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A Perspective on Financial Services Restructuring

Richard M. Whiting
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RESTRUCTURING

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Banking is a very heavily regulated segment of the financial services industry. Such governmental oversight flows from the special nature of banks within the United States economic system. Consequently, bankers have operated under statutorily imposed limitations on many aspects of their business, including, inter alia, the lines of products and services that they may offer and the location of their operations. These laws are premised upon certain assumptions and policy decisions regarding the business of banking.

Changes in the business of banking, in the financial services industry, and in the domestic and international marketplace have affected some of the assumptions and policies underlying this country’s system of financial service and banking laws. As a result, many of these laws, some of which are over fifty-years old, have become ineffective or irrelevant. It is reasonable, therefore, that consideration now be given to comprehensive reform of our current statutory framework.

Gradually becoming aware of the necessity for legislative change, Congress has deliberated upon, and more recently has enacted, banking legislation. Unfortunately, to date such laws have been narrowly focused and do not address the fundamental questions raised by evolving conditions. However, in title II of the Competitive Equality Banking Act of 1987, Congress stated:

It is the intent of the Congress, through the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Represen-

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1. For a discussion of the special nature of the role of commercial banks in the United States economy, see generally Corrigan, Are Banks Special?, 1982 FED. RESERVE BANK OF MINNEAPOLIS ANN. REP. 5.
2. See infra notes 18-66 and accompanying text.
3. See infra notes 67-81 and accompanying text.
4. See infra notes 90-131 and accompanying text.
tatives, to conduct a comprehensive review of our banking and financial laws and to make decisions on the need for financial restructuring legislation in the light of today's changing financial environment both domestic and international before the expiration of such moratorium.\(^6\)

As the moratorium referred to in this provision expired on March 1, 1988,\(^7\) it is obvious that Congress committed itself to an ambitious undertaking.

A distinguishing feature of the democratic legislative process is its encouragement and tolerance of the competition of ideas. This factor definitely operates in the development by various parties of plans to aid Congress in its self-appointed task of restructuring the financial services industry. A plethora of plans and recommendations has been proposed;\(^8\) more are expected. Each plan is different depending upon the drafter's conception of the issues, his resolution of key policy questions, and his assessment of the practicality of the available options.

The purpose of this Article is manifold. First, it will provide a brief introduction to the nature of existing statutory provisions affecting the banking industry, particularly those provisions dealing with limitations on permissible product and service lines and geographic restrictions. Second, the principal policy considerations underlying these laws will be described. Third, the changes necessitating revision of the current framework governing the financial services industry will be reviewed. Fourth, a summary description of the most prominent restructuring plans will be provided. Fifth, this Article will contrast and compare the restructuring plan proposed by the Association of Bank Holding Companies (ABHC) to several of the other plans. Finally, based upon the preceding analysis, some conclusions and recommendations will be suggested to assist Congress and others in the process of addressing reform of the banking system.

I. EXISTING STATUTORY AND REGULATORY ENVIRONMENT

Commercial banks\(^9\) must be chartered either by the federal government, through the authority of the Office of the Comptroller of the Currency (OCC),\(^10\) or by one of the states.\(^11\) Commercial banks may also choose

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\(^6\) Id. § 203(a), 101 Stat. at 584.
\(^7\) Id. § 201(a), 101 Stat. at 581.
\(^8\) See infra notes 132-224 and accompanying text.
\(^9\) Commercial banks generally perform the functions of receiving deposits of money, making loans, engaging in trust services, issuing letters of credit, accepting and paying drafts, renting safe deposit boxes, and engaging in similar activities. BLACK'S LAW DICTIONARY 245 (5th ed. 1979). These are to be distinguished from investment banks, thrifts, and other similar institutions.
whether to have their deposits insured by the Federal Deposit Insurance Corporation (FDIC), by another fund, or not at all.\textsuperscript{12} Approximately 95% of the nation’s 15,000 commercial banks have opted for federal deposit insurance.\textsuperscript{13} Additionally, commercial banks may choose whether to become members of the Federal Reserve System.\textsuperscript{14} Finally, commercial banks may be owned by a parent company, generally subject to the provisions of the Bank Holding Company Act of 1956 (BHCA),\textsuperscript{15} or they may be independently owned by individuals and not by a regulated corporate entity. Approximately 9,750, or over 65% of the nation’s commercial banks have chosen the bank holding company form of ownership.\textsuperscript{16} The decision by management with respect to each of these various strategic options subjects their banking organization to a kaleidoscope of overlapping, burdensome, and confusing regulations.

\textbf{A. Dual Banking System}

The opportunity for America’s bankers to choose either a national or state charter creates the basis for the dual banking system. On one hand, the existence of two separate, but interrelated, banking systems increases the options for innovation and preserves states' rights. On the other hand, the dual banking system allows for the development of competing and sometimes conflicting standards at the expense of a uniform national policy on banking issues. Where the federal government has a legitimate interest, however, Congress may exercise its authority to override state banking laws.\textsuperscript{17} Where Congress does not take preemptive action, state law generally controls. The consequences of this bifurcated system of banking laws are no more perplexing than in the area of ascertaining the precise scope of permissible product and service lines available to the banking industry.

\textsuperscript{11} See generally id. § 214(a).
\textsuperscript{12} Federal Deposit Insurance Corporation, Deposit Insurance in a Changing Environment G-7 (Apr. 15, 1983).
\textsuperscript{14} G. Golemb, Federal Regulation of Banking 8 (2d ed. 1983).
\textsuperscript{15} 12 U.S.C. §§ 1841-1850 (1982 & Supp. IV 1986). All corporations, partnerships, trusts or other companies that own or control a bank must register with the Federal Reserve Board (Board) pursuant to the Act, and must otherwise comply with its provisions. Id. § 1844.
\textsuperscript{16} Association of Bank Holding Co., Bank Holding Company Facts (Spring, 1987).
\textsuperscript{17} This authority stems from the supremacy clause of the United States Constitution. U.S. Const. art. VI, cl. 2.
B. National Bank Product and Service Lines

As a creature of federal law, national banks may offer only those product and service lines authorized explicitly or implicitly by Congress. Various provisions of federal statutes enumerate express powers, which include lending money,\(^{18}\) accepting deposits,\(^{19}\) acting as fiduciary,\(^{20}\) and engaging in limited securities,\(^{21}\) real estate,\(^{22}\) and insurance activities.\(^{23}\) Alternatively, implied powers derive from interpretation of section 24 of title 12 of the United States Code by the Comptroller of the Currency, subject to judicial review.\(^{24}\) That provision states that national banks may exercise "all such incidental powers as shall be necessary to carry on the business of banking."\(^{25}\) Regulatory construction of the "incidental powers" clause has resulted in a "creeping" expansion of permissible activities, including the sale or underwriting of title insurance\(^ {26}\) and the issuance of mortgage-backed securities.\(^ {27}\) Other than the Glass-Steagall considerations discussed below, there appear to be no other applicable statutory limitations, by virtue of membership in the Federal Deposit Insurance Fund, the Federal Reserve System or a holding company system, on the product and service lines available to a national bank.

C. The Glass-Steagall Act

The activities of national banks are subject to one major limitation: statutorily circumscribed involvement in investment banking. The provisions of the Banking Act of 1933,\(^ {28}\) four sections of which are collectively referred to as the Glass-Steagall Act,\(^ {29}\) contain this restriction. Together, these sections separate commercial banking from investment banking. Section 16 of Glass-

\(^ {19}\) Id.
\(^ {20}\) Id. § 92a(a).
\(^ {21}\) Id. § 24(Seventh).
\(^ {22}\) Id. § 92a.
\(^ {23}\) Id.
\(^ {24}\) Id. § 24(Seventh).
\(^ {25}\) Id.
Steagall limits the express powers of a national bank to purchase and sell securities upon the order and for the account of its customers, deal and underwrite in certain United States government and state general obligations, and purchase for its own account and subject to limitations certain investment securities, other than corporate stock.30 Section 20 prohibits all member banks from affiliating with any company "engaged principally" in prohibited securities activities.31 Section 21 bars any person or company engaged in prohibited securities activities from also receiving deposits subject to check or payment upon demand.32 Finally, section 32 of Glass-Steagall prohibits interlocking officer, director, and employee positions between member banks and firms "primarily engaged" in investment banking activities.33

D. State Bank Product and Service Lines

State banks, the other type of banks within the dual banking system, derive their authority to offer products and services, expand geographically, and generally conduct their business from state statute, regulation, or interpretation.34 Federal limitations may also apply to these institutions.35 Although the states have been conservative in the authorization of products and services by confining their institutions to traditional banking business lines, that policy currently is changing.36 A recent study by the FDIC, for example, indicates that the states increasingly have permitted their banks to enter into new product lines, including insurance, real estate, and securities activities.37 In the area of securities activities, however, a few states continue to have in effect "mini-Glass-Steagall" statutes—state statutes modeled after the federal law prohibiting bank investment banking activities.38

The authority of the state to increase the product lines and services avail-

31. Id. § 377.
32. Id. § 378.
33. Id. § 78.
35. For example, the provisions of § 16 of the Glass-Steagall Act are applicable to state member banks. 12 U.S.C. § 335.
36. Perhaps frustrated by the inability to receive additional product and service authority under the federal scheme, bankers have lobbied to obtain such powers from their state legislatures. See Whiting, New Path Needed for Financial Service Industry, Am. Banker, June 25, 1987, at 4, col. 1.
able to state-chartered banks is also subject to federal limitation.  

