THAT WHICH WE CALL A BANK: REVISITING THE HISTORY OF BANK HOLDING COMPANY REGULATION IN THE UNITED STATES

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Introduction

The bank holding company—a company that owns or controls a U.S. bank—is a legal and organizational form unique to the U.S. system of bank regulation.[1] It has become a core principle of U.S. financial services regulation that the parent company and non-bank affiliates of a U.S. bank are subject to comprehensive consolidated regulation and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Yet, bank holding companies were not directly regulated until the enactment of the Bank Holding Company Act (the "BHCA") in 1956.[2] All bank holding companies required to register under the BHCA ("BHCs") are subject to prudential oversight by the Federal Reserve, and their permissible investments and activities have been restricted mainly to owning and managing banks and conducting certain other activities "closely related to banking."[3]

In recent years, the increasing concentration in the U.S. banking sector and the expansion of non-banking activities of U.S. banks and BHCs, particularly as a result of the enactment of the Gramm-Leach-Bliley Act of 1999 (the "GLBA"),[4] called into question the continuing utility of BHC regulation. In the wake of the recent financial crisis, however, Congress reaffirmed the central importance of the BHC construct in the regulatory paradigm. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),[5] widely viewed as the most far-reaching financial sector reform legislation since the Great Depression, expands the model of BHC regulation as the core element in its new architecture of systemic risk regulation.

However, in order to develop a better understanding of how—or even whether—the BHCA structure can be effectively adapted to meet today's regulatory challenges, it is helpful to examine how this legal concept evolved and how its underlying

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[1] PAULINE HELLER & MELANIE FEIN, FEDERAL BANK HOLDING COMPANY LAW § 1.04[5], at 1-20 (2009).
[2] Bank Holding Company Act of 1956, Pub. L. No. 84-511, §§ 1-12, 70 Stat. 134, 135 (1956).
[3] 12 U.S.C. § 1843(c)(8).
[4] Financial Services Modernization Act (Gramm-Leach-Bliley Act), Pub. L. No. 106-102, 113 Stat. 1338 (1999).
[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

policies and definitional boundaries shifted over time. A fresh look at the history of the BHCA, especially from the vantage point of our post-crisis wisdom, provides valuable context for the broader policy debate on the future of the American financial system.

This Article focuses on one crucial aspect of this rich and multi-faceted history. It traces the evolution of the statutory definition of a "bank" for the purposes of the BHCA and the main exemptions from this definition. The key to becoming a BHC subject to the many activity restrictions and regulatory intrusions is control or ownership of an entity that is considered a "bank" under the BHCA. Yet, contrary to what most ordinary Americans may think, what makes an institution a "bank" is not self-evident and depends on whether the statute defines it as such. What types of financial institutions that definition includes, or excludes, has changed several times since 1956.

This Article presents a brief historical account of how and why, and with what consequences, Congress periodically redefined the universe of "banks" and their heavily regulated BHC-parents. For decades after the enactment of the BHCA in 1956, this definition played the key role in determining which holding companies were included in the restrictive BHCA regulatory regime and which ones were left outside of it. As originally enacted, the BHCA defined the term based simply on the formal charter. In 1966, however, Congress introduced a functional definition of "bank" based on whether or not an institution accepted deposits that could be withdrawn on demand. In 1970, that functional definition was narrowed by adding the second requirement that a "bank" had to be engaged in the business of making commercial loans. This definition allowed proliferation of so-called "nonbank banks" that had access to federal deposit insurance but structured their activities to avoid being included in the definition of "bank."

In 1987, Congress outlawed such nonbank banks by broadening the statutory definition to include, in addition, all federally-insured depository institutions. At the same time, Congress created explicit exemptions from that definition for certain categories of federally-insured institutions, including industrial banks, thrifts, credit unions, credit card banks and limited purpose trust companies. This Article examines the origins and evolution of these exempted industries and argues that their significance as organizational alternatives to commercial banks is likely to diminish in the emerging post-Dodd-Frank regulatory regime.

Revisiting how the BHCA definition of "bank" changed over time elucidates several broad themes relevant to today's financial regulation reform. It is a fascinating story of how law shapes market developments, and then, in turn, attempts to respond to such developments. From this perspective, this Article contributes to the growing body of academic literature examining the role of legal rules in defining the general trajectory of socio-economic development.[6] It is also a story of how the law itself was shaped and influenced by political forces and institutions. Adherents of various theoretical paradigms—public choice, interest group politics, pluralist democracy—have extensively researched this phenomenon in a wide range of historical and subject-matter contexts.[7] Tracing the history of the BHCA and its key definition of a bank fits into that broad theoretical paradigm. It is, however, the specific patterns of power politics, which operated to exempt whole swaths of financial activities from the reach of the bank holding company regulation, that make this story not only fascinating from a historical perspective but also instructive from the point of view of understanding current political struggles over financial regulation reforms.

During the legislative negotiations of the Dodd-Frank Act, the desirability of preserving the existing exemptions from the BHCA definition of "bank" was a subject of intense debates. Although the Presidential Administration generally advocated elimination of the exemptions,[8] Congress postponed the final decision until the Government Accountability Office (the "GAO") completes a mandatory study, identifying the nature and extent of affiliation between exempted institutions and commercial companies and determining whether the existing regulatory framework

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[6] *See, e.g.,* Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539, 541 (2011) (arguing that preferential treatment of derivatives under the U.S. Bankruptcy Code contributed to the recent financial crisis); Kathleen C. Engel & Patricia A. McCoy, *Turning A Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2041-42 (2007) (arguing that securitization enabled predatory lending and growth of subprime mortgage markets).

