: Interim Rules, Final OCC Rules and Proposed Rules Under the Gramm-Leach-Bliley Act, After the Gramm-Leach-Bliley Act-A Road Map for Insurance Companies* at 219, 357 (PLI Corp. Law & Practice Course, Handbook Series No. 130-00QT, 2000).

174. See Horn & Smith, *supra* note 164, at 692.

175. 12 U.S.C. § 24a(e)(4) (2000).

176. *Id.*

177. David L. Glass, *The Gramm-Leach-Bliley Act: Overview of the Key Provisions; Presentation Before the State of New York Banking Department*, 17 N.Y.L. SCH. J. HUM. RTS. 1, 8 (2000).

178. According to Laurence H. Meyer, member of the Board of Governors of the Federal Reserve System, “[o]ne thing that is clear is that Congress intended the ‘financial in nature’ test to be broader than the previous test for authorizing new activities for bank holding companies under the Bank Holding Company Act.” Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System, Statement Before H.R. Subcomm. on Fin. Instit. and Consumer Credit, Comm. on Fin. Serv., (May 2, 2001), in 87 FED. RESERVE BULL. 445 (2001); see also *Testimony of Federal Reserve Officers*, 87 FED. RESERVE BULL. 445, 445 (2001) (testimony of Laurence H. Meyer, Member, Board of Governors, Federal Reserve System, before the House Committee on Financial Services,

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permitted to BHCs under the pre-1999 BHC ("so closely related to banking . . . as to be a proper incident thereto"). However, activities that are interpreted as "financial in nature" seem to be virtually identical with those previously defined as "closely related to banking." The new test must, however, be regarded in terms of its potential as well as its actual degree of expansion. Although the "financial in nature" test may now represent only a slight expansion beyond "closely related to banking," such expansion could potentially introduce a whole new age of activities particularly in newly-developing areas like internet banking that are likely to play a major role in the banking industry's near future.<sup>179</sup> This potential for growth may give GLB its most significant effect upon the banking industry. Where GLB has expanded BHC activities, it was not the result of the "new" financial activity test, but rather by adding the following activities to the BHC permissible list. These activities, although largely "closely related" to banking under the pre-GLB test, had been prohibited to BHCs until GLB permitted them through the operation of specific statutes.

One activity GLB added was securities activities, particularly underwriting and dealing in securities. GLB repealed sections 20 and 32 of the Glass-Steagall Act,<sup>180</sup> which prohibited BHCs from conducting such and also specifically noted those activities to be "financial in nature." A second activity GLB focused on was insurance activities, as principal or agent, when the insurance indemnifies against loss, harm, damage, illness, disability or death.<sup>181</sup> GLB,<sup>182</sup> by amending the Act section 4(c)(8),

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May 2, 2001) (outlining the GLB framework and discussing "the joint proposal by the Board and the Secretary of Treasury relating to real estate brokerage and management").

179. Globalization of economy is bringing the need for banks to harmonize and expend their banking activity powers. Joseph J. Norton, *A "New International Financial Architecture?" - Reflections on the Possible Law-Based Dimension*, 33 INT'L LAW. 891, 898 (1999) (recounting the drastic change the last decade has witnessed in traditional banks). On the one hand, the U.S. banking system has traditionally maintained a conservative view in terms of expansion of banking activity powers. Heidi Mandanis Schooner, *Popular Images of Bankers Reflected in Regulation*, 5 GREEN BAG 2D 27, 31 (2001). On the other hand, considering the globalization of the economy and the increase of a worldwide competitive market in the banking and finance sectors, U.S. banking has been overcoming such challenges by gradually opening and relaxing the bank activity powers, which will make banks more efficient and productive. See generally Jerry W. Markham, *Banking Regulation: Its History and Future*, 4 N.C. BANKING INST. 221, 253 (2000).

180. The Glass-Steagall Act specified banks may not be affiliated with any company "engaged principally" in underwriting securities. Glass-Steagall Act, 12 U.S.C. § 377 (2000). Prohibition against directs and management personnel between a bank and a company "primarily engaged" in underwriting securities. 12 U.S.C. § 78 (2000).

181. GLB § 306, 15 U.S.C. § 6715 (2000) (preempting state laws forbidding or restricting affiliation of an insurer with a depository institution).

182. GLB § 102(a), 12 U.S.C. § 1843(c)(8).

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provides that insurance activity is “closely related to banking.”<sup>183</sup> GLB also made merchant banking a financially related activity. Merchant banking is described in part as ownership of any company “as a part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale.”<sup>184</sup> Because merchant banking is such an important part of many securities firms’ business, a securities firm would be deterred from affiliating with a bank if the firm were required to divest its merchant banking activity.<sup>185</sup>

GLB also explicitly included within the term “financial in nature” what the Board had previously deemed “to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.”<sup>186</sup> It simultaneously listed a series of such activities including lending and investing for others, providing financial investment or economic advisory services, and financial data processing services.<sup>187</sup> Financial activities also include those previously prescribed by the Board as permitted in connection with banking overseas.<sup>188</sup> These activities would include those “that the Board determines are usual in connection with the transaction of the business of banking in the places where the . . . bank’s branches transact business.”<sup>189</sup> Most banks would not divest their traditional banking capabilities to affiliate with a securities firm. GLB aimed to establish a “two-way street” . . . designed to enable securities firms and banks to affiliate freely with each other and to ensure that securities firms, once they become partners with banks, are not artificially restricted in their activities.<sup>190</sup>

The BHC Act has permitted BHCs to hold no more than five percent of the stock of any non-financial activity.<sup>191</sup> The new so-called “merchant banking” activities<sup>192</sup> permits FHCs to acquire full ownership in any type of non-financial entity so long as the acquisition is essentially for “the purpose of appreciation and

183. See Bank Holding Companies and Change in Bank Control, 65 FED. REG. 14,433, 14,435 (March 17, 2000) (to be codified at 12 C.F.R. pt. 225).

184. GLB § 103, 12 U.S.C. § 1843(k)(4)(H).

185. *Capital Markets in the New Economy Before the House Comm. on Capital Markets, Sec., and Gov’t Sponsored Enterprises*, 106th Cong. (2000) (statement of Marc E. Lackritz, President, Securities Industries Association), [http://www.sia.com/testimony/html/marc\\_testimony\\_6-7.html](http://www.sia.com/testimony/html/marc_testimony_6-7.html).

186. GLB § 103(a), 12 U.S.C. § 1843(k)(4)(F).

187. GLB § 103(a), 12 U.S.C. § 1843(k)(4).

188. *Id.*

189. 12 C.F.R. § 211.4(b) (2002).

190. Testimony of Mark E. Lackritz, *supra* note 185.

191. 12 U.S.C. § 1843(c)(6)–(7) (2000).

192. GLB § 103, 12 U.S.C. § 1843(k)(7).



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ultimate resale or disposition of the investment.”<sup>193</sup> This underlying purpose ensures the activity is truly “financial in nature” and not primarily to enter into the particular business being acquired. Thus, while the merchant banking activity appears to represent a major exception to the policy of the BHC Act, to separate banking and commerce it is at least a financial, not a commercial, activity. The Board has stated in one published report that the merchant banking authority “contains provisions that are designed to help maintain the separation between banking and commerce . . . .”<sup>194</sup> These provisions include limits on the amount of time that a merchant banking investment may be held and the circumstances under which the FHC may routinely manage or operate an acquired, called a “portfolio,” company.<sup>195</sup>

GLB authorizes the Board and the Secretary of the Treasury to issue such joint regulations implementing the merchant banking authority as the two agencies “jointly deem appropriate to assure compliance with the purposes and prevent evasions of [the BHC Act] and the Gramm-Leach-Bliley Act and to protect depository institutions.”<sup>196</sup> The statute provides that such regulations may impose limitations on transactions between depository institutions and companies controlled pursuant to the merchant banking power.<sup>197</sup>

In response to the statutory authority, the Board and the Secretary of the Treasury jointly issued and adopted interim regulations to implement the merchant banking authority.<sup>198</sup> The regulations imposed are policies and systems to monitor and assess risks associated with merchant banking investments, to assure the corporate separateness of FHCs and each portfolio company, and to limit the potential to which the FHC or its affiliated depository institution may be legally liable for the financial obligations or operations of those companies. In addition, such rules established aggregate investment limits to reduce the potential level of risk to a depository institution affiliated with an FHC.<sup>199</sup>

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193. 12 U.S.C. § 1843(k)(4)(H).

194. Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 16,460, 16,460 (2000) (codified at 12 C.F.R. Parts 225, 1500).

195. *Id.*

196. GLB § 103, 12 U.S.C. § 1843(k)(7)(A).

197. *Id.*

198. Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. at 16,460.

199. See Vincent Di Lorenzo, *Gramm-Leach-Bliley Act Challenges Financial Regulators To Assure Safe Transition In Banking Industry*, 72 OCT N.Y. St. B.J. 36, 38

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Prior to the enactment of GLB, securities and insurance underwriting were considered to be activities “closely related to banking” but were prohibited or limited in holding companies because of the Glass-Steagall Act’s treatment of securities activities and the Garn-St. Germain Act’s treatment of the insurance business.<sup>200</sup> As far as merchant banking went, banks could enter into indirect investments in equities through private investment groups, occasionally acting as manager of the group at collecting performance-based fees.<sup>201</sup> Under the BHC Act, banks also had authority to directly invest in equities through three vehicles: Small Business Investment Companies (“SBICs”), Edge Act corporations, and non-banking subsidiaries.<sup>202</sup> Banks and BHCs had been authorized to operate SBICs that can invest in up to half of the equity of an individual small business.<sup>203</sup> Edge corporations, which are mostly subsidiaries of banks, as well as, subsidiaries of holding companies, could acquire up to twenty percent of the voting equity and forty percent of the total equity of non-financial companies outside the United States.<sup>204</sup> Finally, a BHC could benefit from a presumption that it was not in control of a company if it had the power to vote less than five percent of any class of voting securities; it conclusively did have control, however, if it had power to vote twenty-five percent or more of any voting class.<sup>205</sup> In a modification of its former positions, the Board ruled that a BHC could acquire up to twenty-five percent of the voting stock of a company if the BHC could prove that it did not have control of the company and another stockholder owns more shares than the BHC.<sup>206</sup>

As a result of these expanded activities granted to FHCs, the GLB effectively permits affiliation between BHCs, insurance companies and securities firms under the umbrella of an FHC. However, GLB, except in the case of merchant banking investments, continues to prohibit affiliations between depository institutions and companies engaged in activities that are not

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(2000).

200. See Clyde Mitchell, *Financial Modernization – One Year Later!*, N.Y. L.J., Jan. 19, 2001, at 3.

201. See Alan Greenspan, Remarks at the 36th Annual Conference on Bank Structure and Competition of the Federal Reserve Bank of Chicago (May 4, 2000), available at <http://www.federalreserve.gov/boarddocs/speeches/2000/20000504.htm>.

202. *Id.* (defining these three terms).

203. *Id.* (currently, a small business is defined as an entity with less than USD 20 million of pre-investment capital).

204. *Id.*

205. BHCA § 101, 12 U.S.C. § 1841(a)(2)(A), (a)(3) (2000).

206. Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 80384, 80,387 (Dec. 21, 2000) (codified at 12 C.F.R. pt. 225).

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“financial in nature.”<sup>207</sup> In particular, GLB permits an FHC to engage in non-financial activities only if the FHC was not a BHC prior to November 12, 1999, but became an FHC by acquiring a depository institution after that date, and the FHC is only permitted to retain commercial activities subject to certain revenue limits, cross-marketing limits, and grand-fathering restrictions set forth in GLB.<sup>208</sup> As a result, if a BHC or an FHC that was formerly a BHC is contemplating a merger with a securities or insurance company engaged in part in “non-financial” activities,<sup>209</sup> these “non-financial” activities may be retained only if the insurance and/or securities firm will not be dissolved, pursuant to the BHC or FHC post-merger organization.

BHCs that do not elect FHC status will continue to be regulated by the Board as such, and their permissible activities will continue be limited to those that are “closely related to banking” and “incidental to banking” as prescribed by the BHC Act, the Board orders and regulations in effect as of the date of enactment of GLB.<sup>210</sup> The permissible legal scope of non-electing BHC activities was essentially frozen on November 11, 1999.<sup>211</sup> While most of the “incidental to banking” test<sup>212</sup> has been replaced by the new test of “financial in nature” activities under GLB, some has been retained and applied under the BHCA as modified by GLB. In this respect, section 4(j)(2)(A) of the BHC Act refers to “a notice under this subsection” for BHC-s to obtain the Board’s approval to engage in nonbanking activities.<sup>213</sup> The criteria the Board is directed to apply in considering these notices includes consideration of whether performance of the new activity “can . . . be expected to produce benefits to the public . . . that outweigh possible adverse effects . . . .”<sup>214</sup> This is the previous incidental benefits test. There are three types of notices a BHC may give to the Board under this subsection. Notices are based on the BHC’s request to carry out the following nonbanking activities:

- (i) activities “closely related to banking;”<sup>215</sup>

207. GLB § 103, 12 U.S.C. § 1843 (k)(1)(A) (2000); *see discussion infra* Part VI.

208. GLB § 103, 12 U.S.C. § 1843(n).

209. *See discussion infra* Part VI.