First, the Glass-Steagall restrictions on the securities activities of state banks may apply, depending upon whether the bank is a member of the Federal Reserve System. Second, it is arguable that the Federal Reserve Board (Board) may impose activity limitations on state banks that choose to become a member of, or to continue membership in, the Federal Reserve System. Third, while the FDIC is not a chartering authority and, therefore, may not authorize activities, it has utilized its regulatory authority under section 1819(10) of title 12 of the United States Code to ensure that state-authorized powers are not exercised in a manner inconsistent with the purposes of the Federal Deposit Insurance Act. As a result, insured banks may conduct essentially riskless activities, such as those involving securities, insurance, and travel, directly in the state bank, while more risky activities involving securities, real estate, and insurance underwriting must be conducted in a separate subsidiary and subjected to various other procedural requirements in order to continue to qualify for federal deposit insurance coverage.

As a fourth federal limitation on state-chartered banks, the Board increasingly has invoked its authority in the applications process, or the threat of that authority, to limit, pursuant to the BHCA, product and service lines granted by the charterer. For example, the Board used its authority under section 5(c) of the BHCA to deny the application by Citicorp to acquire a small state bank in South Dakota that was authorized to sell, underwrite, and export from South Dakota a broad range of insurance products and services. The Board held that this proposal constituted an evasion of the

39. See supra note 17 and accompanying text.
40. See supra note 35 and accompanying text.
41. In considering applications for membership into the Federal Reserve System, the Board is empowered to consider “whether or not the corporate powers [of the applicant bank] are consistent with the purposes of this Act.” 12 U.S.C. § 322. The Board could attempt to invoke this authority to regulate pursuant to § 208.7(a)(i) of Regulation H, 12 C.F.R. § 208.7(a)(1) (1987) to limit any changes in the general character of the bank’s business, such as the conduct of real estate activities, after becoming a member of the Federal Reserve System.
44. Id.
45. In connection with applications by bank holding companies to acquire bank subsidiaries pursuant to § 3 of the Bank Holding Company Act of 1956 (BHCA), the Board may attempt to utilize the factors listed in § 3 regarding financial considerations to limit the nonbanking activities conducted by the bank to be acquired. 52 Fed. Reg. 42,301 (1987).
purposes of the BHCA. Further, the Board has intimated that while the nonbanking limitations of section 4 of the BHCA do not apply to the state-authorized activities that banks directly conduct, it may apply such limitations to activities that state bank subsidiaries indirectly conduct. The impact of such an action, at a minimum, would be the federalization of the activities indirectly conducted by state banks and, consequently, a limitation on the bank's chartering authority.

E. Bank Holding Company Product and Service Lines

While bank holding companies are incorporated by the states, enactment by Congress in 1956 of the BHCA, and its subsequent amendment in 1966, 1970, and 1982, ratified the judgment that the parents and affiliates of banks also should be subject to extensive federal regulation. The Board is empowered to administer the BHCA and, in order to implement its authority, the Board has promulgated Regulation Y. Presumably, section 7 of the BHCA reserves to the states the right to regulate banks, bank holding companies, and subsidiaries thereof, to the extent that state action would not contradict federal law.

Section 3 of the BHCA establishes standards and procedures for the acquisition of banks by bank holding companies. The section does not, however, purport to place any activity limitation on the banks to be acquired.

48. Id. at 791.
49. 12 U.S.C. § 1843. The provisions of the BHCA are separated into various sections. Section 3 governs bank holding company acquisition of banks and contains a list of factors to be considered by the Board in acting on such applications. Noticeably absent from this section is the mention of limitations on the activities of banks to be acquired. Id. § 1842. Section 4 of the BHCA relates to the acquisition of nonbanks by bank holding companies and contains specific limitations on the activity limitations of those nonbanks. Id. § 1843. At the current time, there is some dispute regarding the applicability of the activity limitations contained in § 4 to the activities directly or indirectly conducted by banks acquired by bank holding companies.
As will be discussed below, however, section 3(d) of the BHCA places geographic limitations on bank acquisitions by bank holding companies.59

Section 4 of the BHCA60 prohibits bank holding companies from engaging in, or owning shares of companies engaged in, businesses other than banking, with several exceptions. The most important exception from this prohibition is contained in section 4(c)(8) of the BHCA,61 which permits bank holding companies to engage in any activity that the Board determines by order or regulation to be so "closely related" to banking as to be "a proper incident" thereto. The "proper incident" test requires balancing the expected public benefits against the possible adverse effects associated with a specific proposal by a particular bank holding company.62 The former of these two tests, the "closely related" test, is based upon the Board's judgment that the proposed activity meets certain criteria deemed generally to be permissible for bank holding companies.63

To date, the Board has found twenty-four specific activities to be permissible by regulation64 and another twenty-five permissible by order.65 These include a broad range of activities, including mortgage banking, data processing, and operating a finance or trust company. The Board is precluded, however, from exercising its discretion under the "closely related" test in determining that insurance agency and underwriting activities are permissible for bank holding companies.66

59. Id. § 1842(d).
60. Id. § 1843.
61. Id. § 1843(c)(8).
66. Title VI of the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469, 1536-38 (codified at 12 U.S.C. § 1843(c)(8) (1982)), amended § 4(c)(8) of the BHCA by declaring that such insurance activities generally are not "closely related" to banking, unless subject to one of seven specific exceptions. These exceptions are listed at 12 U.S.C. §§ 1843(c)(8)(A)-(G). Many of these exceptions have been construed by the Board in the context of amendments to Regulation Y or in acting on particular bank holding company applications and are the subject of litigation. See, e.g., Independent Ins. Agents, Inc. v. Board of Governors of Fed. Reserve Sys., Nos. 86-1572, 86-1573, 86-1576 (D.C. Cir. filed Oct. 24, 1986). In this last regard, the insurance industry seeks either a judicial or congressional statement that the limitations on insurance activities contained in title VI apply equally to all bank holding company subsidiaries, whether they be nonbanking, banking, or operating subsidiaries within a holding company system.
F. Geographic Restrictions

Federal and state statutes reflect and enforce the historic notion that banking is a local business. State law governs geographic expansion by state banks. The states' treatment of intrastate expansion through branching and placement of automated teller machine facilities generally may be characterized as diverse and changing from a policy of tight restriction to a more liberal allowance of in-state expansion. The latest profile of state branching laws indicates that twenty-three states and the District of Columbia permit state-wide branching,67 twenty-one allow limited branching within the state,68 and seven are unit branching states, wherein branching is not permitted.69 In addition, Mississippi prohibits multibank holding companies, thereby limiting a banking organization only to the intrastate geographic opportunities available under state branching laws.70 Finally, while there exists no federal prohibition on interstate expansion by state banks, no states actively encourage this method of expansion.71

National bank expansion by branching is governed by the provisions of the McFadden Act.72 Based upon deference of federal to state law and the concept of competitive equality between state and national banks, this 1927 law provides equality for national banks to branch within a state to the same extent allowable to a state bank.73 The McFadden Act also prohibits a national bank from branching outside the state where it is located.74 Due to interpretations of the term "branch" as used in the McFadden Act, certain offices or facilities of national banks may constitute branches for purposes of the McFadden Act, at the same time that identical state bank offices and facilities may escape that definition under applicable state law.75

Finally, bank holding company parents are subject to certain federal restrictions on geographic expansion.76 While bank holding companies generally may acquire multiple banks within the state in which they are located, they may acquire additional banks in states other than where they are lo-

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68. Id.
69. Id.
70. Id. at 96.
71. See Miller, Interstate Branching and the Constitution, 41 BUS. LAW. 337 (1986).
73. This theory is explained in First Nat'l Bank v. Dickinson, 396 U.S. 122, 130-34 (1969).
76. 12 U.S.C. § 1842(d) (1982 & Supp. IV 1986). The nonbanking subsidiaries of bank holding companies are not subject to any geographic restrictions. Id.
cated only pursuant to the provisions of section 3(d) of the BHCA.\textsuperscript{77} This provision, also known as the Douglas Amendment, allows interstate bank acquisitions by bank holding companies only if the state in which the target bank is located explicitly authorizes the acquisition.\textsuperscript{78}

Until the early 1980's, few states allowed acquisition of their banks by out-of-state holding companies.\textsuperscript{79} Gradually, however, certain states lowered their barriers to acquisition in various ways. Some states allowed acquisition of their banks by holding companies located in particular regions of the country, while others opened their banks to acquisition on a national basis.\textsuperscript{80} The former type of statute, known as a regional compact, has survived a constitutional challenge alleging that their exclusionary nature violated the equal protection clause.\textsuperscript{81} Additionally, some of these statutes impose a reciprocity requirement, while others do not. Currently, therefore, some states permit acquisition of their banks only by procurers located in certain regions, while other states have adopted a policy of full interstate banking. Certainly, with nine states having endorsed full interstate banking and fifteen states having adopted regional compacts with national triggers, the trend is towards a uniform national policy on interstate acquisition by bank holding companies.