[7] *See, e.g.,* Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 18 (1991) (examining the history of the BHCA through the lens of a public choice theory).

[8] Int'l Monetary Fund [IMF], *United States: Publication of Financial Sector Assessment Program Documentation—Technical Note on Consolidated Regulation and Supervision*, at 16, IMF Country Report No. 10/251 (July 23, 2010).

adequately addresses the risks of such affiliations.[9] This continuing legislative concern with the policy of exempting certain financial institutions from the BHCA further underscores the importance of re-examining the history of these exemptions.

The Article is structured as follows. Part I provides a brief overview of the BHCA statutory scheme and outlines the key shifts in statutory policy priorities throughout the history of the BHCA. Part II examines the political and economic dynamics that led to the enactment of the BHCA in 1956. Part III traces the evolution of the BHCA definition of "bank" from 1956 to 1987, when it was last amended. It provides an overview of the policy reasons and interest group dynamics that led to each major amendment. Part IV discusses in greater detail the key categories of financial institutions exempted from the definition of "bank" in the BHCA. Part V examines the potential impact of the Dodd-Frank Act on the practical relevance of the exemptions from the statutory definition of "bank." It also offers general observations on some of the key lessons of the history of the BHCA for the ongoing financial regulation reform.

I. Background: Bank Holding Company Regulation in the United States

For many companies, becoming a BHC subject to the BHCA regulatory regime has significant legal and economic consequences, particularly with respect to their ability to conduct non-banking and non-financial activities. This Part briefly summarizes the key features of the BHCA statutory scheme and argues that the primary policy objectives of the BHCA evolved over time, in response to the changes in market conditions and political dynamics. As originally enacted, the BHCA was designed primarily to restrict geographic expansion of large banking groups and to prevent excessive concentration in the commercial banking industry. Gradually, however, the key policy focus of the BHCA regime began to shift toward defining the legal scope of permissible banking and "closely related to banking" activities—a process that ultimately led to the enactment of the GLBA in 1999 and the subsequent growth of diversified financial holding companies. Finally, in the Dodd-Frank Act, Congress re-conceptualized the key policy goal of the BHCA as systemic risk prevention and elevated the statute to an unprecedented

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[9] Dodd-Frank Act § 603(b)(1).

level of significance in the emerging post-crisis regulatory framework.

A. The BHCA Statutory Scheme: Brief Overview

The BHCA generally defines a BHC as a "company"[10] that owns or "controls" one or more U.S. "banks."[11] Although the definition of "control" for purposes of determining whether an entity is a BHC is complicated and fact-dependent, the statute generally presumes the existence of "control" where an entity owns more than twenty five percent of any class of voting shares of a bank.[12] All BHCs are required to register with, and become subject to consolidated regulation and supervision by, the Federal Reserve. BHCs submit mandatory periodic reports to the Federal Reserve, and are subject to its direct examination authority. The Federal Reserve has extensive enforcement powers over BHCs, which are subject to capital adequacy regulation and must serve as a "source of strength" to their bank subsidiaries.

The BHCA governs nearly all aspects of BHCs' businesses, including acquisitions of additional banks[13] and permissible non-banking investments and activities.[14] These substantive and

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[10] The BHCA defines "company" broadly:

> "Company" means any corporation, partnership, business trust, association, or similar organization, or any other trust unless by its terms it must terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust but shall not include any corporation the majority of the shares of which are owned by the United States or by any State, and shall not include a qualified family partnership.

12 U.S.C. § 1841(b) (2006).

[11] *Id.* § 1841(a)(1).

[12] *Id.* § 1841(a)(2)(A). The precise threshold for the ownership stake triggering the application of the BHCA depends, in each specific case, on whether the Federal Reserve finds the existence of "controlling influence" on the target company. *Id.* § 1841(a)(2)(C). Thus, ownership of as little as ten percent of voting securities of any class often supports the finding of "controlling influence" that triggers the application of the BHCA.

[13] *Id.* § 1842.

[14] *Id.* § 1843(c).

procedural rules are designed to implement the underlying policy objectives of the BHCA: prevention of excessive concentration of commercial credit and separation of banking and commerce.

The BHCA operationalizes the principle of keeping banking separate from general commercial enterprise by restricting permissible activities and investments of BHCs to banking, managing or owning banks, and a limited set of activities determined to be "closely related to banking."[15] The loss of an ability to own a significant ownership stake in non-financial and even many non-banking financial businesses is the most significant consequence of becoming a BHC.

Under the GLBA, which partially repealed the Glass-Steagall Act and legalized affiliations among banks and securities and insurance firms, certain well-capitalized and well-managed BHCs[16] may qualify for a status of a financial holding company ("FHC"), which allows them to engage in a broader range of activities "financial in nature."[17] Such broadened permissible activities include securities dealing and underwriting, insurance and merchant banking.[18] In addition, the Federal Reserve may allow certain FHCs to engage in purely commercial activities that are "complementary" to their permissible financial activities.[19]

As the umbrella supervisor over the entire BHC, the Federal Reserve has the authority to examine all of its non-bank subsidiaries. Under the GLBA, all functionally regulated non-bank BHC subsidiaries—including securities broker-dealers, investment advisers, insurance companies or commodity futures professionals—are regulated and examined by the applicable primary regulatory agency, such as the Securities and Exchange Commission ("SEC"), Commodity Futures Trading Commission ("CFTC") or state

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[15] *Id.* § 1843(c)(8).