210. *See* GLB § 102, 12 U.S.C. § 1843(c)(8); *see also* Di Lorenzo, *supra* note 199, at 37 (stating that the creation of a FHC is optional).

211. *See* 12 USC § 1843(c)(8).

212. *Id.*

213. BHCA § 4(j)(2)(A), 12 U.S.C. § 1843(j)(2)(A) (2000).

214. *Id.*

215. *See* Garn-St. Germain, 12 U.S.C. § 226 (2000).

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(ii) activities other than “those of banking” and “closely related to banking;”<sup>216</sup> and/or

(iii) activities complementary to “financial in nature” activities.<sup>217</sup>

As discussed in Section III of this article, activities “closely related to banking” were reduced, but not eliminated, after the enactment of the GLB.<sup>218</sup> Most notably, a BHC may look for authority to engage in such an activity, which had been approved before November 11, 1999, but had not been approved for that particular company.<sup>219</sup> In addition, S&L activities have been retained under section 4(c)(8) of the BHC Act, and the Board may exercise the power to approve or reject such activity.<sup>220</sup> The test applied for the second type of nonbanking activity, other than “those of banking” and “closely related to banking,” is an old reference to section 4(a)(2) of the BHC Act, and has no real application today.<sup>221</sup> However, the matter still remains

216. 12 U.S.C. § 1843(a)(2), (c)(8). Section 1843(a)(2) provides:

Except as otherwise provided in this chapter, no bank holding company shall— (2) *after two years from the date as of which it becomes a bank holding company, . . . 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 . . . , and (B) those permitted under [section 1843(c)(8)] . . . . The Board is authorized . . . to extend the two year period . . . for not more than one year at a time . . . but no such extensions shall in the aggregate exceed three years.

*Id.* (emphasis added); *see also* Indep. Cmty. Bankers of Am. v. Bd. of Governors, 195 F.3d 28, 30–31 (D.C. Cir. 1999) (quoting section 4 of the Bank Holding Act).

217. 12 U.S.C. § 1843(k)(1)(B).

218. *See* discussion *infra* Part III.

219. GLB § 102(a), 12 U.S.C. § 1843(c)(8).

220. Press Release, Federal Reserve System, Order Approving the Formation of a Bank Holding Company (July 2, 2001), *available at* <http://www.federalreserve.gov/boarddocs/press/bhc/2001/200107022/default.htm>.

221. In *Independent Community Bankers of America v. Board of Governors of the Federal Reserve System*, the court stated:

Travelers, the acquiring entity, was engaged in various activities, mainly insurance, not allowed for bank holding companies under exceptions (A) and (B). Accordingly, the emerging bank holding company could not lawfully “retain” stock in any subsidiary conducting that business for more than two years after the transaction by which it became a bank holding company. The Board thus made its approval of the Travelers-Citicorp transaction contingent on a commitment that Citigroup would conform to the two-year divestiture requirement.

195 F.3d 28, 31 (D.C. Cir. 1999).

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unresolved because neither the Board nor the courts have confronted this issue.

The need for a financial holding company to secure prior approval from the Board before becoming involved in new nonbanking activities is less stringent under the GLB.<sup>222</sup> The BHC Act and the Board's Regulation Y contain an obligatory notice to the Board of at least 12 business days before a BHC can become involved in new activities, but only if the BHC is eligible for this shortcut and the Board order or regulation permits the proposed activity.<sup>223</sup> If a BHC is not eligible for the expedited processing or the activities are not permissible, the notice period is longer.<sup>224</sup>

GLB's relaxation is apparent with the 30 day "after-the-fact" notice requirement for any intended activity that is "financial in nature," determined from the list in the Act or approval by a Board regulation or order.<sup>225</sup> According to the General Counsel of Bank of America Corporation, "[t]hus, with respect to bank holding companies that elect 'financial holding company' status, not only has the scope of permissible nonbanking activities been expanded, but the Board's prior approval requirement for listed or approved activities has been eliminated as well."<sup>226</sup> A financial holding company still has to apply to the Board if the nonbanking activities are not listed and do not have the prior approval of the Board.<sup>227</sup>

GLB preserves a bank's existing authority to own an operating subsidiary whether inside or completely outside the BHC.<sup>228</sup> The operating subsidiary is restricted, with limited exceptions, to activities permitted to the parent bank.<sup>229</sup> In addition, GLB permits the bank to own a financial subsidiary—a subsidiary that engages in activities beyond those permitted to the bank.<sup>230</sup> Financial subsidiaries, if they become FHBs, may engage in the broader range of activities that are "financial in nature."<sup>231</sup> Unlike financial subsidiaries, operating subsidiaries

222. Paul J. Polking & Scott A. Cammarn, *Overview of the Gramm-Leach-Bliley Act*, 4 N.C. BANKING INST. 1, 7 (2000).

223. See 12 U.S.C. §§1843(c)(8)–(j)(5)(B)(i); 12 C.F.R. § 225.23 (2002); see also Polking & Cammarn, *supra* note 222.

224. See §§1843(c)(8), (j)(1)(A), (3), (4)(C); 12 C.F.R. §§ 225.23–24 (2002); see also Polking & Cammarn, *supra* note 222.

225. GLB § 103, 12 U.S.C. § 1843(k); see also Polking & Cammarn, *supra* note 222.

226. Polking & Cammarn, *supra* note 222, at 7.

227. *Id.* at 7–8.

228. GLB §121, 12 U.S.C. § 24a (2000).

229. *Id.*; see also Polking & Cammarn, *supra* note 222, at 10.

230. GLB §121, 12 U.S.C. § 24a.

231. Under the Act, national banks cannot own a Part 5 subsidiary unless it is a

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of banks which engage in activities that are part of the business of banking are not subject to the operational conditions imposed in the GLB.<sup>232</sup> The GLB allows an FHC to engage in any activity deemed to be “financial in nature.”<sup>233</sup> National banks could elect financial subsidiary status for their operating subsidiaries, if they could meet requirements analogous to those for an FHC.<sup>234</sup> If an activity:<sup>235</sup> (i) is permissible for the bank itself, (ii) listed as ‘financial in nature’ under GLB, (iii) has been determined by the OCC to be ‘*financial in nature*’ (and the Board has not disagreed), or (iv) is ‘*incidental*’ to a financial activity, a financial subsidiary of a bank may engage in it.<sup>236</sup> However, specifically prohibited for bank subsidiaries is the power to engage in underwriting of insurance or providing or issuing annuities, real estate investment or development, and merchant banking.<sup>237</sup> With reference to merchant banking activities, the Board and the OCC may review and remove this prohibition after five years.<sup>238</sup> Through GLB deliberations, the Board has advocated for the limitation of the bank subsidiaries’ power.<sup>239</sup> On the other hand, the OCC has argued for an expansion of the bank subsidiaries’ power, allowing them to carry out any financial activities, including merchant banking activities.<sup>240</sup> Under GLB, the scope of bank subsidiary activities is less than the scope of BHC activities. This is presently a temporary victory for the Board over the OCC.

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“financial subsidiary,” thus prevailing over the OCC’s Part 5 regulations. Polking & Cammarn, *supra* note 222, at 10 n.34.

232. 12 U.S.C. § 371c(e) (2000).

233. GLB § 121, 12 U.S.C. § 1843(k)(1).

234. Polking & Cammarn, *supra* note 222, at 10–11.

235. The Act does not, however, confer similar interpretive authority on the Treasury with respect to national bank financial subsidiaries. . . . Thus, the Board has somewhat greater latitude to expand holding company activities than does the Treasury with respect to national bank financial subsidiary activities. Nonetheless, the OCC still has broad discretion under the National Bank Act to determine that an activity is ‘the business of banking’ or ‘incidental’ thereto, and therefore permissible for a national bank or its operating subsidiary.

*Id.*, at 11 n.37.

236. *Id.* “Curiously, the Act permits a financial holding company to engage in activities that are deemed by the Federal Reserve Board to be ‘complimentary’ to financial-in-nature activities.” *Id.*

237. GLB § 121 (d)(1), 12 U.S.C. § 24(a)(2000). Insurance products authorized prior to January 1, 1999 are grandfathered for national banks and their subsidiaries. GLB § 302, 15 U.S.C. § 6712 (2000).

238. See GLB § 122, 12 U.S.C. § 1843 (2000).

239. *Op-Sub Debate Heats Up as Regulators Consider Merits of H.R. 10*, BANKING POL’Y REP., June 15, 1998, at 5.

240. *Id.*

GLB confers on holding companies some degree of flexibility in structuring these new activities by allowing most “financial in nature” activities to be conducted either in the holding company or in a bank’s financial subsidiary.<sup>241</sup> At the same time, GLB’s functional regulation provisions provide for a common supervisory scheme for these new activities.<sup>242</sup> The long range impact of GLB, however, will become evident only after the bank regulatory agencies refine the scope of permissible activities under the “financial in nature” test, and after these agencies, along with the SEC and state insurance regulators, adopt regulations implementing GLB and imposing conditions, procedures, and examination practices for the newly unified financial services industry.

As stated before, the major contribution of GLB was allowing bank affiliates to offer insurance and to underwrite securities.<sup>243</sup> Since those businesses had previously been found to be “closely related” to banking and were prohibited by special legislation, this change was not accomplished through the introduction of the financial holding company and its ability to offer activities of a financial nature, but rather through repeal of the specific prohibitory provisions. Would not those repeals have been enough without the immense and complex sections of GLB? Of course, GLB does other things and perhaps it was useful for them to be regulated through a unique act. However, how much did the “financial in nature” test add to the “closely related to banking” test? In *Alabama Ass’n of Insurance Agents v. Board of Governors of Federal Reserve System*, the court discussed how the “closely related to banking” test accords with the general national sentiment that financial institutions should not be large.<sup>244</sup>

The new “financial in nature” test essentially eliminates that consideration from future judicial review. As a result, such a test allows for the introduction of functions that are far from “closely related to banking” and gives banking regulators new flexibility to expand banking powers well beyond underwriting securities, insurance activities and perhaps much more that limits the current banking industry. Congress’ intentions in drafting GLB was to make “financial in nature” an easier test to meet than

241. See GLB § 121, 12 U.S.C. § 24a(a)(2)(A)–(b).

242. See *id.* at § 24a(a)(2)(A)–(B), 24a(b)(2000).

243. See Laurence H. Meyer, *Implementing the Banking Reform Bill Poses New Challenges*, 19 BANKING POL’Y REP. at 4, Jan. 18, 2000.

244. See *Ala. Ass’n of Ins. Agents v. Bd. of Governors*, 533 F.2d 224, 231 (5th Cir. 1976), *vacated in part*, 558 F.2d 729 (5th Cir. 1977).

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“closely related to banking.”<sup>245</sup> Unlike the “closely related to banking” test, the “financial in nature” test simply does not have to be tied to bank powers at all.<sup>246</sup>

The new test introduces the banking industry to the electronic age, enabling the Board to take into account changes in the marketplace and technology that broadly affect the market for financial products and services,<sup>247</sup> as well as banking activities approved for U.S. banks to be carried out overseas. This test should allow the FHC’s of the future to engage in a wider variety of activities than are presently allowed.<sup>248</sup> This, of course, will be achieved only if the Board takes a non-restrictive approach to defining permissible activities, while avoiding prescriptions that are too narrow.<sup>249</sup> Although the basic features of banks are simple, there is rarely anything simplistic about the Board and its regulatory regime, which has struggled with and resisted taking this approach to banking.<sup>250</sup> The Board has more often taken a “wait-and-see” approach, which is likely to lead to the Board’s imposition of unnecessary restrictions towards commercial banks, bank subsidiaries and bank holding companies while important banking issues are neglected entirely. Perhaps the fact that banking, commercial banking in particular, continues to remain among the most heavily regulated enterprises in the United States is a testament to the Board’s classic role.<sup>251</sup>

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245. See *Hearing Before the Subcomm. on Fin. Inst. and Consumer Credit of the House Comm. on Fin. Serv.*, 107th Cong., 67–68 (May 2, 2001) (statement of Laurence H. Meyer, Member, Bd of Governors of the Fed. Reserve Sys.).

246. See Robert M. Garsson, *Leach’s Bill Would Now Let Banks Launch Activities and Products Without Fed Nod*, AM. BANKER, Feb. 23, 1995, at 1995 WL 6911223.

247. See 12 C.F.R. pt. 225 (2000).

248. See Samuel J. Baptista, the Financial Services Council Prepared Testimony before the House Committee on Commerce, the Subcommittee on Telecommunications and Finance, and the Subcommittee on Commerce, Trade and Hazardous Materials (June 8, 1995) (transcript available at Federal News Service 620 National Press Building), available at <http://openaccess.dialog.com/gov/cgi/confirmed?Flag=5980>.

249. See David J. Vitale, Vice Chairman, First Chicago Corporation, Prepared Testimony before the House of Representatives Committee on Banking and Financial Services (Apr. 4, 1995) (transcript available at Federal News Service, 620 National Press Building, Washington, D.C. 20045), available at <http://openaccess.dialog.com/gov/cgi/confirmed?Flag=6012>.

250. See Baptista, *supra* note 248. Congress, followed by the Board, has constantly taken a populist suspicion of financial institutions as unduly large, powerful, and monopolistic, which underlies their history of political antagonism toward banks and resulting efforts to restrict them.