\section*{G. Other Regulation}

Not only do federal and state regulations affect "which" product and service lines banking organizations may offer and "where" they may be conducted, they also regulate "how" the banking organizations may conduct their business. The range of regulation in this regard is too broad and detailed to be described fully in this Article.\textsuperscript{82} Suffice it to say that provisions have been implemented both at the state and federal level regarding diverse elements of bank business such as lending limits,\textsuperscript{83} interaffiliate transactions,\textsuperscript{84} investment authority,\textsuperscript{85} capital requirements,\textsuperscript{86} investments in bank

\begin{itemize}
  \item \textsuperscript{77} Id. § 1842(d).
  \item \textsuperscript{78} Id.
  \item \textsuperscript{79} In 1975, Maine became the first state to allow bank holding companies from other states to acquire its banking institutions. See Richard, States' Interstate Banking Initiatives, ECON. REV., Mar. 1985, at 21.
  \item \textsuperscript{80} Id.
  \item \textsuperscript{82} See generally Whiting, Bank Holding Companies, A Legal Primer, 2 BANKING L. REP., May 1986, at 190.
  \item \textsuperscript{83} See 12 U.S.C. § 84(a), (d) (1982).
  \item \textsuperscript{84} Interaffiliate transactions are otherwise known as §§ 23A and 23B of the Federal Reserve Act. See 12 U.S.C. §§ 371(c), (e) (1982).
\end{itemize}
premises, and management interlocks. Further, numerous other laws dealing with bank consumer protection have been enacted. Finally, the federal and state bank regulators have been accorded broad powers to examine banks and their affiliates, require periodic reports, and enforce the regulations under their jurisdiction.

II. GOALS OF BANK REGULATION

The number of laws administered by the three federal, and the fifty state, bank regulators undoubtedly is in the thousands. Perusal of the preambles of several major pieces of federal banking legislation reveals a multiplicity of purposes: "to furnish an elastic currency, to afford means of rediscourting commercial paper, to establish a more effective supervision of banking in the United States"; "to define bank holding companies, control their future expansion and require divestment of their nonbanking interests"; and "to safeguard the consumer in connection with the utilization of credit." These enumerated objectives have been neither consistent nor constant over time. The statutory framework governing the banking industry was not produced at one time and does not reflect a comprehensive plan. Rather, the regulatory scheme for the American bank system evolved ad hoc, more often than not, in reaction to financial crises and political forces.

It is possible, however, to discern in these laws a pattern of purposes that together comprise the fundamental goals of our nation's system of bank regulation. These goals are interdependent. It is helpful to articulate these goals and to keep them in mind while considering revision of our banking laws.

A. Depositor Protection

Banks perform many functions also performed by other entities: they are a source of funds, offer certain financially related services, and provide a place for capital investment. One function unshared with other entities, however, is the holding of individual, corporate, and governmental funds with the highest expectation of return of principal. The assurance of the

86. See E. Symons & J. White, supra note 75, at 287-313.
88. See id. §§ 3201-3207.
90. Federal Reserve Act, ch. 6, 38 Stat. 251 (1913).
safety of deposits, therefore, is a basic objective that bank regulation is designed to achieve.

Many of our banking laws and regulations address this objective, and a variety of approaches are taken. The Federal Deposit Insurance Act, for example, simply insures the first $100,000 of a deposit account. Other tacks are more subtle: some provisions place limitations on affiliation of banks with companies that may expose bank depositors to increased risk; some place restrictions on the use of bank funds for particular purposes, such as investments in real estate; some impose capital standards; and others relate to disclosure of information regarding the bank’s financial condition, check-hold policies, and the like. All of these provisions illustrate that the goal of depositor protection pervades bank regulation. This goal should not be misconstrued as the protection of individual banks. Clearly, the system is not designed to ensure the viability of institutions that cannot survive due to mismanagement or other undisciplined behavior.

B. Protection of the Financial System

The key role that banks play in the nation’s payment system and in the effectuation of monetary policy demands that the stability of the banking system be maintained. Colloquially speaking, the health of the banking system and the health of our country’s economy go hand-in-hand. For this reason, the federal government has provided a public safety net, consisting of federal deposit insurance, access to the discount window, and use of the payments system, to the banking system.

Protection of the individual depositor may require a microeconomic approach, whereas protection of the financial system generally requires a macroviewpoint. Sometimes the two are confused. Limitations on the affiliation of banks with commercial firms, for example, may be suggested by those aiming to protect the individual depositor, as well as by those with an interest in protecting the national payments system. How such limitations are fashioned and implemented depends upon the goal to be accomplished.

C. An Efficient and Competitive Banking System

Many statutory provisions are intended to promote an efficient and competitive banking system. The elements needed to achieve this goal are nu-

94. Id. § 1813(m)(1).
umerous and are not easily quantified. Basically, such a system provides customers high-quality financial products and services at competitive prices. Further, such a system also provides alternatives to the consumer. Additionally, an efficient and competitive system is flexible, so as to allow adaptation to changing economic conditions.

Economic theory instructs that a free market is the optimum environment for vigorous competition and that vigorous competition fosters improved services, lower prices, higher quality, innovation, and greater efficiency. Therefore, the major obstacle to efficiency in banking is excessive regulation. Excessive regulation engenders the opposite. This theory has been wholeheartedly embraced by the current administration. To the extent that a regulatory system erects arbitrary barriers to entry, the objectives of an efficient and competitive system are undermined. Such a system easily becomes irrational and inequitable. Accordingly, considerable judgment is required to fashion a banking system that achieves a balance between this goal and the others previously described.

D. Consumer Protection

A goal of bank regulation, particularly manifest in several statutes adopted since the mid-1970's, is the protection of consumers. To a very large degree, this goal is accomplished automatically in a competitive market. That is, so long as the consumer has alternative sources of financial services, any firm that engages in unacceptable consumer practices will be punished by the marketplace and will not survive. This conclusion is widely accepted by economists. Thus, an efficient and competitive financial system operates in harmony with the goal of consumer protection.

While a healthy, competitive financial services market will inhibit and correct systemic consumer abuses, aberrations can still occur. With that in mind, our regulatory system includes statutory consumer protection from concrete abuses. Also, several consumer laws attempt to minimize abuses by providing for disclosure of information material to proposed financial transactions, promoting equal treatment of all consumers, and applying their restrictions to all providers of financial services. That our banking system has been amended to incorporate consumer protection is a sign of its maturity.

III. FORCES OF CHANGE

The banking industry now aggressively seeks revision of the statutory scheme that governs the conduct of its business. In particular, those provisions restricting the scope of product and service lines available to banking organizations seem to be targeted for modification. Many factors motivate this movement. So many changes have occurred since the laws governing the banking industry were enacted that many laws no longer efficiently achieve their intended goals. In fact, it is even widely accepted that certain statutory provisions actually operate to undermine their stated objectives. In order to understand the relationship between the existing bank regulatory scheme and proposals to revise that scheme, it is important also to know the incentives for change.

A. Compensation for Diminished Profit Opportunities

The quasi-public nature of banks often obscures the fact that they are private corporations run for profit. The many statutory barriers to product and geographic expansion naturally diminish their profit opportunities. While these limitations originally were intended to further particular policy goals, such as the containment of the amount of risk to which a bank is exposed, they also reflect the context of the assumptions in which they were adopted. Where those assumptions have radically changed, the limitations should be reassessed.

For example, the activity restrictions contained in the Glass-Steagall Act and the BHCA were adopted at a time when the limiting effects of those restrictions on profits available to a banking organization were counterbalanced by governmental assurance of low-cost funds. However, when Congress adopted the Depository Deregulation and Monetary Control Act of 1980, which provided for the phase-out of all interest rate ceilings on time deposits and ratified negotiable order of withdrawal (NOW) accounts for consumers, the access of banks to low cost funds was lost. Consequently, the quid pro quo for activity restrictions was removed and, in order to main-

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103. There is a theory that when Congress enacted the Glass-Steagall Act in 1933 it represented a tradeoff of the banking industry's authority to engage in the securities business in exchange for its banking franchise, consisting of low cost funds (deposits) and protection from competition. See Application to Underwrite and Deal in Municipal Revenue Bonds, Mortgage Related Securities, Consumer Related Securities and Commercial Paper: Hearings Relating to Application by Citicorp, J.P. Morgan & Co., and Bankers Trust New York Corporation Before the Board of Governors of the Federal Reserve System (statement of James J. Baechle) (Feb. 3, 1987).

tain profitability, bankers have sought compensating deregulation of the asset side of their balance sheet.

B. Increased Competition

The role of banks as the provider of financial services has diminished significantly in recent years. Concomitantly, nonbanks increasingly perform bank-like functions. The consequences of these trends are negative both for bankers and our nation, and have accelerated the need for change. Where bankers can meet competition through opportunities available under existing law, sometimes termed "exploiting the loopholes," they have done so. However, reasoned and comprehensive legislative action is the better method.