[16] A BHC is "well capitalized" if it maintains a total risk-based capital ratio of ten-percent or greater; it maintains a Tier 1 risk-based capital ratio of six-percent or greater; and it is not subject to any corrective action by the Federal Reserve relating to capital levels. 12 C.F.R. § 225.2(r)(1) (2006). A BHC is "well managed" if it received a CAMEL composite rating of 1 or 2 in its most recent examination and at least a satisfactory rating for management, if such rating is given. 12 U.S.C. §§ 1841(o)(9).

[17] 12 U.S.C. § 1843(k)(1)(A).

[18] *Id.* § 1843(k)(4); *see also* 12 C.F.R. § 225.170 (2005) (listing permissible investments and the conditions that must be met in order for FHCs to engage in merchant banking).

[19] 12 U.S.C. § 1843(k)(1)(B).

insurance regulators. The Federal Reserve, however, retains back-up examination authority with respect to functionally regulated subsidiaries. Importantly, the Dodd-Frank Act further expanded the Federal Reserve's authority to supervise and examine the functionally regulated subsidiaries of any BHC.[20]

Thus, the BHC structure allows U.S. banking institutions to expand and engage in certain non-banking activities but subjects them to fairly intrusive group-wide regulation and supervision under the BHCA scheme. Becoming a registered BHC therefore has significant potential consequences for a company's business operations and strategy. Not surprisingly, which companies fall within and which ones remain outside the statutory definition of a BHC has been one of the key political issues throughout the history of the BHCA. A deeper appreciation and knowledge of that history is a pre-requisite for understanding the evolving role of bank holding company regulation in the United States.

B. The Shifting Policy Focus of the BHCA

Since its enactment in 1956, the BHCA has served multiple policy purposes. The key policy focus of the BHCA regime shifted over time, reflecting fundamental changes in market conditions and political dynamics.

As enacted in 1956, the BHCA was designed principally as an anti-monopoly law that sought to close the key "routes to a national banking empire."[21] The primary policy goal of the new statute was to restrict geographic expansion of large banking groups and, more broadly, to prevent excessive concentration in the commercial banking industry.[22]

Historically, U.S. banks have been severely restricted in their ability to expand geographically and offer banking services within

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[20] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 605(a), 124 Stat. 1376, 1604 (2010). Under the Dodd-Frank Act, all non-functionally regulated subsidiaries of a BHC or a Savings and Loan Holding Company ("SLHC") must be examined by the Federal Reserve in the same manner and with the same frequency as if they were FDIC-insured depository institutions. *Id*.

[21] Note, *The Bank Holding Company Act of 1956*, 75 BANKING L. J. 277, 293 (1958).

[22] *Id.* at 291.

and across state lines.[23] Many state laws prohibited out-of-state banks from establishing branches within their borders, largely due to the interest of the owners of local banks in protecting themselves from competition by larger banks in the market for commercial credit.[24] The McFadden Act, as amended in 1933,[25] "permitted national banks to branch within a state to the extent permitted by state law," but precluded interstate branching by limiting branching to the state in which the national bank was situated.[26] It did not address, however, the interstate banking powers of bank holding companies. As a result, before the passage of the BHCA, banks could form or reincorporate themselves as holding companies and hold separately incorporated banks in different states to engage in interstate banking, without running afoul of the then-ubiquitous interstate banking restrictions.[27]

In addition, such holding companies could conduct purely commercial activities prohibited for banks. The Glass-Steagall Act of 1933, which prohibited banks from participating in the securities dealing and underwriting business and from affiliating with securities firms, otherwise did not impose any specific legal restrictions on the activities of business entities that owned or controlled commercial banks.[28] Since the 1930s, political leaders expressed their concerns with the potential for the formation of financial-industrial monopolies,[29] and the Federal Reserve actively pushed for bank

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[23] LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES 69 (4th ed. 2011).
[24] For a more detailed history about how interstate banking restrictions developed, see Robert T. Clair & Paula K. Tucker, *Interstate Banking and the Federal Reserve: A Historical Perspective*, 1989 FED. RES. BANK OF DALLAS ECON. REV. 1, 3 (1989).
[25] 12 U.S.C. § 36 (1933).
[26] BROOME & MARKHAM, *supra* note 23, at 69.
[27] *See* Carl A. Sax & Marcus H. Sloan III, *The Bank Holding Company Amendments of 1970*, 39 GEO. WASH. L. REV. 1200, 1203 (1970) ("The bank holding company device enabled a parent holding company to circumvent state restrictions on interstate branch banking. The parent could control two or more banks in different states, without violating the anti-branching prohibitions."); Note, *supra* note 21, at 278 ("Prohibitions against interstate branch banking undoubtedly stimulated the use of the holding company form.").
[28] Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933).
[29] In 1938, President Franklin D. Roosevelt sent a special message to Congress urging the passage of legislation enhancing antitrust protections

holding company legislation.[30] But it was the active political lobbying by small independent and community banks, trying to protect their local markets from potential competition from large out-of-state banks, which finally led to the passage of the BHCA in 1956.[31]

The passage of the BHCA effectively closed the possibility for banks to use a holding company structure to avoid legal restrictions on interstate banking and branching. Thus, Section 3(d) of the BHCA (commonly known as the Douglas Amendment) explicitly prohibited BHCs from acquiring banks outside of their home state, unless the acquisition was specifically authorized by the state law of the target bank.[32] Ultimately, safeguarding interstate banking restrictions faded away as the primary policy purpose behind

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against undue concentration of economic power in the hands of private businesses, including bank holding companies. Roosevelt's message reflected, in part, his concern with the growing threat of fascism and the fear of the anti-democratic effects of economic monopolies. HELLER & FEIN, *supra* note 1, § 17.01[2], at 17-4 to 17-5.