251. See Lawrence J. White, *Legislating “Financial Modernization”: Is the Game Worth the Candle?*, 22 REGULATION No. 3 (1999), available at <http://www.cato.org/pubs/regulation/regv22n3/reg22n3/modernization.pdf>.



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The rapid developments of the electronic and technological age in the financial market placed banks, prior to the GLB, under a competitive disadvantage against other financial institutions with regard to the sale of financial products and services to their customers. In this respect, the GLB opened the door for banks to achieve new levels of activity, compete more aggressively in the market and experience opportunity for increased profits. Technological developments and electronic activities are two of the core forces transforming the banking industry. Banks are adopting emerging technologies and electronic activities both to meet customer demands for improved and more convenient service, and also to realize potential cost efficiencies provided by those technologies.<sup>252</sup> As a prime example, remote delivery of products and services is increasingly important to enhance efficiencies and maintain profitability. Several different types of technologies, the best known of which is Internet banking, are emerging.<sup>253</sup> Banks that currently operate Internet sites plan to expand aggressively the size and functionality of their sites. By the year 2000, for example, banks representing more than thirty-seven percent of deposits based within the U.S. already had full service Internet banking.<sup>254</sup>

Banks are also beginning to experiment with new payment systems such as stored value and smart card systems. Technology has fundamentally changed the nature of bank competition, as well as the marketplace in which banks compete. Technology is driving a convergence of information related industries, including banking, telecommunications, and software

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252. See Julie L. Williams & James F.E. Gillespie, Jr. *The Business of Banking: Looking to the Future—Part II*, 52 BUSINESS LAWYER 1279, 1301 (1997) (citing Steve Weber, *Direct Channels Seen as Saviors from Banks' Declining Margins*, 1 ONLINE BANKING NEWSLETTER, Apr. 29, 1996, at 1 (transcript available at the Business Lawyer, University of Maryland School of Law)). For example, the average cost per transaction conducted by Internet banking is estimated to be \$0.01 compared to \$1.07 for the same transaction at a full service branch. *Id.* at 1301 n.192 (citing Booz, et al., *Internet Banking: A Survey of Current and Future Development* (transcript available The Business Lawyer, University of Maryland School of Law)). Similarly, use of the smart card in retail debit and credit payments is expected to enable banks to make authorized payments and extend credit using a local online technology and, thereby, to lower cost and reduce fraud significantly. See Jerome Svigals, *Multiple Application Smart Card Will Be an Engine of Profitability*, 161 AM. BANKER, May 14, 1996, at 17.

253. Julie L. Williams & James F. E. Gillespie, *The Business of Banking: Looking to the Future – Part II*, 52 BUS. LAW, 1279, 1301–02 n.93 (1997) (reporting “16% of U.S. households representing 30% of retail banking profits will be using Internet banking” and “[b]y the year 2000, 40% of U.S. households are expected to have personal computers with modems”)

254. See Karen Furst, et al., *Internet Banking in the U.S.: Landscape, Prospects, Industry Implications*, CAPCO J. FIN. TRANSFORMATION, at 45, 48 (Sept. 2001), available at <http://www.capco.com/pdf/j02art04.pdf>.

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firms. Banks already are facing increasing competition from nonbanks that offer payment services that build upon the bank supplied payments system, but add features that provide customers additional information, convenience, and timeliness.<sup>255</sup> To meet this competition, banks face pressure to develop banking products that “wrap information and other value added elements around” traditional payment services.<sup>256</sup>

The “financial in nature” test permits functions that are not necessarily “closely related to banking,” and thereby allows the U.S. banking industry to enter the electronic age. It is consistent with the branch banking expansions, the trend of mergers and acquisitions in the banking sector, and the increased presence of U.S. banks overseas.

The future still remains unpredictable in terms of how close banking regulators will allow banks to expand their financial services and products into commercial activities. However, what seems predictable is that the Congress and the banking regulatory agencies will now be forced to monitor technology developments closely and remain aware of their impact on the financial market thereby ensuring that the U.S. banking industry can remain competitive.<sup>257</sup>

Another banking regulatory agency, the Federal Deposit Insurance Corporation,<sup>258</sup> upon analyzing GLB, is of the opinion the Board needs to exercise particular caution in easing restrictions on banking activities beyond those actually defined under the act as “financial in nature.”<sup>259</sup> FDIC refers to the fact that the GLB allows the Board, in coordination with the Treasury (OCC), to define additional activities as “financial in nature,” besides the activities already established by the GLB, and believes that any rapid expansion of such activities could have undesirable consequences regarding the safety of bank depository institutions as well as the stability of the financial market.<sup>260</sup>

255. See William S. Haraf, *Public Policy Issues Will Influence Banking's Role in Electronic Commerce*, BANKING POL'Y REP., Mar. 4, 1996, at 2.

256. *Id.*

257. Representative Jim Leach, Address at the Women in Housing and Finance Conference (Feb. 27, 1995), in LEXIS BANKING BULL., March 8, 1995.

258. The Federal Deposit Insurance Corporation's mission is to “maintain stability and public confidence in the nation's financial system.” See Federal Deposit Insurance Corporation, <http://www.1natbanker.com/fdic.htm>. To achieve this goal, the FDIC has insured deposits and promoted safe and sound banking practices since 1933. *Id.*

259. See Arthur E. Wilmarth Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 220 n.7 (2002).

260. See Ricki Helfer, Chairman, Fed. Deposit Ins. Corp., Address before the House

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The distribution of regulatory authorities over “financial in nature” activities between the Treasury and the Board,<sup>261</sup> and the unusual set of provisions coordinating the regulatory activities complicate the regulatory environment within which the concept of “financial in nature” will unfold. Reaching a firm conclusion as to how the Board and the OCC will eventually come out in this power and policy sharing is a tricky matter. The often vague or inconclusive wording in the GLB is already raising questions and issues that will not be decided until the various task forces, primarily from the Board and the OCC, finish drafting the new rules and regulations.

In the political fencing between the Board and the OCC it appears that the Board came out better.<sup>262</sup> This is the result of the Board moving significantly closer to achieving its long-coveted position of being the umbrella regulator for all of the nation’s financial institutions, both bank and non-bank, with more detailed express authority over FHCs than it has over BHCs. On the other hand, the OCC - with only national banks under its supervision - began the controversy in a considerably weaker position than the Board and, with the Treasury’s support, was remarkably successful in holding off most efforts to undermine its position as the agency having primary responsibility for the viability, competitive strength, and soundness of the national banking system.

Even though GLB made some effort to place limitations on the Board’s new authority, in practice the Board is likely to be a “first among equals” regulator with an ability to invite itself to the table with other federal and state financial regulators

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Committee on Banking and Financial Services (May 22, 1997), *available at* 1997 WL 271595 (F.D.C.H.). Under the “financial in nature” test, each industry (banking, securities, insurance or real estate) has different levels of concentration and uses its own yardstick to measure its concentration. Therefore, there is a system of concentration that operates among the entities of the same industry and among various industries. At this stage, it does not seem clear whether, taken either separately or together, concentration in these industries could pose any potential risk in maintaining stability in the financial market as well as towards creation of monopolies.

261. See GLB § 121, 12 U.S.C. § 24a(a)(3)(A), (b)(1)(B) (2000) (authorizing regulation of services “financial in nature” by Secretary of the Treasury and FRB, and requiring coordination between the agencies).

262. See GLB § 111, 12 U.S.C. § 1844(c)(2)(E)(i)–(ii) (2000) (streamlining bank holding company supervision by requiring FRB deference to SEC reports of examination of registered broker-dealers and investment advisers); *see also* 12 U.S.C. § 1844(c)(3)(A) (prohibiting FRB imposition of capital rules where SEC has acted); 12 U.S.C. § 1844(g) (limiting the operation of the “source-of-strength” doctrine with respect to firms supervised by the SEC); GLB § 205, 15 U.S.C. § 78o(i) (requiring SEC consultation with FRB and concurrence of FRB concerning SEC imposition of broker or dealer registration requirements with respect to any new hybrid product); *see also* GLB § 115, 12 U.S.C. §§ 1820a, 1831v (imposing limitations on authority of other federal bank regulatory agencies corresponding to those imposed on the FRB).

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whenever serious issues arise. The nature of the Board's regulatory reach initially led many observers to conclude that the OCC must, therefore, have been the loser, and that the battle was now over.<sup>263</sup>

Actually, the OCC was left in a surprisingly powerful position. An activity cannot be found to be "financial in nature" and thus permissible for a FHC without concurrence of the OCC.<sup>264</sup> This applies even to FHCs over which the OCC has no regulatory jurisdiction at all. In that sense, it must be acknowledged that the OCC obtained a major increase in its regulatory reach as a result of the GLB. The Board, in its increased jurisdiction over national bank subsidiaries also expanded its jurisdiction. Thus, both came out of the legislative controversy with a consequential area to regulate.

Certain issues, like the content of activities that are "financial in nature," such as in the case of deciding whether the activities in real estate brokerage and real estate management services were "financial in nature,"<sup>265</sup> are necessary concomitants of advancement in the technology sector and rapid development of the financial market. In a sense, these advancements are to be welcomed as indicative of the dynamic quality of this developing regulatory system.

## V. COMPLEMENTARY TO A FINANCIAL ACTIVITY

Section 103(a) of GLB delineates a set of permissible activities for an FHC to engage in, provided these activities are "complementary to a financial activity."<sup>266</sup> Since these are not financial activities in and of themselves, they must be non-financial activities, or something generally called commerce. The underlying assumption of the BHCA and the GLB amendments

263. See Steve Blumenthal, *Fed May Wind Up Regulating Nonbank Financial Businesses*, *AM. BANKER*, Mar. 2, 2001, at 12.

264. Malloy, *supra* note 163, at 801-02.

265. In January of 2001, the Board of Governors of the Federal Reserve System (Board) and the Secretary of the Treasury (Secretary) began seeking comment on whether to determine by rule that real estate brokerage and real estate management are activities that are "financial in nature" or "incidental to a financial activity" and therefore permissible for financial holding companies (FHCs) and financial subsidiaries of national banks. See Bank Holding Companies and Change in Bank Control [and] Financial Subsidiaries, 66 Fed. Reg. 307 (proposed Jan. 3, 2001) (to be codified at 12 C.F.R. pts. 225, 1501). The Fed's proposed rule would amend Regulation Y to add real estate brokerage and real estate management to the list of activities permissible for FHCs. *Id.* The Secretary's proposed rule would amend its financial subsidiary regulations to add real estate brokerage and real estate management to the activities permissible for financial subsidiaries of national banks. *Id.* The deadline for receipt of comments on these proposals was March 2, 2001. *Id.*

266. GLB § 103(a), 12 U.S.C. § 1843(k)(1)(B) (2000).

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is that non-financial activity, commerce, is prohibited to bank holding companies.<sup>267</sup> An activity found to be “complementary,” is distinguished from the more general list of commercial activities that Congress considered for FHCs and rejected.<sup>268</sup> Yet, if it is complementary to a financial activity, it is permitted.

To qualify as complementary, and therefore permissible for FHCs, there must be some close connection between the complementary activity and an activity that the statute, a Board decision, or an OCC decision has found to be “financial in nature.”<sup>269</sup> Presumably, the activity must actually be conducted by the involved FHC. The Board wrote the following:

The authority to engage in complementary activities was included as a mechanism for allowing some amount of commercial or nonfinancial activities as long as there is a connection between the complementary activity and a financial activity conducted by the FHC and the activity does not pose unacceptable risks to the safety and soundness of the FHC, its banks or the banking system.<sup>270</sup>

Before a complementary activity may be engaged in by an FHC, it must be found acceptable by the Board.<sup>271</sup> No activity is deemed complementary through operation of the BHCA or GLB. Part of this finding involves a Board determination that the activity “does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.”<sup>272</sup> One does not know quite what to do with this qualification. For one thing, one would assume that all Board decisions incorporate such a finding. For another, is there a negative implication that all other findings may pose such a risk?

The complementary concept may fairly be seen as an aspect of Congress’ appreciation of the expanding nature of markets and

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267. Glass, *supra* note 177, at 17–18.

268. Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 80,384 (proposed Dec. 21, 2000) (to be codified at 12 C.F.R. pt. 225) (demonstrating a scenario in which the Board distinguishes “complementary” activities).

269. *Id.* at 80,385.

270. *Id.* at 80,385.

271. GLB § 103(a), 12 U.S.C. § 1843(k)(1)(B).

272. *Id.* The finding must be made under the notice procedures of the BHCA. 12 U.S.C. § 1843(4)(j) (2000); see Laurence H. Meyer, Governor, Federal Reserve Board, Remarks Before the American Law Institute and American Bar Association (Feb. 3, 2000) (transcript available at <http://federalreserve.gov/boarddocs/speeches/2000/20000203.htm>).

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technology. It is thus completely consistent with the underpinnings of “financial in nature” itself and the future scope that is given to the regulation of banking. It is reflective of the broad license Congress obviously intends to grant the Board and the OCC. One hopes that the regulators in the same spirit receive this posture.