Bankers currently face competition from many sides and for many reasons that were not significant at the time existing banking laws were enacted. First, thrift institutions were accorded increased commercial lending and NOW account authority in 1980. Thus, even though thrifts and their parents have substantially broader asset powers than banks, the public views thrifts and banks as interchangeable, most likely because thrift deposits can be federally insured and the legal distinctions from banks continue to blur. The trend has disfavored banks because their annual asset growth rate has been only 7½% compared to 16% for thrifts. Moreover, in this regard, the unitary thrift holding company, a corporate structure wherein a company may own one thrift association and engage without limitation in all other activities, continues to constitute a significant loophole in federal regulation of insured depository affiliates and presents competition not easily met by present bankers.

Second, unregulated nonbank entities, both financial and nonfinancial, increasingly provide services similar to those available from banks. For example, finance companies and insurance companies have become such active lenders that they have displaced commercial banks as the major providers of consumer installment credit. The fact that captive automobile finance companies are the three largest finance companies in the United States amply demonstrates this trend. Third, beginning in 1981, several commer-

105. See id. § 401, 94 Stat. at 151.
106. See id. § 303, 94 Stat. at 146.
107. See AMERICAN BANKERS ASS'N, EXPANDED PRODUCTS AND SERVICES FOR BANKING: THE PUBLIC POLICY PERSPECTIVE 9 (September 1986) [hereinafter EXPANDED PRODUCTS].
Catholic University Law Review

Cial companies acquired "nonbank banks"\(^{110}\) in order to engage in many aspects of the banking business at the same time that the parent company escaped regulation under the BHCA.\(^{111}\) Although, the provisions of title I of the Competitive Equality Banking Act of 1987\(^{112}\) prospectively prohibit this strategy, approximately 200 institutions are grandfathered permanently and may continue this advantageous arrangement.\(^{113}\)

Fourth, the market share of commercial banking's portion of the wholesale commercial loan market has declined over the past several years; its share of overall short-term commercial credit has slipped from over 43% in 1974 to approximately 27% in 1985.\(^{114}\) Much of this credit now is provided to traditional bank corporate customers, who bypass the banks, by means of the commercial paper markets.\(^{115}\) Additionally, advances in technology drastically have cut the costs of information gathering, analysis, and transmission, thereby permitting other bank customers to securitize their assets and to fund them directly through the capital markets.\(^{116}\) The accumulation of large amounts of capital by institutional investors, i.e., pension funds, also provides a ready alternative to banks as a source of credit.\(^{117}\) Furthermore, the increasing linkage of the world's financial markets allows the domestic borrower, who heretofore would have borrowed from United States banks, to obtain capital from foreign sources.\(^{118}\) Fifth, the liability side of the balance sheet also has experienced significant competition in the form of disintermediation of bank deposits to money market and mutual funds.\(^{119}\) Lastly, foreign bankers have become more active in the United States, claiming a proportionately larger share of domestic banking markets than in prior years.\(^{120}\)

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\(^{110}\) "Nonbank banks" are institutions chartered as banks, but which fail both to perform commercial lending and to accept deposits payable upon demand. Accordingly, such "banks" failed to meet the definition of "bank" for the purposes of the BHCA, before its amendment in 1987 by the Competitive Equality Banking Act of 1987. Consequently, the parent of "nonbank banks" escaped regulation pursuant to the BHCA. See The Recent Performance, supra note 108, at 32-33.

\(^{111}\) Id.; see also P. Heller, Federal Bank Holding Company Law 1-14 to 1-31 (2d ed. 1987).


\(^{113}\) See P. Heller, supra note 111, at 4-81 to 4-92.

\(^{114}\) The Recent Performance, supra note 108, at 3.

\(^{115}\) Id.

\(^{116}\) Id.

\(^{117}\) Id.

\(^{118}\) Id.

\(^{119}\) EXPANDED PRODUCTS, supra note 107, at 14-18.

\(^{120}\) Id. at 12.
C. Need to Improve Bank Performance

The growing intensity of competition within the financial services marketplace has been accompanied by a decline in performance by the banking industry. The FDIC recently reported that 16% of all banks were unprofitable and that the earnings record and return on assets of commercial banks for the second quarter of 1987 was the worst since 1934.121 Over 100 commercial banks failed in 1986, and approximately 200 additional failures are predicted for 1987.122 Furthermore, assessment of the future of banking, as reflected by market valuation of bank stock, is discouraging: prices of bank stock relative to their book value and to other industries are low.123 It is difficult statistically to relate the decline in bank profitability to the increasingly competitive environment. However, bankers are convinced that structural barriers to bank expansion into additional product and service lines have had a significant adverse effect on bank profitability and should be reformed.

D. Need for System Rationalization

The bank regulatory system is ad hoc, overlapping, and confusing.124 Additionally, it has been partially deregulated, not only by the affirmative legislative action embodied in the 1980 legislation removing interest rate ceilings on deposits, but by marketplace developments that creatively and aggressively exploit its provisions. One point that illustrates this latter fact rather well is the numerous types of securities activities that commercial banks conduct, despite the provisions of the Glass-Steagall Act. For example, even though the Glass-Steagall Act supposedly separates commercial from investment banking, commercial banks engage in: private placement of securities, underwriting general obligation municipal bonds, full investment banking activities in the Euromarkets, discount securities brokerage, limited underwriting by subsidiaries not “engaged principally” in those activities, and placement of third-party commercial paper.125 A comparable listing of insurance practices conducted by banks and bank holding companies, despite the provisions of title VI of the Garn-St Germain Depository Institutions Act of 1982,126 also could be prepared.127 While such exceptions to the general barriers to bank product and service expansion provide a necessary out-

121. THE FDIC QUARTERLY BANKING PROFILE 1-3 (3d Qtr. 1987).
122. Id.
123. EXPANDED PRODUCTS, supra note 107, at 23-25.
124. See supra notes 9-17 and accompanying text.
let to bankers frustrated by those restrictions, they foster expensive and time consuming inefficiencies in the form of litigation and lobbying efforts. Bankers believe that such efforts should be avoided and that Congress must legislate comprehensive reform of the system.

E. Benefits for Other Industries

Statutory limitations on bank entry into other businesses have had unintended adverse consequences in those industries. The structure of any market reflects the vigor of competition within it. For example, the fact that banking organizations have been precluded from full engagement in securities activities also has meant that the American consumer has been forced to deal with oligopolistic and highly concentrated securities markets. In the United States, the five largest underwriters of corporate debt control approximately 69% of that market. In the Euromarkets, where United States banking organizations do compete in the underwriting of corporate debt, the top underwriters hold only 49% of the market. Likewise, in the market for underwriting municipal revenue bonds, where banks are excluded as competitors, the top ten firms control about 57% of the market while in the market for underwriting general obligation bonds, which banks do underwrite, the top ten firms hold only 31% of the market.

The higher levels of concentration in markets from which banks are excluded undoubtedly translate not only into higher costs, but also into inferior products, poorer service, and other inefficiencies. The oft-quoted outrageous compensation packages paid to securities executives and the reported flagrant abuses of Securities and Exchange Commission regulations may be attributable to the lack of competition within the investment banking industry. A similar scenario of concentration, lack of competition and poorly served consumers resulting from lack of competition from bankers arguably can be documented in the insurance industry. The need to address all of the deleterious side effects of the existing structural framework provides one of the most compelling reasons for comprehensive restructuring of our banking system.

130. Id. at 19.
131. Id.
IV. RESTRUCTURING PROPOSALS

The forces for change now must be channeled into constructive action. The logical options, it appears, are four-fold. First, no legislative action could be taken—the so-called “muddle through” approach. Under this scenario, the banking system would continue to be revised through marketplace developments and agency and judicial actions. Second, legislative action could be taken to regulate recent developments according to the principles and standards embodied in existing statutes. This approach would constitute an attempt to maintain the neat compartmentalization of the components of financial services industry. Third, legislative action could be taken to endorse a free-market approach. Such action would entail abandonment of historical commitment to governmental regulation and result in wholesale deregulation. Fourth, a middle approach could be taken. Such an approach would attempt a thorough revision of the existing system. It would involve careful evaluation of the extant provisions, keeping those that have worked well. Such a scenario also would include enactment of new provisions that address the changes that have occurred in the system and provide an accommodation for future adjustments. This last approach is the most logical and the one advocated by the ABHC. There follows for reference, and for later discussion, a description of that plan, together with several others.

A. ABHC Financial Service Holding Company Proposal

The most comprehensive restructuring proposal offered by the banking industry in the last two years and, therefore, the one to which all subsequent plans are compared, was developed by a national banking association, the ABHC. The ABHC plan has been introduced by Representatives David Dreier (R-Cal.) and Toby Roth (R-Wis.) in the form of H.R. 3360. The concept has been endorsed by four other national banking trade associations: the American Bankers Association, the Consumer Bankers Association, the Bank Capital Markets Association, and the Reserve City Bankers Association.