[30] *Id.* § 17.01[4], at 17-7.

[31] *See* Clair & Tucker, *supra* note 24, at 12 (explaining that the Douglas Amendment, the part of the BHCA that effectively prohibited interstate banking by BHCs, "was first proposed by the American Bankers Association and was heavily supported by the Independent Bankers Association.").

[32] Bank Holding Company Act of 1956, Pub. L. No. 84-511, § 3(d), 70 Stat. 134, 135 (1956). The Douglas Amendment prohibited BHCs from acquiring banks outside of their home state:

> Notwithstanding any other provision of this section, no application shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which such bank holding company maintains its principal office and place of business or in which it conducts its principal operations unless the acquisition of such shares or assets of a State bank by an out-of-state bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication.

Id.

the BHCA, but only after an intense legislative and regulatory struggle.[33]

Moreover, the tendency toward increasing concentration of bank lending has severely compromised the broader policy of preventing excessive concentration of credit.[34] In the decades

[33] Various legal and economic developments continued to undermine the practical impact of interstate banking and branching restrictions in the years after the passage of the Douglas Amendment. Thus, the Douglas Amendment did not restrict the interstate expansion of non-bank offices. In the 1970s, state legislatures began to allow out-of-state BHCs to control banks in their states, often under various reciprocal arrangements. Furthermore, as a result of the Savings and Loan ("S&L") crisis in the 1980s, state legislatures increasingly turned a blind eye to interstate branching restrictions to allow for acquisitions of insolvent banks and thrifts by out-of-state banks and BHCs. In 1994, Congress finally repealed the Douglas Amendment and interstate branching restrictions through the Riegle-Neal Interstate Banking and Branching Efficiency Act (the "Riegle-Neal Act"), allowing banks to branch across state lines for the first time. For a more detailed history of interstate branching, the Douglas Amendment and the Riegle-Neal Act, see Christian A. Johnson & Tara Rice, *Assessing a Decade of Interstate Bank Branching*, 65 WASH. & LEE. L. REV. 73, 77-88 (2008) (undertaking an economic analysis of the correlation between restrictive state regulation and out-of-state branch banking entry); Edward J. Kane, *De Jure Interstate Banking: Why Only Now?,* 28 J. MONEY, CREDIT & BANKING 141, 141-48 (1996) (explaining the seemingly sudden willingness to relax interstate banking restrictions in terms of increased failure rates and reorganizations among depository institutions in the 1980s and early 1990s); Note, *supra* note 21, at 283-84 (arguing that the Douglas Amendment was a "major setback to the development of multi-office banking").

[34] For discussions of the consolidation and concentration in the U.S. banking sector, see Kenneth D. Jones & Tim Critchfield, *Consolidation in the U.S. Banking Industry: Is the "Long, Strange Trip" About to End?,* 17 FDIC BANKING REVIEW 4, at 31-61 (2005) (examining the structural changes in the banking industry from 1984 to 2003); Allen N. Berger et al., *The Transformation of the U.S. Banking Industry: What a Long, Strange Trip It's Been*, 1995 BROOKINGS PAPERS ON ECON. ACTIVITY 2, at 55-219 (1995) (examining the changes in banking industry structure in 1979-1995); Allen N. Berger et al., *The Consolidation of the Financial Services Industry: Causes, Consequences, and Implications for the Future*, 1999 JOURNAL OF BANKING AND FINANCE 23, at 135-94 (1999) (discussing a number of adverse and positive consequences of financial services industry consolidation); J. P. Hughes et al., *The Dollars and Sense of Bank Consolidation*, 1999 JOURNAL OF BANKING AND FINANCE 23, 291-324 (1999) (discussing the incentives for banks to consolidate and finding that the benefits are

following the enactment of the BHCA, the wave of bank mergers, acquisitions, and consolidations, in response to the growing competitive pressures and search for the economies of scale, effectively created a two-tiered banking system in the United States, where a small number of large financial groups hold the vast majority of the banking industry's assets and liabilities, with the rest dispersed widely among a far greater number of small and medium-sized banks.[35]

Soon after 1956, the main focus of BHC regulation gradually began shifting away from its original emphasis on prevention of undue concentration of commercial bank credit toward the issue of separation of banking and commerce.[36] This shift reflected fundamental changes in global and domestic financial markets. By the 1970s, the interest rate volatility and growing competition in the global and domestic financial markets fundamentally altered the dynamics in the U.S. banking sector. Investment banks and other market actors, which were not subject to the same regulatory restrictions as banking institutions, took advantage of macro-economic volatility by creating financial instruments that offered higher returns to investors—such as money market mutual funds—and steering commercial companies toward raising capital in

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highest for banks engaging in interstate expansion that diversifies macro-economic risk).