Describing the meaning of a complementary activity proves difficult. Equally difficult at this stage in the development of GLB amendments is to comprehend any understanding of the importance this category of activities will achieve. As to the former issue, any idea as to the Board’s intentions appears in a December 2000 proposed rule.<sup>273</sup> First, the Board independently indicated it is thinking about “certain types of data storage, Internet and portal hosting activities, and broad advisory activities involving data processing activities, so long as the companies also provide financial data processing or other financial products and services.”<sup>274</sup> Second, the Board looked favorably in the proposed rule on three proposals put to it for a “complementary” determination:

1. Data Storage for any type of data so long as the custodian provides these services for financial data;
2. General data processing, without limit as to the type of data processed, so long as 20 percent of the total revenue from these activities is derived from providing data processing services to the companies in the FHC;
3. Electronic information portal services comprising information search, exchange, consolidation, screening, filtering or aggregation services involving any type of data.<sup>275</sup>

Presently, the proposed rule has not been adopted in final form. Unfortunately, it does appear to conform to the rather conservative Board approach to banking that GLB was designed to liberate.

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273. Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. at 80,384.

274. *Id.*

275. *Id.* at 80,386.

## VI. ACTIVITIES “NON-FINANCIAL IN NATURE”

In 1956, Congress enacted the Act, defining a BHC as “any company which has control over any bank.”<sup>276</sup> The Act derived not from a bank but from a business corporation which traditionally, having obtained a state charter, was allowed to engage in any business whatsoever. In 1970, in order to prevent BHCs from engaging in the businesses of both banking and ordinary commerce, the Board convinced Congress to amend the Act making very clear that the activities of banking and commerce cannot be performed by the same business entity or be intermingled.<sup>277</sup> At least one commentator believes that the separation of banking from commerce is both artificial and stultifying.<sup>278</sup>

To understand the difference between the business of banking and commerce, first, the banking industry looks at their definitions and scope of activities in the perspective of U.S. banking law. “Banking” at a minimum means the activities of making commercial loans and holding demand deposits.<sup>279</sup> “Commerce” means any activity that is strictly non-financial in nature.<sup>280</sup> For example, operating a factory, running a retail store, or selling burgers would be the kinds of activities falling under the definition of “commerce.”<sup>281</sup> GLB revisited the business of banking and commerce with respect to the structure and activities of FHCs. Other than the as yet thin sliver of complementary activities,<sup>282</sup> the GLB prohibits mixing banking and “commerce” in financial services holding companies, including the constituent banks.<sup>283</sup>

Two major groups represent opposing views in regard to the combination of banking and commerce. There are those who

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276. 12 U.S.C. § 1841(a)(1) (2000).

277. See *supra* Part III.

278. See Peter J. Ferrara, *The Regulatory Separation of Banking from Securities and Commerce in the Modern Financial Marketplace*, 33 ARIZ. L. REV. 583, 654 (1991).

279. For a detailed analysis about the business of banking, see *supra* Part II.

280. The term “commerce” has been identified with “non-financial in nature” activities, which is the wording used in the GLB.

281. Minor aspects of this commerce division are, for particular reasons, handled irregularly under the mix of banking laws. For example, small business investment companies, certain investments under Federal Reserve Regulation K dealing with foreign investments, or holdings under five percent of the shares of companies under sections 4(c)(6) and 4(c)(7) of the BHC Act may be controlled by BHCs pre-GLB. See Bank Holding Companies and Change in Bank Control, 12 Fed. Reg. 16,460, 16,461 (proposed Mar. 28, 2000) (to be codified at 12 C.F.R. pts. 225, 1500).

282. See discussion *supra* Part V.

283. See Laurence H. Meyer, Governor, Federal Reserve Board, Implementing the Banking Reform Bill Poses New Challenges, Address before Washington, D.C. - based group Women in Housing and Finance, in BANKING POL’Y REP., Jan. 18, 2000, at 4.

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argue that banking and commerce should remain separated,<sup>284</sup> and others who believe that the gulf between banking and commerce could be cautiously bridged.<sup>285</sup> In support of the combination is the traditional role commerce has played in banking in the United States.<sup>286</sup> Eliminating the current separation of banking and commerce would create a new world of benefits, although attendant risks would ensue for the banks and their activities.<sup>287</sup>

Many years before the enactment of the GLB, the Board stated “the separation of banking from commerce [is created] in order to guard against the potential concentration of financial resources, conflicts of interest, in the control of credit, and risks to insured depository institutions that are likely to result from the control by banking organizations of commercial enterprises.”<sup>288</sup> Taking into consideration this position of the Board, which remains the Board’s current position, those who support the concept of division between commerce and banking follow some major arguments, including the following:

1. potential expansion of the federal safety net;
2. potential increased concentration of economic power;
3. potential regulation for commercial parent of depository institutions;
4. potential for increased contagion effects; and
5. potential for increased conflicts of interest.<sup>289</sup>

The potential expansion of the federal safety net could lead to the creation of conglomerations of banks and commercial firms

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284. See generally Jonathan Brown, *The Separation of Banking and Commerce*, GIS for Equitable and Sustainable Communities, at <http://www.public-gis.org/reports/sbc.html> (last visited Jan. 26, 2003).

285. See James L. Bothwell, Chief Economist, U.S. General Accounting Office, Statement Before the House Committee on Banking and Financial Services on Financial Regulation: Bank Modernization Legislation, <http://financialservices.house.gov/banking/5797gao.htm> (May 7, 1997).

286. See generally Joseph H. Sommer, *The Birth of the American Business Corporation: Of Banks, Corporate Governance, and Social Responsibility*, 49 BUFF. L. REV. 1011 (2001) (discussing the history of American banking).

287. Bothwell, *supra* note 285.

288. See Bank Holding Company and Bank Merger Orders Issued By the Board of Governors, 69 FED. RESERVE BULL. NO. 2 105, 108 (1983).

289. See *infra* notes 290–317 and accompanying text.



that would increase the risk to the safety net, and any associated subsidy might be transferred to commercial operations and result in inappropriate risk-taking, misallocations of resources, and uneven competitive playing fields in other industries. While establishing firewalls between banks and their commercial affiliates could possibly mitigate such risks, such firewalls may not work in times of stress, or where managers are determined to evade them.<sup>290</sup>

The end of current restrictions and the consequent formation of very large conglomerate enterprises could result in unhealthy concentrations of economic power. This could

“adversely affect the efficient operation of the economy and place consumers at risk of increased prices if they began to exert market power in either their banking or commercial operations. This risk would be enhanced to the extent that these new conglomerates could effectively access the subsidy inherent in the safety net and gain further advantages over their competitors.”<sup>291</sup>

Other opponents of banking - commerce linkages, including House Banking Chairman Jim Leach, have raised the specter of unfair competition if banks and commercial companies combine.<sup>292</sup> He has argued that in protecting the interest of its own affiliates, banks would be expected not to lend to competitors or potential rivals of the affiliates.<sup>293</sup>

The elimination of barriers between banking and commercial activities will open the doors to a vast restructuring of the U.S. business place, and there are fears that banks will abandon their traditional role of impartial provider of credit. “No longer,” says Congressman Leach, “would banking be simply a service to the general public and commercial and industrial firms. Instead

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290. Richard L. Fogel, Assistant Comptroller General, General Government Programs, Using “Firewalls” in a Post Glass-Steagall Banking Environment, Testimony Before the Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce (Apr. 13, 1988), <http://161.203.164/d48t13/135537.pdf>.

291. See Press Release, Congressman James A. Leach, Leach Releases GAO Study Warning Against Mixing of Commerce and Banking (March 27, 1997) (<http://financial.services.house.gov/banking/prdutoc.htm>) (quoting General Accounting Office Study on Separation of Commerce and Banking).

292. See Steve Cocheo, *Special Briefing: The Banking-Commerce Debate; Socks, stocks, wrenches, deposits, cars, loans, hamburgers, computers*, A.B.A. BANKING J., July 1997, at 7.

293. *Id.*

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banks would become integrated into these firms, and could own or be owned by companies as diverse as Wal-Mart, Sony, Amoco, Avon or Microsoft [with consequent loyalty to their financial success].”<sup>294</sup> The affect on competition and concentration of ownership of corporate America due to the combination of banking and commerce present legitimate and longstanding concerns.

In large part, such concerns also indicate conglomerated banks would continue the process already under way to create a dominant and controlling market with other banks of the same size. Although there has been no foreshadowing, antitrust issues may eventually be exposed.<sup>295</sup> A strong inverse relationship exists between the size of a bank and the extent of lending to small businesses, as expressed as a percent of bank assets.<sup>296</sup> Evidence has shown that larger, more complex banks do not provide as much credit to small businesses as do smaller, simpler banks.<sup>297</sup> Small businesses are typically more dependent on bank credit than large businesses, and it is possible that the shifts occurring will diminish the availability of credit to them.

There is, however, a good case for banks to engage in non-financial activity, especially where technological innovation has a prominent place, because today's banks are at the forefront of new product development. But the unrestricted mixing of banking and commerce does raise particular concerns. For example, conglomerated banks will have an advantage over less diversified banks in supporting research and innovation and in selling new products and services.<sup>298</sup> However a flourishing industry in new product development, financial consulting and marketing can supply these ingredients to smaller banks in sufficient quantity. The idea is not inconceivable that use of the wide market in technological facilities could outdo any large private bank's internal resources.

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294. See Congressman James A. Leach, Chairman, House Committee on Banking and Financial Services, Statement before Subcommittee on Capital Markets, Securities, and Government-Sponsored Enterprises, (Feb. 12, 1997).

295. See Lawrence G. Goldberg & Lawrence J. White, *De Novo Banks and Lending to Small Businesses: An Empirical Analysis*, J. BANKING & FIN. 851, 864 (1997) (considering antitrust implications of the mergers of local banks, which primarily lend to small businesses).

296. *Id.* at 853–54.

297. See Allen N. Berger & Gregory F. Udell, Summary, *Universal Banking and the Future of Small Business Lending*, Financial Institutions Center, <http://fic.wharton.upenn.edu/fic/papers/95/p9517.html> (Apr. 1995).

298. See INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 659 (F.M. Scherer & David Ross eds., 3d ed. 1990) (discussing the advantages of diversified size in business).

In addition, the integration of banking and commerce could quickly lead to foreign commercial and industrial firms gaining access to the U.S. payments systems, discount windows, and deposit insurance. The extent of oversight and control the Federal government could have over these ventures would be small. We are, after all, dealing with the entry of commercial enterprises - essentially unregulated - into the American market. The degree of liability exposures toward their clients would, however, be practically unlimited.<sup>299</sup> It seems plain that GLB never intended to accomplish this kind of integration. On the House floor Representative Leach was quite clear that the GLB repudiates the mixing of banking and commerce:

[W]hile the financial modernization legislation provides for increased competition in the delivery of financial products, it repudiates the Japanese industrial model and forestalls trends toward mixing commerce and banking. The signal breach of banking [and commerce that exists in current law is plugged, which has the effect of stopping the] potential [adaption of the Japanese banking system structure and supervisory]<sup>300</sup> of the American economy.... At many stages in consideration of bank modernization legislation, powerful interest groups attempted to introduce legislative language which would have allowed large banks to merge with large industrial concerns—i.e., to provide that Chase could merge with General Motors or Bank of America with Amoco. Instead, this bill precludes this prospect and, indeed, blocks America's largest retail company from owning a federally insured institution, for which an application is pending.<sup>301</sup>

The Senate Report on GLB when in bill form also spoke to the prohibition of a general mixing of banking and commerce.<sup>302</sup> In explaining what the Board must consider in establishing new activities that are "financial in nature" or "incidental to financial activities," the Report asserts:

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299. See Leach, *supra* note 294.

300. See Bayan Rahman, *Japan Tries to Dispel Fears Over Banking System*, FIN. TIMES, December 28, 2001, Asia/Pacific Section at 10 (discussing the current weakness of Japan's banking system and the resulting bank losses and collapses).

301. 145 CONG. REC. H11,529-30 (daily ed. Oct. 28, 1999) (statement of Rep. Leach).

302. S. REP. NO. 106-44, at 21 (1999).

This authority includes authority to allow activities that are reasonably connected to one or more financial activities. . . . This authority provides the Board with some flexibility to accommodate the affiliation of depository institutions with insurance companies, securities firms, and other financial service providers while continuing to be attentive not to allow the general mixing of banking and commerce in contravention of the purposes of this Act.<sup>303</sup>

In addition, Representative Leach spoke to what he and his colleagues intended regarding the mix of banking and commerce in his remarks to the Conference of State Banking Supervisors at their meeting in May 2000:

[o]f all the things I am proud of in the modernization legislation it is that our government's two principal financial bodies—the Treasury and the Fed—changed judgment [sic] and today adamantly stand with me against mixing commerce and banking. There should be no misunderstanding. If this precept had been included in the final legislative product, I would have done my best to pull the plug on financial modernization.<sup>304</sup>

Risk was also perceived that the independence of all banks, particularly our largest, would have been jeopardized if commercial firms had been allowed to combine with them because these firms could have seen banks as a potential profit source with somehow measurable limited risks.<sup>305</sup> According to some studies released several years ago regarding market valuations, “such companies as GE, BP-Amoco, AOL-Time Warner and Microsoft could and would eagerly gobble up even such financial giants such as Citigroup, Chase and Wells Fargo.”<sup>306</sup> The face of economic organization in America might

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303. *Id.*

304. Congressman James A. Leach, Remarks at the Conference of State Banking Supervisors (May 12, 2000), *available at* <http://financialservices.house.gov/banking/prdu1062.htm> (last modified May 17, 2000).