133. The American Bankers Association is the largest national banking association representing 12,000 full service banks of all sizes and locations. Am. Banker, Oct. 20, 1987, at 28, col. 1.
134. The Consumer Bankers Association represents 725 commercial banks, savings and loans, savings banks, and credit unions. Its goal is the promotion of the retail banking industry. Id.
135. Formerly the Dealer Bank Association, the Bank Capital Markets Association represents 175 banks involved in securities activities. Id.
136. The Reserve City Bankers Association’s membership consists of approximately 400
The ABHC concept provides for the creation of an umbrella corporation, the financial services holding company, which would be defined by ownership of a bank holding company and any other subsidiary engaged in "financially related" activities.\textsuperscript{137} Such activities are limited to: (1) controlling a savings and loan association; (2) underwriting and distributing securities; (3) operating, sponsoring, and selling securities of an investment company; (4) acting as an investment advisor; (5) engaging in the business of selling and underwriting insurance; (6) engaging in real estate development and brokerage; and (7) engaging in any activity permissible for a multiple savings and loan association or a bank holding company.\textsuperscript{138} Each of the "financially related" subsidiaries and the bank holding company would be functionally regulated pursuant to the existing regulatory scheme: the parent corporation would not be regulated, but the Board would certify that each of its subsidiaries is confined to "financially related" activities;\textsuperscript{139} that any bank subsidiary is insulated from its affiliates pursuant to the provisions of sections 23A and 23B of the Federal Reserve Act;\textsuperscript{140} and that the parent corporation generally is not controlled by another company.\textsuperscript{141} Also, H.R. 3360 would provide national banks new, relatively riskless, nonbanking powers (e.g., real estate, securities, and insurance brokerage) and expand existing asset limitations on national bank investments in service corporations.\textsuperscript{142} Finally, the ABHC proposal would empower the Board to receive periodic reports from financial service holding companies and to enforce the specific activity and insulation provisions of the proposed act.\textsuperscript{143}

\textbf{B. Corrigan Proposal}

On January 29, 1987, E. Gerald Corrigan, President of the Federal Reserve Bank of New York, released a publication entitled \textit{Financial Market Structure: A Longer View}, which also recommends a restructuring alternative for the financial system;\textsuperscript{144} on November 20, 1983, Senators Wirth (D-Colo.) and Graham (D-Fla.) introduced a bill, S. 1891, to implement this

\textsuperscript{137} H.R. 3360, \textit{supra} note 132, § 2(c).
\textsuperscript{138} \textit{Id.}
\textsuperscript{139} \textit{Id.} § 2(d).
\textsuperscript{140} \textit{Id.} § 2(e).
\textsuperscript{141} \textit{Id.} § 2(f).
\textsuperscript{142} \textit{Id.} §§ 9-10.
\textsuperscript{143} \textit{Id.} § 7.
\textsuperscript{144} \textit{FEDERAL RESERVE BANK OF NEW YORK ANN. REP.} (1987) [hereinafter CORRIGAN PLAN].
The Corrigan proposal offers three holding company options to engage in the financial services business. First, a bank or thrift holding company would be defined by ownership of a depository institution. Such companies could engage in a full range of financially related activities, including securities and insurance, and other services determined to be financially related by a newly established "Financial Services Oversight Board." Through the depository institution subsidiaries, these holding companies could also offer government insured deposits, including transaction deposits, and would have direct access to the payments system and the discount window. These companies could not be owned or controlled by nonfinancial companies or engage in nonfinancial activities. Their subsidiaries would be subject to functional regulation by existing regulators, and the Board would have consolidated supervision over the parent organization.

Second, the proposal would authorize creation of a new type of holding company called a "financial holding company." These holding companies could engage in financial services, but could not own any depository institutions unless the parent chose to convert to a bank or thrift holding company. These holding companies would be permitted full access to the payments system and limited access to the discount window. In return, they would be subject to prudential supervision and could be subject to interest-bearing liquidity reserves on transaction accounts offered to customers.

Third, the proposal would permit "commercial" financial holding companies to combine general commerce and financial services, other than ownership of a bank or thrift. These companies would receive no special assistance from the government, such as direct access to the payments system or discount window.

Finally, in order to provide increased protection of the payments system, a large dollar payments corporation would be created jointly between the Federal Reserve and the private sector.

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146. CORRIGAN PLAN, supra note 144, at 40.
147. Id. at 41.
148. Id. at 40-41.
149. Id. at 43.
150. Id. at 39-40.
151. Id. at 39.
152. Id.
153. Id. 39-40.
154. Id.
155. Id. at 37.
would be required to subscribe to this corporation, while financial holding companies could choose whether to subscribe.

C. FDIC Plan

In October 1987, the FDIC published Mandate for Change: Restructuring the Banking Industry. The study concluded that banks can be effectively insulated from affiliates with relatively minor revisions to the existing statutory framework. In this regard, the FDIC would add restrictions governing dividend payments and general loan limits by banks, extend the coverage of sections 23A and 23B to bank subsidiaries, and give the FDIC authority to require reports as needed from nonbank affiliates. Accomplishment of these steps, together with increasing the examiner and supervisory staff of the FDIC, would permit the elimination of Glass-Steagall Act restrictions on bank securities activities and the gradual phase-out of the activity limitations and the provisions under the BHCA providing for supervision of the parent company. Thus, the FDIC concludes that banks may be affiliated with any other business, commercial or financial, without need of any holding company structure.

D. Barnard Proposal

On September 30, 1987, the House Committee on Government Operations submitted a report based on a study made by its Commerce, Consumer and Monetary Affairs Subcommittee. The report made specific recommendations for a legislative framework for financial services holding companies. On December 18, 1987, Representative Doug Barnard (D-Ga.) introduced a bill to implement these recommendations, H.R. 3799.

The Committee recommended a new and comprehensive scheme authorizing the creation of financial services holding companies empowered to own any insured depository, securities company, or other company engaged in activities deemed by Congress to be of a “financial nature.” The Board would be responsible for the interpretation of the phrase “financial nature.” The Board also would have general oversight over the parent company, but would not have the authority to require applications for new activities or to regulate the holding company, except to accomplish effective bank and thrift supervision.

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156. See FDIC Plan, supra note 109 and accompanying text.
157. Id. at 98.
158. Id. at 86-91.
159. Id. at 100-01.
160. BARNARD REPORT, supra note 129.
162. Id. at 74.
insulation, as described below.163 A financial services holding company must be owned as a separate subsidiary, and any publicly owned financial or commercial parent and all its affiliates would be functionally regulated.164

The report recommends extensive statutory insulation of insured depository institutions within the financial services holding company.165 Such insulation would prohibit all interaffiliate bank loans and any federal bail-out of the holding company.166 The insulation program also would require rigorous capital standards for depository institutions, as set by the appropriate regulator, company reimbursement of federal insurance funds for any losses, legal separateness, cross-marketing free from coercive tie-ins and other unfair competitive practices.167 While the Board would have no regulatory power, it would be assigned responsibility for: monitoring and evaluating the insulation scheme and conflict of interest controls; establishing, but not enforcing, minimum capital adequacy ratios for the parent; analyzing the aggregate stability of the financial system; prohibiting actions threatening the legal separateness of depository institutions; and requiring reports and disclosures to carry out these responsibilities.168 Except as required to accomplish effective insulation, holding company oversight would be strictly limited to prevent burdens upon nondepository subsidiaries that would exceed those applicable to their independent competitors.

E. Carper Bill

Representative Thomas Carper (R. Del.) has introduced a bill, H.R. 3063,169 that allows the states to lead the way to expanded bank powers. This bill provides that, unless disapproved by the Comptroller of the Currency, a national bank may engage, through a separate subsidiary, in any activity authorized for state chartered banks in the state in which the national bank is located.170 These bank subsidiaries would be subject to the same antitying and section 23A lending restrictions that apply to other affiliates of the bank. Further, the activity may only be conducted in the state in which the national bank is located, unless state law of the other state allows the activity to be conducted by the national bank.171

The bill also provides that a bank holding company may control a non-

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163. Id. at 74-75.
164. Id.
165. Id. at 79-81.
166. Id. at 79.
167. Id. at 81.
168. Id. at 78.
170. Id. § 3(b)(1).
171. Id. § 3(b)(6)(A).
bank company engaged in any nonbanking activity, if the activity is authorized for state banks in the state in which the holding company has a bank subsidiary.\textsuperscript{172} The activity must be conducted only in the state authorizing the power, and in any other state that allows the activity to be conducted by an out-of-state bank holding company.\textsuperscript{173}

Finally, the bill provides that, with appropriate regulatory approval, any bank holding company or national bank may affiliate with a "qualified securities company."\textsuperscript{174} The bill defines a "qualified securities company" as a registered broker or dealer that may underwrite or deal in a limited range of corporate securities representing pools of assets that the bank may originate.\textsuperscript{175} It may also underwrite or deal in any security, provided such activities are conducted principally outside of the United States.\textsuperscript{176}

\textbf{F. Double Umbrella Plan}

An individual Governor of the Federal Reserve Board, H. Robert Heller, has also developed a plan for the future framework of banking.\textsuperscript{177} Pursuant to this plan, the concept of the bank holding company would be expanded to include not only bank, but thrift, insurance, investment, securities, and real estate subsidiaries.\textsuperscript{178} Thus, a full range of financial services would be available from the subsidiaries of one organization. These subsidiaries would be functionally regulated and the parent company would be required to be a "source of strength" to its banks, which would continue to have access to the discount window and federal deposit insurance.\textsuperscript{179} However, strict limits on the amount and nature of loans and other transactions between the bank and all other subsidiaries and affiliates would be imposed.\textsuperscript{180}

Under Governor Heller's plan, these newly authorized financial services holding companies could be owned by any other firm, including commercial corporations.\textsuperscript{181} However, the parent company of a financial services holding company would also be required to serve as a source of financial strength.