[35] During the period between 1934 and 1980, the total number of commercial banks in the U.S. remained relatively stable, oscillating only slightly within the approximate range of 13,000 to 14,000 institutions. At the end of 1980, the number of FDIC-insured commercial banks stood at 14,434, and their total assets were slightly below $1.9 trillion. *Number of Institutions, Branches and Total Offices*, FDIC, http://www2.fdic.gov/hsob/ (click on "Commercial Bank"; then click on "CB01") (last visited Nov. 11, 2011). As of December 31, 2005, there were 7,526 FDIC-insured commercial banks, with total assets of slightly over $ 9 trillion. *Assets*, FDIC, http://www2.fdic.gov/hsob/ (click on "Commercial Bank"; then click on "CB09") (last visited Nov. 11, 2011). As of June 30, 2011, there were 6,413 FDIC-insured commercial banks, with total assets of over $12 trillion. *Statistics on Depository Institutions*, FDIC, http://www2.fdic.gov/SDI/main4.asp (last visited on November 19, 2011).

[36] PATRICIA A. MCCOY, BANKING LAW MANUAL: FEDERAL REGULATION OF FINANCIAL HOLDING COMPANIES, BANKS AND THRIFTS § 4:03 (Matthew Bender ed., 2nd ed., 2011).

commercial paper and bond markets.[37] In response to this phenomenon of disintermediation, commercial banks and BHCs began actively seeking expansion of permissible securities, insurance, real estate and derivatives activities.[38] As a result, where to draw the line between permissible and impermissible non-banking activities of registered BHCs became the core issue in the interpretation and implementation of the BHCA.

Throughout the 1980s and 1990s, federal banking regulators gradually extended the scope of permissible banking and "closely related to banking" activities, in order to ensure the continuing economic viability of the U.S. banking industry in the increasingly competitive global environment.[39] For instance, by 1987, the Federal Reserve's interpretation of Section 20 of the Glass-Steagall Act, which prohibited member banks from affiliating with any entity "engaged principally" in the underwriting and distribution of securities,[40] effectively allowed BHCs to develop significant securities operations through the establishment of so-called "Section 20" subsidiaries.[41]

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[37] *See, e.g.,* Margaret M. Blair, *Financial Innovation, Leverage, Bubbles, and the Distribution of Income*, 30 REV. BANKING & FIN. L. 225, 235 (2010) (explaining how money market funds were created by institutions not regulated by the FDIC in response to high interest rates); BROOME & MARKHAM, *supra* note 23, at 52-55 (explaining that inflation in the 1960s, coupled with the cap on interest rates banks could charge, led to increased competition from money market funds, which "invest in short term money market instruments, such as Treasury Bills, that pay interest to the investor.").

[38] The securities, insurance, real estate and other industries fiercely fought against regulatory expansion of banking institutions' permissible activities.

[39] *See generally* Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking,"* 63 U. MIAMI L. REV. 1041 (2009) (examining the evolution of the OCC's decisions allowing national banks to conduct derivatives activities).

[40] 12 U.S.C. § 377 (1994).

[41] Beginning in 1978, the Federal Reserve gradually expanded the range of securities activities permissible to BHCs' non-bank subsidiaries. *See, e.g. United Bancorp*, 64 FED. RESERVE BULL. 222 (1978) (allowing United Bancorp to form a subsidiary to engage *de novo* in underwriting and dealing in government and municipal securities); *Bankers Trust N.Y. Corp.*, 73 FED. RESERVE BULL. 138, 152-53 (1987) (allowing Bankers Trust New York to engage in commercial paper placement subject to certain limitations). In 1987, the Federal Reserve permitted BHCs' to underwrite and deal in corporate securities through Section 20 subsidiaries, subject to the revenue

In 1999, the GLB Act finally repealed portions of the Glass-Steagall Act to "facilitate affiliation among banks, securities firms, and insurance companies, permitting financial conglomerates to cross-sell a variety of financial products to their customers."[42] The GLBA retained the principle of separation of banking and pure commerce by a last minute amendment, which "deleted the portion that would have allowed banks to engage in commercial activity."[43] At the same time, the new law expanded the ability of certain well-capitalized and well-managed BHCs that qualified for the new FHC status to engage in certain commercial activities.Among other things, the GLBA permitted FHCs to engage in merchant banking activities, i.e., making controlling portfolio investments in non-financial firms, subject to certain holding period limitations and the general prohibition on FHCs exercising routine management of their portfolio companies.[44] The GLBA also gave the Federal Reserve authority to permit individual FHCs to engage in purely commercial activities that are "complementary" to their financial in nature activities.[45]

Thus, by the beginning of the twenty-first century, the main remaining original policy objective of the BHCA was the separation of banking and pure commerce. At the same time, the interplay of the activity-broadening provisions of the GLBA and the exemptions from the BHCA definition of "bank," discussed below, has significantly weakened the wall between banking and commerce in practice.[46] As a result, the continuing practical relevance of the BHCA regulatory regime came under intense criticism. To some, the BHCA, as amended by the GLBA, was not robust enough to regulate

limitation, which was gradually increased to twenty-five percent of a securities subsidiary's gross annual revenue. *Citicorp, J. P. Morgan & Co. Inc. & Bankers Trust of N.Y. Corp.*, 73 FED. RESERVE BULL. 473, 502 (1987). *See also* Securities Industry Association v. Board of Governors, 839 F.2d 47, 49-50 (2d Cir. 1988), *cert. denied*, 486 U.S. 1059 (1988) (denying petition for review of the Federal Reserve's decision in Citicorp, J.P. Morgan & Co. Inc. & Bankers Trust of N.Y. Corp. and five related decisions).