305. *Id.*

306. *Id.*

have been revolutionized overnight had the Congress, the Board, and the other regulatory agencies not continued to maintain a careful watch on issues of this nature.<sup>307</sup> Through the enactment of GLB, Congress “recognizes the direction of the market, allows for freer competition within financial services without sanctioning mergers among auto companies, retail chains and banks.”<sup>308</sup> Whatever its limitations on bank diversification, GLB may be seen as establishing a scheme of regulation to protect the public’s trust and confidence in the U.S. banking system.<sup>309</sup>

Some banking experts have questioned whether anyone can adequately regulate a commercial parent of a depository institution. Is the Board, for instance, capable of overseeing the activities of a large automaker because it owns a bank? A report from the FDIC, regarding the issue of the merger of bank and thrift charters partially answers this question: “[b]ecause unrestricted savings-and-loan holding companies are essentially unregulated, only limited data on their activities exist.”<sup>310</sup> Chairman Greenspan said the “Board also has concluded that it would be wise to move with caution in addressing the removal of the current legal barriers between commerce and banking because the unrestricted association of banking and commerce would be a profound and surely irreversible structural change in the U.S. economy.”<sup>311</sup> If the Congress were to dramatically change the rules through some BHCA/GLB expansion, thus governing the separation between banking and commerce, the result could bring great uncertainty in the market to the bank safety net. As a result, Congress could do more harm than good. Accordingly, modifications of the fundamental banking structural rules and regulations regarding the separation of banking and commerce should proceed at a deliberate pace in order to test the response of markets and technological innovations to the future alteration of banking rules.

Allowing the conglomeration of banks and commercial firms could also increase risks to the deposit insurance fund and taxpayers burden if commercial firms were to extend to their

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307. *Id.*

308. See Congressman James A. Leach, Chairman, House Banking and Financial Services Committee, Remarks before ABA Leadership Council (Mar. 28, 2000), *available at* <http://www.house.gov/leach/aba.htm>.

309. *Id.*

310. See FDIC Staff, *A Unified Federal Charter for Banks and Savings Institutions*, 10 BANKING REV. No. 1, at 10 n.20 (Summer 1997), <http://www.fdic.gov/bank/analytical/banking/1997summ/index.html>.

311. See Alan Greenspan, Chairman, Board of Governors, Statement before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, July 17, 1997, 83 FED. RESERVE BULL. 738, 738 (1997).

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banking affiliates any financial stress they experience.<sup>312</sup> Even if prudential barriers were established to keep such a problem from actually being transmitted to bank affiliates, depositors who believed commercial affiliates were experiencing financial problems might decide to withdraw their funds from the commercial firms' bank affiliates for fear that the banks' soundness might also be in jeopardy.<sup>313</sup> "If enough depositors did this, the fear could be self-fulfilling in that the viability of both the affiliated banks and the commercial firms could become threatened."<sup>314</sup>

Allowing conglomeration of banks and commercial firms could also add to the potential for increased conflicts of interest and raise the risk that banks might engage in anticompetitive or unsound practices. For example, some have argued that, to foster the prospects of their commercial affiliates, banks might begin to restrict credit to their affiliates' competitors, or tie the provision of credit to the sale of products by their commercial affiliates.<sup>315</sup> Perhaps more likely, banks might begin to extend credit to their commercial affiliates when they would not have done so otherwise, thus increasing the risk of loss, risks to the deposit insurance funds, and potential taxpayer loss.<sup>316</sup> Some policy makers have expressed particular concern that commercial affiliates of depository institutions, especially when facing financial troubles, could sustain defaults which could bring failure to these depository institutions.<sup>317</sup> This could have irreversible systemic impact on the financial market and weaken the "legendary" reputation of the bank safety network.

On the other hand, some commentators contest the prevailing wisdom and encourage a growing combination of banks with commerce.<sup>318</sup> This view must, of course, contend with the clear position taken for most of this century by Congress and the Board that banking and commerce should not mix. These advocates claim that such a step only ratifies current market realities, including commercial ownership of thrifts and nonbank

312. See Leach, *supra* note 291.

313. *Id.*

314. *Id.*

315. See Anthony Saunders, *Banking and Commerce: An Overview of the Public Policy Issues*, 18 J. BANKING & FIN. 231, 239-40 (1994).

316. See United States General Accounting Office GAO/GGD-94-88, *BANK INSIDER ACTIVITIES: INSIDER PROBLEMS AND VIOLATIONS INDICATE BROADER MANAGEMENT DEFICIENCIES* 16 (March 1994) (describing "insider abuse can occur through transactions between a member bank and its affiliates").

317. Saunders, *supra* note 315, at 241.

318. See Allen N. Berger et al., *The Consolidation of the Financial Service Industry: Causes, Consequences, and Implications for the Future*, 23 J. BANKING & FIN. 135 (1999).

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banks, and the incursion of commercial firms into some traditional banking activities.<sup>319</sup>

The major arguments expressed regularly in support of authorizing the combination of banking and commerce are the following:

1. potential increased economies of scale;
2. potential increase of international competition between U.S. banks and foreign banks; and
3. greater diversification of risks.

Some banking experts claim the U.S. banking industry would benefit from the relaxation of banking and commerce restrictions because it would allow banks to expand their scale of operations and lower their unit costs of production and data management.<sup>320</sup> The presence of significant increased economies of scale in the banking sector has led to banking consolidation over the last decade.<sup>321</sup>

These increased economies have caused dramatic consolidation specifically in the banking industry during the last decade, while the increased economies have not affected the financial services industry to the same degree.<sup>322</sup> For instance, the ten largest banking organizations in the United States accounted for twenty-seven percent of all operating income in the financial services industry in 1990, compared to forty-five percent in 1999.<sup>323</sup>

Also supporting increased U.S. bank powers is the fact that U.S. banks must compete in an increasingly international market where many of the major foreign competitors have commercial affiliations which give them an advantage over U.S.

319. See generally Arthur K. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 421-23 (2002).

320. See Berger, *supra* note 318.

321. See George J. Bentson et al., *Scale Economies in Banking: A Restructuring and Reassessment*, 14 J. MONEY CREDIT AND BANKING 435 (1982).

322. See SEC. INDUS. ASS'N, 2001 SEC. INDUS. FACT BOOK 40 (2001) at [http://www.sia.com/reference\\_materials/pdf/2001FactBook.pdf](http://www.sia.com/reference_materials/pdf/2001FactBook.pdf) (explaining that, in securities the share of revenue from the top ten firms accounted for 50.7 percent of industry revenues in 1999, down from 56.9 percent in 1990).

323. See Franklin Allen, James McAndrews & Philip E. Strahan, *E-Finance: An Introduction* 14, Publ'n 01-36, (Oct. 7, 2001) (manuscript) at <http://www.bc.edu/~strahan/EFinanceIntro7.pdf>.

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banking institutions.<sup>324</sup> For example, it would be quite difficult for a U.S. chartered bank to compete effectively in German markets where its German competitors are actively involved in air transport and many other commercial enterprises.

The argument for greater diversification of risk is the historical and traditional economic argument that risk is more sustainable if diversified.<sup>325</sup> Shakespeare eloquently conveyed this idea in *The Merchant of Venice*, Act I, Scene 1, in a conversation between Salerio, a Venetian trader, and Antonio, the merchant of Venice:

Salerio: I know Antonio  
           Is sad to think upon his merchandise.  
 Antonio: Believe me, no; I thank my fortune for it,  
           My ventures are not in one bottom  
           trusted,  
           Nor to one place; nor is my whole estate  
           Upon the fortune of this present year:  
           Therefore my merchandise makes me not  
           sad.<sup>326</sup>

Proponents of this portfolio theory believe that banks would be benefited and their overall risks reduced by allowing for greater diversification across more product lines.<sup>327</sup> Because the gains from this type of diversification rise when firms' earnings are less correlated and fall when firms' earnings are more correlated, this argument rests on the assumption that the earnings of commercial firms fluctuate independently of the earnings of banks.<sup>328</sup>

However, a more comprehensive study covering a longer period of time and greater control over more factors, found that the variation in the stock returns of bank holding companies and nonfinancial companies are highly correlated, and the study concluded that the benefits of diversification are overstated.<sup>329</sup> By

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324. Statement of Lawrence H. Meyer, FRB Governor, Testimony Before the Committee on the Judiciary (June 3, 1998), in 84 FED. RES. BULL. 619 (Aug. 1998).

325. See Christopher T. Mahoney & Cara S. Lown, *Banking and Securities and Insurance: Economists' Views of the Synergies*, FED. RESERVE BANK OF N.Y. ECON. POL'Y REV., at 5, Oct. 1, 2000.

326. WILLIAM SHAKESPEARE, *THE MERCHANT OF VENICE*, act 1, sc. 1.

327. See Saunders, *supra* note 315, at 236.

328. See Anthony Saunders & Pierre Yourougou, *Are Banks Special? The Separation of Banking from Commerce and Interest Rate Risk*, 42 J. ECON. & BUS. 171, 181 (1990).

329. See Michael J. Isimbabi, *The Stock Market Perception of Industry Risk and the Separation of Banking and Commerce*, 18 J. BANKING & FIN. 325, 342-43 (1994).



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combining with commercial firms, banks might obtain better information about the commercial firms' activities, which the banks could then use to reduce the default rate on their loans.<sup>330</sup> The commercial firms could benefit by obtaining bank loans at lower interest rates.<sup>331</sup> Neither argument, however, involves the subject of portfolio diversification.

Some observers have also argued that restrictions on bank affiliations lead to inefficiencies, because such restrictions impede the free flow of capital or managerial resources.<sup>332</sup> In addition, they feel that commercial ownership would bring more capital into banking.<sup>333</sup> In recent years, this has not presented a problem because many banks have been buying back stock and using excess capital.<sup>334</sup> But capital excesses could disappear in a prolonged economic downturn. Based on a report issued from the FDIC, commercial companies have not historically been a source of risk to the thrift industry, where the intricacies of the thrift holding company structure have supported closer alliance of banks with commerce than exists in the commercial bank field.<sup>335</sup> Also, a report from the Office of Thrift Supervision asserts unitary thrift holding companies have historically helped rather than harmed their subsidiaries.<sup>336</sup>

A central aspect of the entire issue of the relationship between financial activities and commerce is whether any real distinction exists between the two. At least one commentator argued for the lack of a distinction.<sup>337</sup> Alternatively, another commentator contends that since a commercial activity is anything the Board says it is, this in itself creates the separation.<sup>338</sup> By permitting banks to affiliate with securities

330. See Kose John, et al., *Universal Banking and Firm Risk-Taking*, 18 J. BANKING & FIN. 307, 309 (1994).

331. See *id.* at 308 (explaining that acquisition of a bank by a commercial firm can lead to growth in both size of the institution and the scope of its activities and thus reduce average costs of producing banking services).

332. See Saunders, *supra* note 315, at 237.

333. *Id.* at 234–35.

334. Edward D. Herlihy, et al., *Materials Submitted by Craig M. Wasserman*, at 397, 587 (PLI Corp. Law Practice Course, Handbook Series No. B0-00ZO, 2001).

335. *FDIC Maps Problems in Crafting Common Charter*, BANKING POL'Y REP., Dec. 16, 1996, at 4.

336. Steve Cocheo, *Special Briefing: The Banking- Commerce Debate*, A.B.A. BANKING J., July 1997, at 7.

337. See Prepared Testimony of Arthur Levitt, Chairman U.S. Securities & Exchange Commission, Before the House Banking and Financial Services Committee Financial Institutions & Consumer Credit Subcommittee Concerning H.R. 268, the Depository Institution Affiliation and Thrift Charter Conversion Act, FED. NEWS SERVICE, Feb. 13, 1997, available in LEXIS, NEXIS Library, Federal News Service File.

338. See Peter J. Wallison, *The Gramm-Leach-Bliley Act Eliminated the Separation*

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firms and insurance companies, Congress has now admitted that the affiliation confers no improper benefits on affiliates. One may derive from this that the Board cannot determine whether to permit an affiliation by deciding whether it could confer an anticompetitive benefit, or would potentially harm the bank. Instead, it must decide what is or is not a financial activity without reference to any policy or precedent standard. As a result, some commentators state that (i) there is no natural distinction between financial activities, such as insurance and securities underwriting, and commercial activities generally, and (ii) that there is no practical basis for doing so.<sup>339</sup>

In justifying the above view, these commentators provide the following example related to leasing activity which clearly is included in the “family” of financial activities: they state that there is no difference between a company which buys cars and then leases them out (which transaction constitutes a financial activity, since banks are permitted to buy and lease equipment, in our case, cars), and a company which buys the engines from Ford, the body from Honda, the transmissions from GM and assembles the cars that it leases out.<sup>340</sup> Is the Board going to say that a company that buys the equipment that it leases can be affiliated with a bank, while a company that assembles the same equipment cannot? Does that distinction make any sense?

Although there are no particular cases in which the Board has ruled with reference to commercial firms engaged in the above transactions, the current state of the law sets up a clear difference between a company that buys equipment for lease and is consequently in the business of financing, and one that assembles equipment that it leases in commerce. Whether such distinction makes any sense is another question.