\textsuperscript{172} \textit{Id.}
\textsuperscript{173} \textit{Id.}
\textsuperscript{174} \textit{Id.} \textsuperscript{6}.\textsuperscript{175} \textit{Id.} \textsuperscript{6(b)}.
\textsuperscript{176} \textit{Id.}
\textsuperscript{177} \textit{See Address by Governor H. Robert Heller, The Shape of Banking in the 1990's, Forecasters Club of New York (June 26, 1987). There currently are no proposed statutory provisions to implement this plan.}
\textsuperscript{178} \textit{Id.} at 10.
\textsuperscript{179} \textit{Id.}
\textsuperscript{180} \textit{Id.} at 11.
\textsuperscript{181} \textit{Id.}
to its bank subsidiaries. Thus, a "double umbrella" of protection for bank subsidiaries would be imposed. No special regulation of the owner of a financial services holding company is proposed.

G. "Safe" Bank Approach

Another alternative to bank restructuring is embodied in the concept of the "limited," the "narrow," the "debanked," or the "safe" bank. This notion is not new, tracing its origins to 100% reserve banking as discussed several decades ago. The most comprehensive description of modern-day application of the concept is made by proponent Robert Litan in his recently published book.

Implementation of the "safe" bank approach would entail creation of an optional new financial holding company, which could engage through separate subsidiaries in any activity, financial or commercial, subject to certain conditions. First, its "bank" subsidiary would be confined only to accepting deposits and investing in highly liquid, high-quality securities. Second, all commercial and consumer lending would be restricted to a separate lending subsidiary that funds itself through the capital markets. Third, parents and affiliates of the bank subsidiary could not have deposit accounts at their related banks. This requirement would protect the integrity of the payments system. Fourth, any corporation, commercial or not, could own the financial holding company. Fifth, all current owners of nonbank banks or unitary thrifts would be required to conform to the new structure. For all others, the concept is voluntary. Sixth, no cross-selling restrictions would be placed on the activities of the banks or their affiliates. Seventh, the FDIC would define the kind of assets in which the bank could invest and the Board would have only such authority over the parent as to ensure the integrity of the payments system.

182. Id. at 11-12.
184. R. LITAN, WHAT SHOULD BANKS DO? 164-78 (1987). Like the Heller approach, supra note 177-82 and accompanying text, this plan has not been proposed in statutory form.
185. See R. LITAN, supra note 184, at 164-68.
H. Financial Services Council Proposal

Several members of an affiliation of banking, financial, and commercial firms, previously called the "Mayflower Group," have formed an organization known as the Financial Services Council (FSC). The FSC has developed a comprehensive legislative proposal, the Depository Institution Affiliation Act, that would allow any type of business to engage in banking, insurance, thrift, securities, real estate, and other financial service activities in compliance with a proposed framework.\textsuperscript{193} This scheme is contained in a bill, S. 1905, that recently was introduced by Senators Cranston (D–Cal.) and D'Amato (R–N.Y.).\textsuperscript{194}

The FSC would create a new type of financial company, a "depository institution holding company," which would be any company that controls an insured financial institution and voluntarily has chosen to file a notice that it intends to comply with the proposed new statutory framework.\textsuperscript{195} In this last regard, the FSC would create a new governmental entity called the "National Financial Services Committee," composed of all federal agencies responsible for regulating financial institutions and entities. The Committee would do several things: receive notices filed by proposed depository institution holding companies, provide a forum for all federal and state regulators to reach a consensus regarding how the regulation of depository institutions should evolve, provide a mechanism for developing responses to financial crises, and file certain reports with Congress regarding future improvement in the regulation and oversight of depository institutions.\textsuperscript{196}

All of the subsidiaries of a depository holding company, including insured depositories, would be subject to functional regulation. The existing federal regulators would be granted enhanced powers to insulate affiliated depository institutions, including greater and more flexible power over affiliate transactions and additional enforcement authority, such as the ability to require prompt divestiture of any depository institution unable to maintain applicable minimum capital requirements.\textsuperscript{197} Further, the proposed law would subject depository institution holding companies to the tying and insider lending restrictions now applicable to banks and would authorize in-
creased criminal and civil penalties in the case of violation of the regulations protecting the insured depository institution.\textsuperscript{198}

\section*{I. Consumer Bank}

Representative John J. LaFalce (D-N.Y.) has introduced a bill, H.R. 3209, also known as the Consumer Services Bank Act of 1987.\textsuperscript{199} The bill provides that a national bank may become certified by the Comptroller of the Currency as a “consumer services bank.”\textsuperscript{200} In order to receive such certification, the bank must agree not to make commercial loans, to offer low cost checking accounts, and to comply with several other consumer-related requirements.\textsuperscript{201}

As defined by the bill, a consumer services bank would not be a “bank” under the BHCA.\textsuperscript{202} Thus, any company would be free to own or control such a bank. However, the bank would be required to disclose in writing its actions on behalf of an affiliate.\textsuperscript{203} As a further protection, it would also be required to advise its customers that they are not required to purchase any product or service from an affiliate in order to obtain credit or other financial services from the bank.\textsuperscript{204} In addition, a consumer services bank could be acquired by an existing bank holding company across state lines. However, in any state in which a consumer services bank has a deposit-taking office, it would be required to make consumer loans in that state equal to at least sixty-five percent of the deposits received from residents of that state.\textsuperscript{205}

\section*{J. ABA Bill}

The nation’s largest banking association, the American Bankers Association (ABA), has caused the introduction in both houses of Congress of related bills, H.R. 50\textsuperscript{206} and S. 60,\textsuperscript{207} that would provide banks with supplemental product and service authorization.\textsuperscript{208} This bill is designed to remove the “timid frittering” that has characterized the evolution of the fi-

\begin{itemize}
\item \textsuperscript{198} Id. § 101(b)(1).
\item \textsuperscript{199} H.R. 3209, 100th Cong., 1st Sess., 133 CONG. REC. E3398 (daily ed. Aug. 7, 1987).
\item \textsuperscript{200} Id. § 3(1).
\item \textsuperscript{201} Id. § 5(a).
\item \textsuperscript{202} Id. § 7(a); see also 12 U.S.C. § 1841(c) (defining bank as an institution that, in part, engages in the business of making commercial loans); H.R. 3209, supra note 199, § 5(a)(1) (consumer services bank cannot make commercial loans).
\item \textsuperscript{203} H.R. 3209, supra note 199, § 5(b)(3)(A).
\item \textsuperscript{204} Id. § 5(b)(3)(B).
\item \textsuperscript{205} Id. § 5(a)(5).
\item \textsuperscript{206} H.R. 50, 100th Cong., 1st Sess. (1987).
\item \textsuperscript{207} S. 60, 100th Cong., 1st Sess. (1987).
\item \textsuperscript{208} S. 60 was introduced by Senator Garn. S.60, 100th Cong., 1st Sess., 133 CONG. REC. S150 (daily ed. Jan. 6, 1987).
\end{itemize}
The major provisions of the bill relate to new products and services for banks and bank holding companies, as well as certain procedural changes. For example, under H.R. 50, national banks could engage directly in insurance agency or brokerage, realty brokerage, full service stock brokerage, travel agency, and miscellaneous financial planning and clerical services. The OCC would also have “leeway authority” to grant national banks powers commensurate with those of federal thrifts and state banks. Also, all FDIC-insured banks could invest up to 3% of assets in a bank service corporation (BSC), and up to 15% in multiple BSC’s. BSC’s would have the same powers as national banks, plus insurance underwriting, real estate development, and the underwriting and distribution of municipal revenue bonds, mortgage-backed securities, commercial paper, mutual funds, corporate debt, and securities backed by any loan a bank could own. Additionally, a bank holding company could engage in the same activities listed above as permitted to BSC’s, either directly or through separate subsidiaries. They could also acquire thrifts, subject to the McFadden Act and the Douglas Amendment. Finally, H.R. 50 would provide for certain procedural changes, such as expedited bank holding company formation procedures, new notice procedures for bank holding company nonbanking activities, and minimalization of duplicate regulation by the federal bank and securities regulators.

**K. 1987 Senate Bill**

Senator William Proxmire (D-Wis.), Chairman of the Senate Banking Committee, has recently introduced a bill, S. 1886, for congressional consideration. This bill, entitled the “Proxmire Financial Modernization Act of 1987,” would reconstitute the framework governing the combination of the banking and securities business. The full Senate approved the bill on March 20.
30, 1988 by a vote of ninety-four to two. The bill may provide the basis for future discussion in conference with the House Banking Committee.