[42] F. JEAN WELLS & WILLIAM D. JACKSON, CONG. RESEARCH SERV., RL 30375, MAJOR FINANCIAL SERVICES LEGISLATION, THE GRAMM-LEACH-BLILEY ACT (P.L. 106-102): AN OVERVIEW 2 (1999).

[43] John Krainer, *FRBSF Economic Letter 98-21: The Separation of Banking and Commerce*, FEDERAL RESERVE BANK OF SAN FRANCISCO LETTER (July 3, 1998), http://www.frbsf.org/econrsrch/wklyltr/wklyltr98/el98-21.html.

[44] 12 U.S.C. § 1843(k)(4)(H)-(I) (2006); 12 C.F.R. §§ 225.170(a)-(f) (2005).

[45] 12 U.S.C. § 1843(k)(1)(B).

[46] *See infra* Part IV.

properly the risks posed by financial conglomeration.[47] To others, the GLBA did not go far enough in removing the obstacles on the path of financial innovation and market efficiency.[48] In general, however, most critics agreed that the BHCA had largely outlived its usefulness.[49]

The financial crisis of 2007-09 brought the seemingly obsolete statute to the forefront of regulatory reform. The key piece of post-crisis reform legislation, the Dodd-Frank Act, effectively expands the BHCA model of regulation and supervision, with some modifications, to all financial institutions designated as "systemically important" and thus subject to consolidated supervision by the Federal Reserve.[50]

Under the Dodd-Frank Act, all systemically significant financial groups, regardless of whether or not they own a commercial bank, have to register with and become subject to consolidated supervision by the Federal Reserve in a manner similar to BHCs. Among other things, the Federal Reserve has the power to impose heightened capital requirements and other elements of prudential regulation on systemically significant "non-bank financial companies."[51] Systemically important non-bank financial companies and

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[47] *See, e.g.*, Arthur E. Wilmarth, Jr., *How Should We Respond to the Growing Risks of Financial Conglomerates?* 17 (George Washington Law Sch. Pub. Law and Legal Theory Working Paper No. 034, 2001), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=291859.

[48] *See, e.g.,* Cantwell F. Muckenfuss III & Robert C. Eager, *The Separation of Banking and Commerce Revisited*, *in* MIXING OF BANKING AND COMMERCE: THE 43RD ANNUAL CONFERENCE ON BANK STRUCTURE AND COMPETITION: PROCEEDINGS 39, 40 (Douglas D. Evanoff ed., 2007).

[49] *See, e.g.,* Carl Felsenfeld, *The Bank Holding Company Act: Has It Lived Its Life?* 38 VILL. L. REV. 2 (1993); Keith R. Fisher, *Orphan of Invention: Why the Gramm-Leach Bliley Act Was Unnecessary*, 80 OR. L. REV. 1301 (2001).

[50] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 113, 124 Stat. 1376, 1398 (2010). The Financial Stability Oversight Council ("FSOC"), a newly created systemic risk regulator, makes the determination whether any entity is a systemically important financial institution ("SIFI"). *Id.*

[51] *Id.* § 165. The statute defines a non-bank financial company as a company "predominantly engaged in financial activities," meaning that at least eighty-five percent of such company's consolidated gross revenues or eighty-five percent of its consolidated assets are derived from activities "financial in nature," as defined in section 4(k) of the BHCA. *Id.* § 102(a)(6).

their subsidiaries are subject to the Federal Reserve's reporting requirements, as well as examination and enforcement by the Federal Reserve.[52] Although the statute requires the Federal Reserve to consult with the primary regulators of the depository institutions and functionally regulated subsidiaries of the systemically important non-bank financial companies, the Federal Reserve has significant back-up authority to take necessary actions with respect to any of these entities.[53]

The principal difference in the treatment of systemically important non-bank financial companies is that the non-banking activity restrictions applicable to BHCs do not apply to non-bank financial companies.[54] The Federal Reserve may require any non-bank financial company supervised by it to form an intermediate holding company to bring under a single roof all of the group's "financial in nature" activities.[55]

In addition, the Federal Reserve now has the authority to be the consolidated supervisor for savings and loan holding companies ("SLHCs"),[56] which were previously regulated by the Office of Thrift Supervision ("OTS"), and for the new category of securities

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[52] The Dodd-Frank Act requires the Federal Reserve to tailor its supervision and regulation of non-bank financial companies to the relevant industry sector. Thus, the Federal Reserve must establish prudential standards for non-bank financial companies that are no less stringent than standards currently applicable to such companies, "taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors" the agency deems appropriate. *Id.* § 165(a).

[53] *See id.* §§ 161-62 (describing the enforcement and examination powers of the Federal Reserve).

[54] *Id.* § 167(a).

[55] *Id.* § 167(b). The intermediate holding company regime is designed to create a company that will be under the Federal Reserve supervision, while keeping the parent outside of such supervision, except in limited circumstances. The Federal Reserve must require any systemically important non-bank financial company to establish an intermediate holding company if it finds that such intermediate holding company is necessary for appropriate supervision or to ensure that Federal Reserve supervision does not extend to commercial activities. *Id.*

[56] *Id.* § 312. *See generally id.* §§ 604, 606; Savings and Loan Holding Companies, 76 Fed. Reg. 56,508 (Sept. 13, 2011) (to be codified at 12 C.F.R. pts. 238-239). This Article also refers to savings associations as "thrifts" and to SLHCs as "thrift holding companies."

holding companies ("SHCs").[57] Although the full details of these two regulatory schemes are still being developed, the Federal Reserve's rule-making to date clearly indicates that both SLHCs and, to a lesser extent, SHCs are going to be subject to regulatory and supervisory regimes essentially similar to the BHCA regime.[58]

Thus, the post-crisis reform is reinventing the BHCA, which was originally intended primarily to guard against the perceived dangers of excessive concentration of financial and economic power and the emergence of diversified financial-industrial conglomerates, as the basic infrastructure for systemic risk regulation across the entire financial services sector. In effect, the BHCA regulatory regime is being adopted for a variety of financial institutions other than traditional BHCs. To what extent this approach to systemic risk regulation will be effective in practice remains to be seen.[59] Nevertheless, revisiting the key factors that shaped the emergence and subsequent evolution of the BHCA helps to develop a better understanding of its current transformation.