The Board has made clear that it would be wise to tread carefully in removing the legal barriers between commerce and finance.<sup>341</sup> The free and open association of banking and commerce would be a profound and surely irreversible structural

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of Banking and Commerce: How This Will Affect the Future of The Safety Net, Address Before the Federal Reserve Bank of Chicago Annual Conference on Bank Structure & Competition (May 5, 2000) (manuscript at 2, at <http://www.aei.org/sp/spwall000505.htm>).

339. *Id.* at 2. See also *Pssst! Reform Really Did Let Commerce In*, AM. BANKER, June 2, 2000, at 1 (discussing Peter J. Wallison’s view that restrictions on commercial activities will fall as the line between financial and commercial activities is continually redrawn).

340. Wallison, *supra* note 338, at 3.

341. See Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Banking and Financial Services, U.S. House of Representatives, 83 FED. RES. BULL. 249, 253 (Feb. 13, 1997).

change in the American economy. Hence, the Board must be sure whatever changes are made do not distort our development toward the most efficient financial structure.<sup>342</sup> However, the Board allows for some flexibility in the matter of merging banking and commerce.<sup>343</sup> In this respect, the Chairman states that there is “no reason not to proceed in incremental steps.”<sup>344</sup> The first phase is to tackle those banks that already operate in an environment of non-financial commerce and integrate banking and finance only in those areas. Chairman Greenspan explained: “[p]erhaps those organizations that either have or establish well-capitalized and well-managed bank subsidiaries should be permitted a small basket of nonfinancial assets . . . .”<sup>345</sup> Then, only later, as the success is measured of these developments, should they consider fully dismantling the barrier between banking and commerce.<sup>346</sup>

As reported in the *American Banker*, one senior federal regulator has stated that “[t]he line between banking and commerce is blurring, and e-commerce is driving it. [The GLB] has tremendous flexibility built in for innovation and experimentation.”<sup>347</sup> The Board officials insist that the central bank understands the reform law’s goal: freeing financial companies to innovate, compete, and adapt to changing market conditions. During an interview, Fed. Governor Laurence Meyer acknowledged that “Gramm-Leach-Bliley made a very substantial break’ with past law” and cautioned against “overly conservative regulations that impede the direction that Congress wanted the country to move in.”<sup>348</sup> Comptroller of the OCC, John D. Hawke, Jr., in an interview said that “[t]he business of banking is changing all the time. With the advent of new technology it’s going to keep changing . . . . It’s an evolving concept.”<sup>349</sup>

In support of the views expressed from the Board and OCC, Congress also believes that the effect of changes in technology will impact the business of banking, and its scope of activities.

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342. *Id.*

343. See Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, July 17, 1997, 83 FED. RES. BULL. 738 (Sept. 1997).

344. *Id.* at 742.

345. Greenspan, *supra* note 341, at 253–54.

346. See Greenspan, *supra* note 343, at 742.

347. See Barbara A. Rehm, *Commerce, a Reform Gem, in Fed’s Hands*, AM. BANKER, Nov. 9, 2000, at 1.

348. *Id.*

349. *Id.*

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Congressman Jim Leach, who had previously stated that “without [the GLB], every major bank would have been acquired by a commercial company,”<sup>350</sup> has more recently commented that the “line between finance and commercial is a very difficult one to draw; it is a line that moves. . . . From here out, it is a principally regulatory, rather than legislative, issue.”<sup>351</sup>

GLB contains several provisions in its authorization of merchant banking activities designed to distinguish merchant banking investments specifically from the more general considerations that deal with the mixing of banking and commerce. In order to put a relatively bright line around merchant banking, GLB defined permissible merchant banking investments as investments that meet two important requirements: 1) the investment may be held only for a period of time to enable the resale of the investment, and, 2) while the investment is held by the FHC, it may not routinely manage or operate the commercial firm except as necessary or required to obtain a reasonable return on the investment on resale.<sup>352</sup> In addition, GLB imposed limits on bank funding of portfolio companies owned by the bank’s parent holding company and on cross-marketing activities between banks and portfolio companies owned by the same financial holding company.<sup>353</sup> These restrictions were also intended to reinforce the separation between banks and the commercial companies owned in reliance on the new merchant banking authority.<sup>354</sup>

Given the frequency with which the public must deal with the term “commerce” – and similar marks such as “commercial” – it may gradually be starting to realize that different goods and services identified by the term “commerce” have different origins. On balance, goods and services legally identified as “commerce” will be separated from banking and financial services. They also will be separated from some goods and services which are closely related to banking and financial services.<sup>355</sup>

350. *It’s Been More Effective than People Think*, AM. BANKER, Nov. 7, 2000, at 1 (quoting Congressman Jim Leach in an interview with Barbara Rehm).

351. Rehm, *supra* note 347.

352. Kenneth J. Robinson, *Banks Venture into New Territory*, 1 ECON. & FIN. POL’Y REV. 1, 4, 5 (2002) [http://www.dallasfedreview.org/pdfs/v01\\_n02\\_a01.pdf](http://www.dallasfedreview.org/pdfs/v01_n02_a01.pdf); see generally GLB §§ 102, 122, 12 U.S.C. § 1843(c)(8), 1850 (2000).

353. *Id.*

354. See Statement of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, Before the Committee on Finance (April 4, 2001), in 87 FED. RES. BULL. 403, 405, June 2001 (discussing the role of the U.S. in international trade and competition).

355. See *Commerce Nat’l Ins. Servs., Inc. v. Commerce Ins. Agency, Inc.*, 995 F. Supp. 490, 499 (D. N.J. 1998), *vacated by, remanded by* 214 F.3d 432 (3d Cir. 2000).

## VII. IMPLEMENTATION OF THE BUSINESS DIVISIONS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

GLB embodies changes, particularly for banks, securities firms and insurance companies, through its renovation of the American financial services industry.<sup>356</sup> The enactment of the Act, most significantly the creation of the financial holding company with its newly created powers, opened new opportunities for those industries. Banks, in particular, slowly began adapting the new legislation to better accommodate their customers' interests.<sup>357</sup>

The convergence of the various segments of the financial services industry is far from complete—it may be that it has barely begun—but two years after the passage of GLB, key elements of a new financial services industry structure seems to have coalesced, building a two-way street for banks to enter the securities and insurance businesses and for brokers and insurers to enter banking. Interestingly, banks seem more eager to enter into the business of securities and insurance than the other way around.<sup>358</sup> This indicates a readiness of banks to adapt quickly the new financial activities prohibited until the enactment of GLB.

When the compromise on GLB was reached, the stock prices of banks, securities firms, and insurance companies all increased.<sup>359</sup> Particularly sharp increases occurred at BHCs and securities firms that act as advisors in financial M&As as well as at life insurance companies.<sup>360</sup> Moreover, simulated mergers across the financial services industries indicate that the largest diversification benefits would result if BHCs combined with life insurance firms.<sup>361</sup>

For example, the Citicorp/Travelers merger, which so far has been a success story,<sup>362</sup> provided the clearest indication yet that

356. Geoffrey M. Connor, *The Financial Services Act of 1999—The Gramm-Leach-Bliley Act*, 71 PA. BAR ASS'N. Q. 29, 33 (2000).

357. Anthony M. Santomero, The Causes and Effects of Financial Modernization, Address at the Annual Meeting of the New Jersey Bankers Association (Mar. 17, 2001), in PR NEWswire, Mar. 17, 2001, available at LEXIS, NEXIS Library, PR Newswire File (explaining that a small number of all bank holding companies had converted to a FHC).

358. See generally Rodger S. Lawson & Joyce Kraeger, *Insurers, Banks Go Slow in Wake of GLB*, NAT'L UNDERWRITER PROPERTY & CASUALTY- RISK & BENEFITS MGMT., Sept. 18, 2000, at 21.

359. See Cara S. Lown, *Summary of Session 1 Presentations*, FED. RES. BANK OF N.Y. ECON. POL'Y REV., Oct. 2000, at 7, 9.

360. *Id.* (reporting shareholders favored BHCs that undertook securities underwriting prior to GLB's passage).

361. *Id.* at 9.

362. One analyst has argued that Citigroup's chairman and chief executive, Sandy

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much of the world envisioned by GLB already existed at the time of its enactment. Senator Rod Grams of Minnesota acknowledged this reality by stating that “[m]any times Congress shows up at the dance after the music is over.”<sup>363</sup> Citigroup Inc. is the first global financial supermarket, with assets of approximately USD 700 billion and more than one hundred million customers.<sup>364</sup> It offers a complete array of financial services, including commercial and consumer banking, insurance underwriting and sales, securities brokerage and underwriting, investment services and consumer finance.<sup>365</sup> Like major commercial retail enterprises, such as Wal-Mart, competing with smaller rural stores, Citigroup’s lower costs and diversification, offering various financial products and services, give it a huge competitive advantage. Whether this advantage will compensate for clashes in corporate cultures, duplications of activities and mismatched businesses, remains to be seen. The Citigroup merger gave managers opportunity to blend two distinct cultures and give lenders and brokers an incentive to work together. Some events, such as the loss of prior Citicorp Chairman John S. Reed in open competition with Travelers Chairman Sanford Weil, suggest that all is not yet at rest. Reed, before his ouster, publicly viewed the merger as a success stating, “[t]he two institutions had virtually no businesses in common, and the intent was to create a new institution spanning the sum of all the businesses, integrating a full set of activities around corporate and consumer customers and adding a global dimension to Travelers.”<sup>366</sup> Considering that Citicorp had client relationships but no products to sell and Travelers had the products but no client relationships, the merger gave Travelers a broader sales platform and supplied Citigroup’s global credit and payment businesses with securities and insurance products.

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Weill, who bought into Travelers in 1992 and built up his worldwide financial empire with a series of large deals, including a merger with Citicorp in 1998, looked set to cash out of the business at an opportune time. Citigroup stated it would spin off Travelers Property Casualty in a two-part exercise. Citigroup will first sell up to 20 per cent of the company in an initial public offering, expected in the first quarter of 2002. In addition to its proceeds from the IPO, Citigroup will receive a dividend of about one billion dollars from Travelers Property Casualty, to be paid in 2002. Gary Silverman, *Citigroup Spin-Off to Fund Purchases, Disposal of Travelers Property and Casualty Insurance Arm Marks Strategy Retreat*, FIN. TIMES, Dec. 20, 2001, at 27.

363. Dean Anason, *Senate Passes Reform Bill, Gramm Calls for a Sequel*, AM. BANKER, Nov. 5, 1999, at 1.

364. *Bank/Insurance Mergers on the Cards in U.S.*, LIFE INS. INT’L, Oct. 31, 1999, at 4, 1999 WL 11526444.

365. See Barbara A. Rehm, *Sole U.S. Triple-Threat, Citi Exploits its Edge*, AM. BANKER, Oct. 26, 2001, at 1.

366. *Id.*

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Citigroup's goal of becoming a significant financial services provider for retail customers, equipped also with the resources that the bank and its affiliates command to achieve this goal, undoubtedly presents a major competitive challenge for any size financial services company.<sup>367</sup>

The Citicorp/Travelers merger has not unleashed a wave of mergers among other major banks, insurers and securities firms looking to establish global financial supermarkets. If Chase had linked up with Merrill Lynch, that would have represented another cross-industry connection. Chase, however, chose to merge with J.P. Morgan, another large bank holding company, indicating a basically conservative view of GLB or, perhaps, a lack of imagination. The result has been positive but without the expansive effects of the Citigroup merger. Market globalization, along with pressure from corporate customers, will undoubtedly spur further consolidation of banks into financial services companies, seeking to offer a wider set of financial products and services. In a speech at the Securities Industry Association's annual meeting, William B. Harrison, Jr., chief of the newly-created J.P. Morgan Chase & Co., said that the most successful companies will be full-service firms that can handle everything from banking to securities underwriting to merger advisory services. "If you look at global wholesale investment banking, there may be only a handful of full-service end-game winners by the end of this decade, down from several dozen major players today.' Bigger is not only better, but absolutely mandatory," Harrison said.<sup>368</sup> It seems that his acts did not quite match his rhetoric.

So far, more than one hundred firms, the majority of them banks, have sought the Board's permission to set up financial holding companies under GLB,<sup>369</sup> indicating that banks have worked quicker than securities and insurance industries to adapt to the new law for entering into new business activities to increase their profits. Some will acquire new businesses and try to integrate them. They also will cut overlapping costs and attempt to gain economies of scale and scope and consequently, drive down unit costs in the way of the vertically integrated 20th Century financial institution.<sup>370</sup>

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367. Douglas P. Faucette, *The Impact Of Convergence and the Gramm-Leach-Bliley Act on the Insurance Industry*, 8 GEO. MASON L. REV. 623, 630 (2000).

368. David Boraks, *J.P. Morgan Chase Chief Praises Full-Service Mode l- For a Few*, AM. BANKER, Nov. 12, 2001, at 1.

369. Alan Levinsohn, *The Coming of a Financial Services Bazaar?*, STRATEGIC FIN., Apr. 1, 2000, at 4047.

370. *Id.*

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Banking companies are moving into securities and insurance, but there has not been much traffic in the other direction. Of the one hundred new financial holding companies only a few non-banks, including MetLife, have chosen to become one.<sup>371</sup> On one hand, the Board urges for patience, adding that it's too soon to judge how well the central bank will use its power to "understand the overall entity [of the FHC] and the risks it poses to the bank,"<sup>372</sup> on the other hand the securities and insurance industries have assessed that over the near to medium term, financial holding company status does not offer significant enough benefits to them, given the associated costs. Those costs include, in particular, the prospective burden of additional regulation by the Board, onerous capital requirements and risk examinations, a cumbersome rulemaking process, and vague criteria for Board intervention into non bank subsidiaries. Also, the non-participation of the country's large insurance underwriters, other than Travelers, in the formation of the new financial services industry may be result of the mutuality and limited stock history of the large insurance companies. The mutual form of business organization has some advantages, but acquisition experience and ability to adjust quickly to change are not among them.