The bill would repeal sections 20 and 32 of the Glass-Steagall Act on a phase-in basis and provide a framework under the BHCA by which bank holding companies may engage a nonbanking subsidiary in underwriting, distributing, and dealing in all types of securities. Under the bill, the Board would approve applications to form a securities subsidiary under section 4(c)(15) of the BHCA, based on the Board's judgment as to adequacy of capital and managerial resources; bank holding companies that lacked adequate resources could exercise the additional authority on a phased-in basis. Once approved, the subsidiary could engage in all types of securities underwriting and dealing, subject to numerous statutorily imposed restrictions. These restrictions would apply to interaffiliate transfers of information and funds, prohibitions on interlocks, sharing of facilities and logos, and restrictions on affiliate loans to purchasers or issuers of securities underwritten by the holding company securities affiliate.

The bill also provides that bank holding companies with total assets of $30 billion or more would not be permitted to purchase an investment firm with assets of $15 billion or more. National banks would be permitted directly to underwrite and distribute municipal revenue bonds, unit investment trusts, United States government securities, and other securities. All other securities activities would be required to be conducted in the affiliate. Finally, the Securities and Exchange Commission would have jurisdiction over the securities affiliate.

L. Miscellaneous Plans

Although the preceding listing and discussion of proposed plans to restructure the financial services industry is lengthy, it is not exhaustive. For example, in testimony given in October 1987 before the Telecommunications and Finance Subcommittee of the House Energy and Commerce Committee, Federal Reserve Board Chairman Alan Greenspan and Securities and Exchange Commission Chairman David S. Ruder agreed to submit to that subcommittee their blueprint for regulatory reform. Additional
plans by other interested parties are in the process of formulation. Finally, the House Banking Committee has held hearings on bank securities activities and is expected to propose its own restructuring plan as late as March, 1988.

V. COMPARATIVE ANALYSIS OF CERTAIN PLANS

Each of the proposed restructuring plans summarized above reflects a serious, albeit different, approach to resolving the issues confronting the banking component of the nation's financial services industry. All of the plans are designed to accomplish the goals of bank regulation set forth earlier, but each plan differs, depending upon the assumptions and policy choices made during its formulation. Using the ABHC financial services holding company concept as a basis for comparison, several, but not all, of the restructuring proposals will be evaluated to determine their success in achieving the public policy objectives of bank regulation.

A. Depositor Protection

The goal of depositor protection cannot be analyzed independently, but frequently is linked to the other goals of bank regulation, particularly the objective of a competitive banking system. Thus, most of the bank restructuring plans seem to proceed from the premise that increasing the profitability of the banking organization, while at the same time limiting the amount of risk to which the bank is exposed, is the best means of ensuring the integrity of bank deposits. Consequently, this approach involves the balancing of an increased array of product and services lines that may be marketed to supplement the banking organization's earnings against a range of possible safeguards designed to mitigate the risks inherent in the affiliated business to the deposit base.

1. Earnings Enhancement

The ABHC financial services holding company approach represents a significant broadening of the range of permissible new product and service lines that would be made available to bank affiliates. The scope of new "financially related" activities would add a nice diversity of product and service lines to the banking organization, many of which would be profitable as well as positively correlated to the earnings flow from existing banking functions. These new activities also would complement many existing functions currently conducted by banks and, therefore, promise increased efficiencies and synergies.

225. See Wall & Eisenbeis, Risk Considerations in Deregulating Bank Activities, ECON. REV., May 1984, at 6-19.
The potential for increased earnings from the newly available product and service lines for bank and thrift holding companies under the Corrigan proposal, likewise, is limited to "financially related" activities. In this regard, the Corrigan proposal offers earnings opportunities comparable to those of the ABHC proposal. In contrast, the proposals by the FSC, the Barnard subcommittee, and the FDIC all contemplate unlimited affiliation between banks and other businesses, thereby providing unlimited possibilities for enhanced earnings. It should be noted, however, that the legal authority to enter new businesses does not guarantee increased earnings; this result is affected by many factors, including the organization's management abilities, market competition, available capital and, particularly, the dampening effect that governmentally imposed bank regulation, supervision, and insulation may have on the overall operation of the organization.

a. Geographic Expansion

It is commonly accepted from an economic standpoint that geographic diversification also provides earnings enhancement opportunities and contributes to the protection of the deposit base of a banking organization. Yet none of these proposals attempts to address the concept of interstate branching or interstate bank acquisitions. This, in part, reflects satisfaction with the progress that has been made towards interstate banking through state initiatives. However, the principal reason that no plan speaks to this issue, other than to endorse existing statutory provisions, is concern that the issue is too politically divisive of the banking industry and would undermine attempts to procure product and service line diversification.

2. Safeguards

The two principal methods of safeguarding bank deposits from risks inherent in affiliated businesses are through the insulation of the bank deposits from the other businesses and through the regulation and supervision of the overall banking organization. It seems true that the degree of insulation and the level of regulation and supervision are related to each other and, taken together, may have an inversely proportional negative effect on the business synergies of the component parts of the banking organization. That is, the more regulation or supervision, the less insulation is needed. Furthermore, the greater the amount of insulation or regulation, the less the value of the relationship of the new product or service line to the efficiency of the overall

226. See supra note 144 and accompanying text.
banking organization. Each restructuring proposal contemplates a different balance of these factors.

a. Insulation

Bank deposits may be insulated from affiliated business risks in three ways: legal separation of the activities, economic insulation, and counteracting the market perception of relatedness. The ABHC proposal achieves legal separation and would require all banks to be indirectly owned by the financial services holding company through a bank holding company subsidiary. This provision, in effect, provides double legal insulation. Similarly, almost all the other proposals provide for the conduct of banking and non-banking activities in separate subsidiaries with a distinct legal identity.

The ABHC concept provides for economic insulation by relying on existing provisions of statutory law such as: (1) the limits on interaffiliate loans and other transactions, as provided in sections 23A and 23B, between the bank and other entities within the financial services holding company structure; (2) the restrictions on dividends payable by a bank; and (3) the provisions of the federal securities laws on antifraud and disclosure, which prohibit a bank's affiliate from stating or implying that its obligations are federally insured. The Corrigan plan similarly would rely on existing provisions for economic insulation, but as discussed later, would supplement this with consolidated supervision and regulation.

Many of the other plans impose additional requirements on interaffiliate relationships in order to achieve economic insulation. The FDIC plan is the most stringent in this regard. The FDIC plan endorses sections 23A and 23B, and extends them to transactions between banks and the banks' non-bank subsidiaries and affiliates. The FDIC also would require stronger enforcement of the reinforced sections 23A and 23B, regulatory audits, and disclosure of interaffiliate transactions. Similarly, the Barnard subcommittee and the FSC place great emphasis on methods to increase the economic insulation—the “R-Value”—of the bank component of their proposed financial services holding company. Both of these plans, for instance, would grant the primary bank regulator increased authority to promulgate and enforce regu-

230. See supra text accompanying notes 139-41.
231. See supra text accompanying note 149.
232. See supra text accompanying note 158.
lations regarding limitations on interaffiliate transactions. Delegating this authority to the regulators, rather than embedding it in statutory law, is designed to provide for future flexibility.

Assuring the marketplace perception that bank deposits are insulated from related businesses is not an overt objective of the ABHC plan. Perhaps because the members of the ABHC have lived with the "holding company as a source-of-strength" doctrine, they believe that the marketplace already understands that the bank, in fact, is protected from the risks undertaken by affiliates. Similarly, the Corrigan plan does not address this issue, primarily because it has concluded that any financial holding company would be operated and perceived as a common enterprise except where the bank could be so insulated from its parent and affiliates as to make it purely a passive, and therefore undesirable, investment.

In contrast, most of the other major plans take affirmative steps to assure the market perception of insulation of the bank's deposits from affiliated businesses. The FDIC, Barnard, and FSC plans all would choose from a menu of tactics to achieve this market perception. Among the tools suggested to accomplish this type of insulation are: (1) the bear-down provisions, contained in the Barnard and FSC plans, requiring divestiture of the bank where the owner failed to meet regulatory capital requirements; (2) the back-stop provision, requiring each parent in the corporate chain to assume unlimited liability for its subsidiaries; and (3) the antibail-out provision, contained in the Barnard plan, prohibiting federal bail-out of the holding company and requiring holding company reimbursement for any losses to the federal deposit insurance funds.

b. Regulation and Supervision

All of the restructuring plans are premised either explicitly or implicitly upon the assumption that inadequacies in the wall insulating bank deposits from affiliate risk can be compensated for by increased regulatory or supervisory oversight. The ABHC plan reflects a reasonable degree of comfort with its proposed insulating wall and articulates a preference for supervision over regulation. Thus, viewing arbitrary and burdensome regulations as counterproductive to the efficient operation of a financial services holding company, the ABHC plan advocates that less regulation does not necessarily mean less supervision. Consequently, the ABHC plan proposes functional supervision of all the bank and nonbank components of its financial services holding company pursuant to extant regulatory provisions, and does not propose any

233. See supra text accompanying notes 168, 196, and 198.
regulatory scheme for the consolidated holding company.\textsuperscript{235} In this regard, the Board is accorded essentially minimal supervisory duties: to certify that the company engages only in financially related activities, to ensure the insulation of the subsidiaries pursuant to sections 23A and 23B, and to verify that the company is not owned or controlled impermissibly.