II. Back to the Beginning: The Birth of the Statute

The BHCA was enacted in 1956 primarily to thwart what was perceived as a trend toward greater concentration in the commercial banking markets and, more specifically, to prevent banks from engaging in *de facto* interstate banking.

Bank holding companies emerged in the early 1900s as a form of so-called "chain" banking, as opposed to the traditional "unit" banking.[60] Although they quickly drew criticism from bankers and policy-makers, neither state nor federal legislation at the time limited the use of a holding company structure as a method of establishing banking operations in multiple states.[61] In the absence of

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[57] Dodd-Frank Act § 618. *See generally* Supervised Securities Holding Companies Registration, 76 Fed. Reg. 54,717 (proposed Sept. 2, 2011) (to be codified at 12 C.F.R. pt. 241).

[58] *See generally* Regulation LL, 76 Fed. Reg. 56,508 (Sept. 13, 2011) (to be codified 12 C.F.R. pt. 238); Regulation MM, 76 Fed. Reg. 56,508 (Sept. 13, 2011) (to be codified at 12 C.F.R. pt. 239); Regulation OO, 76 Fed. Reg. 54,717 (Sept. 2, 2011) (to be codified at 12 C.F.R. pt. 241).

[59] For some observations on this issue, *see infra* Part V.B.

[60] George S. Eccles, *Registered Bank Holding Companies*, *in* THE ONE-BANK HOLDING COMPANY 82, 84-85 (Herbert V. Prochnow ed., 1969).

[61] *Id*. at 85-86.

regulation, bank holding companies proliferated and became a significant force in the financial market in the late 1920s, during the pre-Depression boom era.[62]

Yet, the New Deal reform, which significantly shaped the modern system of financial regulation in the United States, did not directly address the status of bank holding companies.[63] The Glass-Steagall Act, adopted in 1933, created a system of separation between banks and securities firms but otherwise did not limit permissible activities of companies that owned commercial banks.[64] This regulatory vacuum created numerous opportunities for the use of the holding company structure by companies seeking to escape the legal restrictions on mixing banking and commerce and geographic expansion of banks.

After World War II, when commercial companies began to acquire banks at a rapid rate, bank ownership through a holding company structure became the "generally accepted model."[65]

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[62] *Id*. at 86.

[63] The Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933), however, made the first attempt to introduce some form of regulation of bank holding companies. The statute required bank holding companies that owned a majority of shares of any bank member of the Federal Reserve System to register with the Federal Reserve and obtain the Federal Reserve's permit to vote their shares in the selection of directors of any such member-bank subsidiary. *Id.* § 5144. To avoid this requirement, a bank holding company could either avoid majority stakes in member-banks or refrain from voting its shares. *Id.* The statute granted a blanket exemption for holding companies that owned only one member-bank. *See* Burton Alan Abrams, An Economic Theory of Lobbying: A Case Study of the U.S. Banking Industry 110 (1974) (unpublished Ph.D. Dissertation, Ohio State University) ("The Bank Act of 1933 constituted the first attempt at federal regulation of bank holding companies.").

[64] *See generally* Banking Act of 1933, Pub. L. 73-66, 48 Stat. 162 (1933). It is often inaccurately asserted that the Banking Act of 1933 created the separation of banking and commerce. In fact, the Banking Act of 1933 prohibited affiliations between insured depository institutions and entities "engaged principally" in the underwriting of debt and equity securities. *Id.* § 5144(e)(1).

[65] Walker F. Todd, *The Evolving Legal Framework for Financial Services*, 13 CATO J. 207, 208 (1993) (recognizing that the present common legal form of large banking corporations in the United States, a bank holding company with many banking and non-banking subsidiary corporations, was rare in the 19th century and became the generally accepted model only after

Importantly, this feature of the pre-BHCA regulatory regime was highly beneficial to small banking institutions that did not seek interstate expansion. In the mid-1950s, the U.S. banking market was highly decentralized and comprised thousands of small banks operating in geographically limited areas and owned by local business elites. Thus, at the time, it was typical for the owners of small state banks to own local commercial companies as well.[66]

As the use of the bank holding company form by larger banks grew, the opposition from independent state banks, which felt increasingly threatened by the potential entrance in local markets of out-of-state competitors, began to mount.[67] Senator Carter Glass, who spent thirty-two years on the House and Senate Banking and Currency Committees, described the self-interested motives of independent and community bankers:

> The fact is that the little banker is the monopolist. He wants to exclude credit facilities from any other source than from his bank. He wants to monopolize the credit accommodations of his community. He does not want any other bank in his State to come there. If it is a manufacturing enterprise, he welcomes it. Whether it be a branch of some great industrial operation or otherwise, he welcomes it; but if it is to trade in credit, if it is to accommodate the commercial and industrial borrowing demands of the community, he wants to monopolize that himself.[68]

The Independent Bankers Association of America (the "IBAA"), representing small independent and community banks, was one of the fiercest advocates of new legislation that would limit and regulate bank holding companies. Most importantly, the IBAA

World War II); Carter H. Golembe, *One-Bank Holding Companies*, *in* THE ONE-BANK HOLDING COMPANY 66, 71 (Herbert V. Prochnow, ed., 1969).