Financial institutions had hoped the Internet and new technology would allow them to live out their visions of creating financial supermarkets. Bankers have dreamed to broaden their services from the more traditional services, such as checking and savings accounts and offering loans, to giving investment advice, purchasing insurance and trading stock.<sup>373</sup> And doing it all on line without the need for cost-heavy branch staff.

Banks look to integrating their businesses into financial institutions which will ultimately emerge as too big to fail. Their well-being will thus be underwritten by the word of the FDIC backed by the financial strength (read full faith and credit) of the United States. This fact is like the elephant at the picnic: everyone is aware of it, but no one wants to mention it. The FDIC and the Board appropriately maintain a constructive

371. See *id.* MetLife became the first insurance company under GLB to receive approval for the purchase of a federally chartered bank, Grand Bank of Kingston, N.J. in February, 2001. Greg Davies, *Insurers Bank on Brand; Is it Enough?*, Oct. 10, 2001 at Insurance and Technology online, <http://www.insurancetech.com/it1/story/IST20011010S0006>.

372. Barbara A. Rehm, *In Focus: Critics Show Impatience with Fed's Implementation of G-L-B*, AM. BANKER, Nov. 19, 2001, at 1 (quoting Richard Spillenkothen, the Fed's top Supervisor).

373. Lauri Giesen, *A Dream Come True?*, AM. BANKER—BOND BUYER, Apr. 2001, at 20.



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ambiguity around this fact. However, the Board and its sister bank regulatory agencies also are careful not to deny this perception too vehemently or to prohibit by regulation the banks' initiatives to get bigger. Neither have the anti-trust laws been forcefully used to constrain bank mergers. Otherwise, the Board, and other agencies, may find themselves tripping over their own words someday. These institutions need not repeat the mistakes of the 1930s to learn the lessons of that time.

Like Citigroup, other financial services organizations which are already or are yet to be created, will expand into new markets, products and services and face increased competition brought by industry-wide consolidation. They will necessarily look for greater economies of scale as a defensive measure. Increasingly, these organizations will look to reduce the cost of risk and expand the scope of their risk management efforts. Cross-selling of new products and services will generate new business, but also create privacy issues due to the sharing of customer information.<sup>374</sup> Under GLB there will also be functional regulation of the various financial businesses conducted by financial holding companies including their banks. This will, of course, be concentrated in the fields of securities (SEC functional regulation) and insurance (functional regulation by the state insurance regulators). How this regulatory regime is implemented will determine whether consumers receive the intended benefit of the legislation.<sup>375</sup>

Anticipations of a flurry of bank and insurance company mergers have to the present time not materialized.<sup>376</sup> Roger Lawson and Joyce Kraeger report that,

[b]oth industries have adopted a "wait and see" approach while regulators sort out their respective roles under GLB's call for traditional and functional regulation. Many banks have been reluctant to take on the risks associated with insurance underwriting and have preferred

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374. See Robert Cox, *GLB Act Will Change Bank Risks*, NAT'L UNDERWRITER, RISK & BENEFITS MGM'T, PROPERTY & CASUALTY, May 1, 2000, at 3 (discussing possible consumer and regulator misgivings).

375. Joseph A. Smith, Jr., *Retail Delivery of Financial Services After the Gramm-Leach-Bliley Act: How will Public Policy Shape the "Financial Services Supermarket"?*, 4 N.C. BANKING INST. 39, 46 (2000).

376. See John Kocjan & Mike Laporta, *Comment: Why Bank-Insurer Mergers Don't Make Sense*, AM. BANKER, Aug. 23, 2000, at 7 (suggesting reasons that bank-insurance combinations are unlikely to result in synergy).

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instead to partner with or acquire insurance agencies, accessing the distribution opportunities presented by such partnerships to generate service fees- something they know quite a bit about.<sup>377</sup>

As for insurers, while they continue to look at banks as an additional distribution source and as a business creator in their own areas of underwriting, their entry into the business of banking largely appears to be occurring by means of the thrift charter.<sup>378</sup>

The continuing bank focus on agency activities reflects the view of many bankers that they do not need to own the factory in order to sell the product.<sup>379</sup> A bank interested in insurance products may indeed find the best of both worlds by partnering with an insurance underwriter to devise new insurance products that the bank may then sell to its customers, perhaps through its own agency activities.<sup>380</sup> There are a number of reasons banking companies currently disfavor acquisition of an insurance underwriter. First, the additional regulatory burdens of owning an insurance underwriter and the risks posed by underwriting have given some bankers pause to reflect on whether insurance underwriting is in the long-term, best interests of their shareholders. Furthermore, that insurance companies in general have a lower return on equity than most banking institutions, suggests that bank-insurance combinations would not be viewed favorably by the market.<sup>381</sup>

For an FHC to provide banking, insurance, and securities services, while complying with the regulations, is an immense burden.<sup>382</sup> These difficulties are a result of the disparity among the regulations that govern each service.<sup>383</sup> Before GLB, the OCC

377. See Rodger S. Lawson & Joyce Kraeger, *Insurers, Banks Go Slow In Wake Of GLB*, NAT'L UNDERWRITER, PROPERTY & CASUALTY-RISK & BENEFITS MGM'T, Sept. 18, 2000, Another Perspective, at 21.

378. See Lee B. David, *Banking-Mergers-Is Commercial Banking Still a Distinct Line of Commerce*, 57 TUL. L. REV. 958, 959-61 (1983) (explaining are three major types of depository institutions in the United States).

379. See Lee Ann Gjertsen, *MassMutual Tailors Products for Bank Sales*, AM. BANKER, June 16, 2000, at 7 (describing MassMutual's development of products geared towards bank customers).

380. See generally James R. Kraus, *Consolidation Ahead*, U.S. BANKER, June 2000, at 30 (predicting that small insurance companies will be replaced in the future by large financial conglomerates who offer insurance as one of many products).

381. See Bob Stein, *Viewpoints: Look At The Numbers, And Don't Be So Ready to Write Off Bank-Insurer Deals*, THE AM. BANKER, June 30, 2000, at 9.

382. Lissa L. Broome & Jerry W. Markham, *Banking and Insurance: Before and After the Gramm-Leach-Bliley Act*, 25 J. CORP. L. 723, 781 (2000).

383. *Id.*

nudged the Board to expand bank powers, but the GLB shifted the balance of power to the Board. Under the GLB, Congress left to the Board the responsibility of drawing the line between finance and commerce, and between the products and services that bank-owning companies may or may not offer. In particular, once a non-bank agrees to become a financial holding company, the Board can question its business movement from acquisitions to product offerings. In other words, once the Board gets control there is severely constrained. One expert went so far as to describe the Board's engagement as "extortion" and added that Congress should allow the OCC to define new "bank products" and services, so that the banking industry will once again experience regulatory competition between the Board and OCC.<sup>384</sup>

Federal agencies and state regulators are required under the GLB to share certain information and engage in coordinated rulemaking.<sup>385</sup> Whether cooperation among these various entities can be achieved and sustained remains to be seen. How functional regulators and the Board, as an FHC's oversight regulator, will interact is also an open issue.<sup>386</sup> The Board and the OCC have taken very different views about their respective regulatory roles under the GLB. For instance, Board Governor Laurence Meyer has stated the Board "needs to know more about the activities within large insured depository institutions [such as national banks] than can be derived from access to public information or from the reports of the primary bank supervisors."<sup>387</sup> Jerry Hawke, the Comptroller of the Currency and functional regulator of national banks, contends that the Board's role is "helping to protect banks from risks that might arise elsewhere in the corporate family, outside the bank."<sup>388</sup> One commentator stated:

The GLB facilitates consolidation in the financial services industry on both a national (more than 500 financial holding companies) and a cross-

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384. See Barbara A. Rehm, *In Focus: Critics Show Impatience With Fed's Implementation of G-L-B*, AM. BANKER, November 19, 2001, at 1 (quoting Charles W. Calomiris, a finance professor at Columbia University's Graduate School of Business). This is the prevailing view though not definitive.

385. GLB § 307, 12 U.S.C. § 6716 (2000).

386. See Eileen Canning, *Fed's Ferguson Offers More Details on Fed's Role as Umbrella Supervisor*, 32 SEC. REG. & L. REP. (BNA) 740 (2000) (describing the increased coordination and cooperation that GLB requires between the FRB and functional regulators).

387. See Comptroller Pokes Holes in Fed's Umbrella, THE AM. BANKER, July 28, 2000, at 1.

388. *Id.*

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border basis (for example, Charles Schwab/U.S. Trust, Credit Suisse/Donaldson Lufkin & Jenrette, UBS/PaineWebber, Dresdner Bank/Wasserstein-Perella, etc.)<sup>389</sup> and pushes existing bank holding companies to restructure their existing activities in order to take advantage of the new powers granted and comply with their attendant requirements and conditions. It may cause many bank holding companies that become FHCs to deal with a new set of regulators, and may leave those bank holding companies that cannot qualify as FHCs to occupy niche positions in the new financial services industry.<sup>390</sup>

During early 2000, cross-border consolidations had been increasing; however,<sup>391</sup> most of these consolidations were composed of community banks and not the predicted “huge conglomerates.”<sup>392</sup> Of the newly formed FHCs, seventy five percent were comprised of bank holding companies whose assets did not go past USD one billion.<sup>393</sup> Now that insurance companies can sell securities products, Allstate Insurance Co.,<sup>394</sup> for example, has begun selling mutual funds. Bill Howell, president of the Insurance Education Foundation in Indianapolis said, “[t]hat’s what people want. They don’t want to go to one place to get insurance and one place to get stocks. They want to go to one place to get their insurance, stocks and do their banking.”<sup>395</sup>

Securities firms, like insurance companies, have their own set of competitive products and services. They are trying to fight commercial banks that are offering cheap credit to their clients and winning lucrative investment banking work such as

389. See Clyde Mitchell, *Financial Modernization - One Year Later!*, N.Y. L.J., January 19, 2001, at 3.

390. See Robert D. Webster & Glen R. Cuccinello, *Gramm-Leach-Bliley Act Modernized U.S. Financial Services Industry*, THE METROPOLITAN CORP. COUN., June 2000, at 17.

391. Robert S. Lawson & Joyce Kraeger, *Insurers, Banks Go Slow In Wake of GLB*, NAT’L UNDERWRITER, PROPERTY & CASUALTY/RISK & BENEFITS MGMT., Sept. 18, 2000, at 21 (reporting that on March 23, 144 of these types of consolidations existed and on May 12, 2000, 212 existed).

392. *Id.*

393. *Id.*

394. Allstate, *Financial Products*, at <http://www.allstate.com/Finance/FinancialProducts/pagerender.asp?page=main.htm> (last visited Nov. 12, 2002).

395. Philana Patterson, *Industry Move to One-Stop-Shopping Increases Competition in Financial Services*, THE BLACK COLLEGIAN ONLINE, at [http://www.black\\_collegian.com/career/industry\\_reports/onestop200-1st.html](http://www.black_collegian.com/career/industry_reports/onestop200-1st.html) (last visited Nov. 12, 2002).

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underwriting securities or advising on deals.<sup>396</sup> Under such competitive circumstances, securities firms are fighting back by getting into the lending business, which historically has been handled by commercial banks.<sup>397</sup> Philip Purcell, the CEO and Chairman of Morgan Stanley, believes the acceptance of lending from the bank will require it “to move closer to the measured culture of commercial” banking, thus building relationships with clients.<sup>398</sup> As a further possible result, the “pressure to do more lending” may induce investment banks to combine with commercial banks.<sup>399</sup>

To survive and be successful, commercial banks, securities firms and insurance companies need to undergo radical changes in their strategies and operations. They could achieve this by implementing new approaches to designing and deploying projects that allow these financial institutions to execute at Internet speed in order to meet consumers’ demands of the new business world. Another strategy would be to perform “more financial transactions online and integrat[e] the Internet throughout the firm [to] redesign” financial operations, thus eliminating factors not enhancing value and “creat[ing] a customer-centric organization by integrating customer service information across their financial products” and services.<sup>400</sup> In order to meet consumers’ demands, these institutions must take an active role in safeguarding the protection of the privacy of the consumer data and information that these financial institutions collect and exchange in the course of their activities.<sup>401</sup>

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396. See Gerard Baker & Gary Silverman, *Fed Concern Over Venture Capital Flow*, FIN. TIMES, Mar. 16, 2000, at 10 (stating that the “big commercial banks such as Chase Manhattan, Bank of America and Citigroup have all established affiliated [underwriting and] venture capital units that in recent years have been investing . . . in business start-ups”, which have developed into a lucrative source of profit).