While not assigning general oversight responsibilities to any regulator, the Barnard study, the FSC, and the FDIC subscribe to the idea that increased supervision is the proper way to address any increased risks associated with their plan. In fact, it is worth noting that the FDIC was particularly emphatic on this point. It stated: "In summary, a supervisory safety and soundness wall can be built around banks that will allow their owners, subsidiaries and affiliates freedom to operate in the market place without undue regulatory interference."\textsuperscript{236} This conclusion by the federal insurer of deposits is especially helpful in determining the balance necessary to protect bank deposits.

c. \textit{Separation of Banking and Commerce}

The separation of banking and commerce is in reality the ultimate regulatory tool and rightly is part of the preceding section. However, because it is such a fundamental and divisive issue,\textsuperscript{237} it merits separate discussion.

The ABHC and the Corrigan proposals alone establish a line separating banking and commerce. Hence, a commercial firm cannot own or control a financial services holding company, such as a bank's parent, under either concept. The ABHC position in this regard is practical. The ideology of the separation of banking and commerce, while maybe not a historical fact, is a political reality. The ABHC, therefore, chooses not to enter this controversial area. In this regard, Corrigan believes that the combination of banking and commerce is not common in world markets, introduces unacceptable risks into the banking system, and should be permitted only upon the showing of compelling public policy reasons. The other major plans, however, postulate that any corporation, financial or commercial, should be permitted to own a bank and that any incremental risks can be managed through increased supervision or insulation.

\textsuperscript{235} \textit{Structure and Regulation of Financial Firms and Holding Companies: Hearings Before a Subcomm. of the Comm. for Government Operations, 100th Cong., 1st Sess. 12} (1986).

\textsuperscript{236} FDIC PLAN, \textit{supra} note 109, at 102.

\textsuperscript{237} Contrast, for example, the position put forward in \textit{The Separation of Banking and Commerce in American Banking History: Hearings on the Structure and Regulation of Financial Firms and Holding Companies Before a Subcomm. of the Comm. on Government Operations, 99th Cong., 2d Sess.} 393 (1986), to \textit{SEARS, ROEBUCK \\& CO., FINANCIAL SERVICES: CONSUMERS AND THE SEPARATION OF BANKING AND COMMERCE} (Nov. 1985).
B. Protection of the Financial System

All of the safeguards described in the preceding section indirectly and generally protect the financial system. They accomplish this goal by diminishing the risks associated with the activities of bank affiliates. Except for the Corrigan proposal, however, none of the major restructuring plans specifically provides for the protection of the three primary components of the federal "safety net": the payments system, the large dollar payments mechanism, or the federal deposit insurance fund.

The Corrigan proposal creates a framework with substantial involvement by the Federal Reserve System. The other principal proposals do not directly address the topic, holding that access to, and the liabilities of, the safety net may be limited, not by complete restructuring, but by proper administration of the existing scheme. For example, the ABHC has stated that, as a matter of safety and soundness, bank regulators should fashion restrictions on the availability of the safety net. Similarly, the FDIC has suggested that the Board exercise existing authority to restrict institutions from running overdrafts and require that overdrafts be fully collateralized. Furthermore, the Barnard Committee recommends that operational changes to the network be considered, but that the payments system risk is not relevant to the issue of expanded product and service authority.

C. An Efficient and Competitive Banking System

More than any other factor in the formula for a successful financial services system, the goal of efficiency and competitiveness is counterbalanced against the safety and soundness considerations previously discussed. A 100% riskless system will lack the benefits that flow from efficiency and competition; an absolutely unfettered system in terms of competitive restraints likely will result in an intolerable amount of risk. Each of the proposed restructuring plans adopts varying approaches to achieve this goal.

The ABHC proposal provides for expanded competitive opportunity by permitting reciprocal and equal entry by the banking, thrift, securities, insurance, and real estate industries into each others' business. Arbitrary, excessive, and protectionist barriers, such as the restrictions of the Glass-Steagall Act, between the industries and the insurance provisions of section 4(c)(8) of the BHCA, would be eliminated. Thus, a rational and "level playing field" is established for all participants within the defined area of financial services. This perhaps is the most distinguishing feature of the ABHC plan. It would facilitate the mobility of the capital and management resources necessary for fuller competition and greater efficiency.

Additionally, the ABHC plan provides various options for competitor
firms to implement their strategic plans. They may maintain their opera-
tions unchanged, thereby continuing to serve their market niche, or they 
may expand to whatever level of competition within the financial services 
marketplace they choose. Also, this feature of the ABHC plan allows for the 
efficiencies and competitive benefits that flow from dealing with different reg-
ulatory schemes. Finally, the ABHC plan does not impose such severe insu-
lation and regulatory requirements as to destroy the inherent synergies 
between financial product and service lines.

The Corrigan proposal is similar to the ABHC plan in that it significantly 
expands the competitive opportunities of the financial services industry, in-
corporates a concept of volunteerism and contains minimal insulation re-
quirements. The aspect of the Corrigan proposal most open to criticism, 
however, is its imposition of Federal Reserve System oversight on the parent 
bank or thrift holding company. The Board's administration of comparable 
responsibilities under the BHCA has demonstrated that its implementation 
of the application, supervision, and examination processes has significantly 
impaired the achievement of competitive and efficiency goals within the 
banking industry; it is easy to forecast the same result under the Corrigan 
plan.

The Barnard and FSC plans are alike in that they allow unlimited compet-
itive opportunities in the ownership of banks. They also do not subject cor-
porate bank owners to regulation and impose relatively limited insulation 
requirements on bank affiliates.

D. Consumer Protection

Protection of the consumer is already an express goal of many existing 
statutory provisions. It appears that each of the restructuring proposals as-
sumes that the protections provided in those laws would be adequate in the 
context of any restructured financial services industries scheme, that these 
protections should be extended to customers of the financial services com-
pany, or that incremental adjustments should be made by the regulators as 
future developments warrant. The Barnard plan, however, stipulates that 
cross-marketing restrictions should not be imposed on the components of a 
financial services holding company. In general, it may be concluded that the 
drafters of the major restructuring plans believe that consumer protection 
will flow naturally from a competitive marketplace, and are willing to accept 
imposition of additional and reasonable consumer protections upon a dem-
stration of their need.

VI. Conclusion

The commitment undertaken by Congress in title II of the Competitive Banking Equality Act of 1987 to review our financial services structure has initiated a national discussion. There is a consensus of opinion on certain issues. First, there is unanimity regarding the conclusion that the core business of traditional banking is deteriorating. Second, there is agreement that other industries now provide bank-like functions without complying with the regulations applicable to banks. Third, there is a concession that banks are "special" either as a matter of fact or politics. Fourth, there is widespread agreement that comprehensive legislative changes to the current statutory and regulatory framework governing the banking and the financial services industry must be effected. Finally, most commentators understand that any revision of the laws applicable to banking must strike a balance between the competing and interrelated public interest goals of deposit protection, the safety and soundness of the banking system, a competitive and efficient banking system, and consumer protection.

This Article has described and discussed several financial services restructuring proposals that further the national debate. Each represents a legitimate attempt to achieve the balance of public policy considerations so often alluded to herein. Deciding which is the best proposal is a matter of judgment on several fronts: legal, political, and practical. As a matter of personal and professional judgment, the author acknowledges his obvious bias that the financial services holding company concept developed by the ABHC constitutes an eminently reasonable and appropriate solution to the issues confronting Congress. In part, this conclusion results because the ABHC plan represents a compromise to the Corrigan and the FSC plans.

No one expects or believes that Congress will enact a comprehensive restructuring plan upon the expiration of the bank products and services moratorium on March 1, 1988. It is hoped, however, that Congress will have moved considerably down the road toward establishing the balance of public interest factors needed as the foundation to any plan. In this regard, Congress must keep several additional principles in mind. The plan Congress ultimately implements should reflect a resolution of substantive concerns and not a deference to industry interests. Any plan should rise above the volume of political action committee and industry campaign contributions and avoid arbitrary and protectionist tendencies. To the extent possible, Congress should permit the marketplace to fashion the regulatory structure. Where governmental discipline is needed, increased supervision and disclosure should be preferred to overt prohibitions.

The plan eventually adopted should build upon portions of the existing
system that have worked well. Unnecessary tinkering should be avoided. Furthermore, Congress should examine experiences in this country and overseas in order to predict the results of any proposed restructuring actions. For example, Congress should study the combination of banking and insurance, or banking and securities, where it exists in the United States and abroad, to determine the effects this combination has had on competition, depositor and system risk, and the consumer. Congress also would be wise to avoid the temptation to delegate its authority to administer the banking system to one central authority. This policy would eliminate the flexibility found in our current diversified system and tend to destabilize the system as a whole when that central regulator errs. Closely linked to this advice, Congress should design a system with a safety valve—one that induces change gradually and can be reversed to avoid permanent negative results. Finally, and most importantly, Congress should attempt to break its habit of dealing with banking and financial issues. In this respect, Congress historically has been reactive—responding to crises in the banking industry by enacting narrow, remedial action. Instead, Congress should consider all options and positively act in fashioning a new financial services structure. The nation deserves deliberate and forward thinking on this important topic.