397. See Rebecca Knight, *Brokerages Diversify and Hope for Rebound*, FIN. TIMES, Dec. 24, 2001, available at 2001 WL 31077730. For example, E\*trade, the major on-line securities/brokerage firm, entered, in the year 2001, the consumer lending business, buying online mortgage originator LoansDirect. In an effort to provide more services, including banking and credit cards. *Id.* Even a major player in investment banking like Morgan Stanley has felt threatened by competition and invested USD “2 billion in capital into a Utah banking subsidiary” in order to strengthen its lending department. Charles Pretzlik & Gary Silverman, *Morgan Stanley Boosts its Lending Capacity in Response to Bank Rivals*, FIN. TIMES, Aug. 16, 2001, at 5.

398. *Id.*

399. Pretzlik & Silverman, *supra* note 397, at 1.

400. See *Financial Services Firms Toss Out Old Growth Strategies* (Oct. 24, 2001), Smartpros at <http://accounting.smartpros.com/x31483.xml> (discussing a Deloitte & Touche report on the performance of banks, securities firms and insurance agencies for the year 2001).

401. See Therese Rutkowski, *Privacy Under Gramm-Leach-Bliley*, INS. NETWORKING & DATA MGMT, June 2001 at 44 (explaining the “price insurers have had to pay for

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In passing GLB, Congress tried to establish the right balance between the privacy needs of consumers and the needs of financial institutions to use information to serve customers' needs.<sup>402</sup> Today, financial institutions have more restrictions on their use of customer information than any other industry. Intense competition in the market is causing some firms to go beyond these requirements and offer customers even more protection. Most importantly, customers have been empowered, because they now know how their information is being used, and they have the final say over the use of this information, even it means to terminate business with their current firm.<sup>403</sup>

The constitutional right to privacy is intertwined throughout our Nation's history and its importance and its complexity is engrained in our society.<sup>404</sup> Unlike other banking issues in which the public is apathetic towards, the provisions relating to privacy in GLB strike a cord in the hearts of Americans.<sup>405</sup> In fact, surveys have come to the conclusion that the public would contest the distribution of information contained in their accounts.<sup>406</sup>

Within months of the enactment of the Financial Modernization Act, non-banking industries made efforts to incorporate thrift charters into their businesses.<sup>407</sup> In essence, GLB increased the activities multi-thrift holding companies may conduct, but it prohibited both the entrance into or its purchase by companies not in the financial industry.<sup>408</sup> Moreover, thrift holding companies held a lead over FHCs because there was not a notice obligation towards the Board or OTS so it could institute a new power.<sup>409</sup>

Community banks are starting to realize that they should not implement electronic services simply to have them, but rather they are important to their competitive survival. They

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modernization" and the extent the insurance companies had to change internal procedures in order to comply with GLB).

402. Edward J. Janger & Paul M. Schwartz, *The Gramm-Leach-Bliley Act, Information Privacy, and the Limits of Default Rules*, 86 MINN. L. REV. 1219, 1224 (2002)

403. See Alan E. Sorcher, *Gramm-Leach-Bliley Privacy Rules Empower Consumers*, AM. BANKER, July 13, 2001, at 8.

404. Robert A. Bennett, *The Burden of Privacy*, US BANKER, July 2000, at 55.

405. *Id.*

406. See *id.* (reporting a survey conducted by Synergistic Research Corp. that concluded 85% felt such an opposition).

407. Steven Marlin, *Firms In Other Industries Move Rapidly To Add Banking Services To Product Mix*, BANK SYS. + TECH., Aug. 1, 2000, at 35.

408. See Nicole Duran, *In Brief: OTS: Multithrift Firms Have Full GLB Rights*, AM. BANKER, May 29, 2001.

409. *Id.*, at 4.

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should be used as a means of redesigning their business processes by adding convenience and reducing operating costs. GLB was a catalyst to increase the availability of the online banking service.<sup>410</sup> For the year 2001, community banks that offered online banking increased from 55% to 75%.<sup>411</sup> This occurrence has caused community banks to use the Internet to remain competitive.<sup>412</sup>

Although the insurance industry is concerned about the scope of the “umbrella” regulation by the Board under GLB, it may be ready to accept this based upon the 50-state insurance regulation to which it is already subject.<sup>413</sup> The Chairman of the Board, Alan Greenspan, said that he had not considered suggestions for a federal charter when asked in 2001.<sup>414</sup> Greenspan went on to indicate that the ramifications for each state to have separate legal rules would be for companies to have to seek the advice of lawyers rather than risk managers.<sup>415</sup> Such an occurrence would not be in the best interest of companies and Greenspan indicated a federal charter would be “irresistible.”<sup>416</sup>

Since June of 2000, there has been a movement for U.S. banking groups to change their status to FHCs through the filing of an election under GLB.<sup>417</sup> In the international market, the movement has not been as strong, with only fourteen foreign-based banking groups having filed elections.<sup>418</sup> Before GLB was passed, a majority of its support for its enactment came from foreign universal banks.<sup>419</sup> The rationale for the foreign support for GLB is based on the fact that if a separate foreign bank and foreign insurance company had offices in the U.S. and they desired to merge their U.S.-based offices, then the previous U.S. law would have required one of them to divest within five years.<sup>420</sup>

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410. Maria Bruno, E-Mania Takes Community Banks by Storm: According to Grant Thornton, Community Banks Must Commit to Big Changes, or Else, *BANK TECH. NEWS*, May 2001, at 4.

411. *Id.*

412. *Id.*

413. See Rob Garver, *GLB Matchup: Big Insurers, Small Banks*, *THE AM. BANKER*, Dec. 1, 2000, at 1.

414. Michele Heller et al., *In Defense of GLB*, *AM. BANKER*, May 14, 2001, at 4.

415. *Id.*

416. *Id.*

417. See Raphael Soifer, *Banking Services: Banks Fail To Get In On The Act - The Take-up Rate Among International Banks To Become Financial Holding Companies In The US Has Been Relatively Low*, *THE BANKER*, Oct. 1, 2000, at 896.

418. *Id.*

419. *Id.*

420. *Id.* (describing that such divestment would “be sufficiently onerous to preclude the European merger in the first place”).

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Although GLB was forecasted to facilitate the expansion of European financial institutions into the U.S. market, it will actually be a secondary incentive as compared with “European economic integration as well as the technological revolution.”<sup>421</sup> “Banks and insurance companies will merge, although the much-ballyhooed European banc assurance paradigm has not been without its rough spots.”<sup>422</sup> Norbert Walter, chief economist for the Deutsche Bank Group, said “[t]he experience with banc assurance has not been encouraging. Obviously, there are cultural differences, but we have to find ways of coexistence of the different cultures; if we are not capable of doing that we will lose.”<sup>423</sup>

Not soon thereafter the passage of GLB did various trade groups initiate organizations.<sup>424</sup> One such organization that arose was the American Bankers Insurance Association, which was a merger between the “Bankers Association, Insurance Association and the Association of Banks in Insurance.”<sup>425</sup> Beth Climo, the executive director of American Bankers Insurance Association stated:

As more bankers take advantage of these opportunities, it's important that they have one place they can turn to for information and support . . . . “That is what ABIA will be. . . . Our mission is to increase financial institutions’ ability to offer insurance and annuity products. . . . We think we will be a valuable partner for banks in the insurance business.”<sup>426</sup>

With passage of the Act, Congress has set the course of the financial services industry. Technological advancements, the growing sophistication of customer attitudes and diversification of consumer financial needs will continue to produce new investment options. Thus, the traditional providers of financial products and services –insurance companies, banks, securities firms –will have to continue to diversify the types of products

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421. Steve Tuckey, *It Changes Tops GLB on Global Scene*, INS. ACCT, Mar. 6, 2000, at 1.

422. *Id.*

423. *Id.*

424. *New Group For Post-GLB Era*, INS. CHRONICLE, June 4, 2001, at 15.

425. *Id.* (describing the purpose of this newly formed association as “serv[ing] as a non-profit affiliate of the ABA as a full service insurance association for the banking industry”).

426. *Id.*



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they offer to remain competitive. The usefulness of cross-industry consolidation as a tool for achieving diversification will no doubt continue to grow. Now that the antiquated anti-affiliation provisions have been removed, the pace will only quicken.

## VIII. CONCLUSION

The enactment of GLB categorized the business divisions in the perspective of the U.S. banking industry as follows: "banking," "closely related to banking," "financial in nature," "complementary to a financial activity," and "non-financial in nature" or "commerce." These divisions are distinguished by defining the specific role each one plays in the U.S. banking industry. The role of federal and state regulatory agencies in banking, securities, insurance and other related financial areas will be to define clearly and issue regulations which better facilitate the competition of banks and bank holding companies in the different business areas.

Most important, the financial market has become so competitive, and the technology so improved, we hope that the agencies, Congress, and the courts will assist and coordinate their work efficiently in order to allow financial institutions to use their business sense effectively in making U.S. banking industry more competitive and responsive to market needs. Business should be driven by market needs, not by elegant legal interpretations.

The banks choosing to become FHCs and the national banks electing to utilize GLB to conduct activities through subsidiaries are dependent on that charter. An enticing selection of business devices awaits. State banks can become BHCs; they might elect a national charter and operate as a national bank charter. Some activities might be subject to supervision under still another agency; for example, securities activities by the SEC or insurance through state insurance agencies.

The power sharing between the Board and the Treasury (OCC) for defining new "financial in nature" activities for FHCs or for bank subsidiaries beyond those now available may increase the Board's creative role as regulator in order to make banks more competitive. One must await the effect of these challenges within the Board, which, with few exceptions, has not been regarded as a leader in innovative banking regulation. Creative regulation has more typically been found in the chartering

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agencies, federal and state,<sup>427</sup> and in the courts, which, one hopes, will see themselves as part of the future of banking.

Competition rather than stultifying regulation among banks and other financial institutions would be consistent within the underlying principles of U.S. banking law, principles reaffirmed in GLB. It is also hoped that competition among regulatory agencies will continue to provide measures of regulatory efficiency and expertise in defining the permissible activities to be carried out by FHCs and banks. Protection against abuse of restrictive regulatory authority from the agencies will, as always, be found through active participation from the courts and Congressional oversight.

The Board's challenges in the implementation of GLB will not end simply through the adoption of a few rules and regulations. The real measure of the Board's performance will be the interagency cooperation necessary for the increasingly large and complex financial organizations that GLB authorized, and the market and technology are creating. The FHCs are no longer simply banks, securities firms, or insurance companies. They are something different – conglomerates – and it will take skill to represent the public interest in supervising them. The goal must not be the expansion of the agencies' jurisdiction so much as the fulfillment of a responsibility to the public.<sup>428</sup> The fencing now in progress between the OCC and the Board does not augur well for this process.

GLB erased a majority of financial regulations that dominated for the past sixty years and catalyzed market-oriented modernization.<sup>429</sup> American consumers and businesses could be benefited by this development.<sup>430</sup>

Not the least of the regulators' challenges will be to shepherd the financial services industry through thickets of cynicism. Free markets provide the potential for productive creativity. They also are breeding grounds for greed and

427. See Carter Golembe, *Reforming Bank Capital Regulation: The Great Leap Forward*, GOLEMBE REPORT, July 2001, at 7 (discussing the definition of "federal dual banking").

428. See Laurence H. Meyer, *Implementing the Gramm-Leach-Bliley Act: One Year Later*, Remarks Before the American Law Institute and American Bar Association (Feb. 15, 2001), at <http://www.federalreserve.gov/boarddocs/speeches/2001/20010215/default.html>.

429. See John S. Barry, *Creating a Financial Services Industry for the 21<sup>st</sup> Century Part 1: Tear Down the Walls*, Jul. 5, 1996, available at LEXISNEXIS, News Library, ALLNEWS File.

430. *Id.* "More profitable investments could be available; capital could be easier to obtain, and its cost could be reduced; and the financial services sector could enjoy more stability and security." *Id.*

corruption, one need only read the morning newspaper. The savings and loan disaster was not too long ago. The regulators are in the key position to ensure that increased freedom of operation does not mean the reduction of honesty. The future is uncertain as to whether GLB can provide the benefits its sponsors imagined is a question yet to be answered.<sup>431</sup>

Finally, GLB enables us to predict the future. With the exception of complementary activities<sup>432</sup> and merchant banking, nothing has been done to connect banking with the vast arena of ordinary, non-financial commerce. We must be prepared to consider the merger of banks and automobile manufacturers and giant retailers. Clearly, such a development is on the horizon. It is already being discussed and, as we have pointed out,<sup>433</sup> there are those who believe that it has already been accomplished. Abolition of the present barriers could, however, take place only when the banking and financial institutions prove that GLB has worked properly and accomplished the advantages promised by the law. If this is achieved successfully, these institutions would "force" Congress and the regulatory authorities to allow them into the next level of market freedom and authorize expanded business in order to achieve a greater diversification of products, greater safety from a more diversified portfolio mix and, not to be forgotten, larger profits. Nobody can predict when this will happen. Old traditions die hard, GLB itself is proof of this. However, what is predictable is that Congressional regulators and the public will monitor closely the impact of GLB upon the U.S. financial system and behave consistently with the experience.

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431. See Di Lorenzo, *supra* note 199, at 42.

432. *Supra* Part V.

433. Peter J. Wallison, The Gramm-Leach-Bliley Act Eliminated the Separation of Banking and Commerce, How This Will Affect the Future of the Safety Net, Address Before the Federal Reserve Bank of Chicago's Annual Conference on Bank Structure and Competition (May 5, 2000), at 4 & n.2, 5.