[66] *Id.* at 68.

[67] *See* Roe, *supra* note 7, at 21-23. *See also* Note, *supra* note 21, at 278-79 ("Opposition grew as holding companies swept across state lines. Opponents argued that holding companies were not sufficiently responsive to the needs of the community, were subject to a conflict of interests, were diminishing or eliminating competition and were often merely a subterfuge for the evasion of state and federal laws.").

[68] 75 Cong. Rec. 9892 (1932) (remarks of Senator Glass).

wanted to stop larger banks from expanding their interstate banking capacity.[69] Even before the 1950s,the small community and independent banking industry exerted a great deal of political power and influence, as "small-town bankers [were] disproportionately represented in the Senate."[70] Small businesses were also politically influential; along with money and status, small business people were sufficiently geographically dispersed to make "many in Congress responsive to their needs."[71]

These interest groups' lobbying efforts, driven by their fear of what they viewed as unfair competition from large "money-center banks," were particularly effective not only because of the sheer political power of independent and community banks but also because their ideological stance reflected the deeply rooted traditional American distrust of big businesses. Having aligned themselves ideologically with the majority of ordinary Americans sharing the belief that "large institutions and central accumulations of economic power [were] inherently undesirable," these interest groups were able to exert pressure on Congress to take the appropriate action.[72]

The Federal Reserve was another key player in the passage of the BHCA. As the country's central bank and the primary federal regulator of state-chartered member banks, the Federal Reserve expressed concern over the rapidly growing network of bank holding

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[69] *Amend the Bank Holding Company Act of 1956: Hearing on S. 2523, S. 2418, and H.R. 7371 Before the Subcomm. Of the Comm. on Banking and Currency*, 89th Cong. 457 [hereinafter *1966 Hearings*] (1966).

[70] Roe, *supra* note 7, at 49.

[71] *Id.* at 47.

[72] *Id*. at 33. In addition to the IBAA, the primary interest groups lobbying for the passage of the BHCA were the American Bankers Association, the National Federation of Independent Business, the National Association of Supervisors of State Banks, the Association of Reserve City Bankers and a handful of state bankers associations. *Providing for Control and Regulation of Bank Holding Companies: Hearings on S. 829 Before the Committee on Banking and Currency,* 80th Cong. 20 (1947); *Bank Holding Bill: Hearings on S. 2318 Before a Subcommittee of the Committee on Banking and Currency*, 81st Cong. 101 (1950); *Bank Holding Legislation: Hearings on S. 76 and S. 1118 Before the Committee on Banking and Currency,* 83rd Cong. 56-57 [hereinafter *1954 Hearings*] (1954); *Table of Contents to Control and Regulation of Bank Holding Companies: Hearings on H.R. 2674 Before the Committee on Banking and Currency,* 84th Cong. iv-v [hereinafter *1955 Hearings*] (1955).

companies as early as 1927[73] and repeatedly attempted to introduce bank holding company legislation throughout the 1930s.[74] Thus, in 1947, the Federal Reserve's proposed draft legislation was approved by the Senate Committee on Banking and Currency and contained many of the provisions on regulation and supervision of bank holding companies later included in the BHCA.[75] While none of the Federal Reserve's proposed bills were ultimately enacted, they became a part of the long series of attempts by the critics of the unregulated bank holding company model to have Congress enact legislation closing that regulatory gap.[76]

Much like the independent and community banks, the Federal Reserve pursued its own institutional interests in pushing Congress to pass laws regulating bank holding companies. A big part of what motivated the Federal Reserve's interest in bank holding company legislation was its desire to protect its administrative turf and further consolidate its own power. In 1954, Representative Wright Patman introduced a bill to audit the Federal Reserve, which if passed, would have greatly compromised the Board's autonomy

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[73] Carl T. Arlt, *Background and History*, *in* THE ONE-BANK HOLDING COMPANY 12, 16 (Herbert V. Prochnow, ed., 1969).

[74] R.D. III, Note, *Approaches to Regulation of One-Bank Holding Companies*, 55 VA. L. REV. 952, 954 (1969).

[75] *See* HELLER & FEIN, *supra* note 1, at 17-7 ("The Board's draft legislation to strengthen bank holding company regulation was approved by the Senate Committee on Banking and Currency on June 19, 1947. Many of the provisions of the bill found their way into the legislation that eventually was enacted as the Bank Holding Company Act of 1956.").

[76] Thus, in 1938, Senators Carter Glass and William McAdoo introduced bank holding company legislation, at the urging of the President. S. REP. NO. 84-1095, at 3 (1955) ("In 1938, in a special message to Congress, the President urged that the Congress enact legislation that would effectively control the operation of bank holding companies; prevent holding companies from acquiring control of any more banks, directly or indirectly; prevent banks controlled by holding companies from establishing any more branches; and make it illegal for a holding company or any corporation or enterprise in which it is financially interested to borrow from or sell securities to a bank in which it holds stock."). Following the failure of that bill, bank holding company legislation was introduced every two to three years for the next seventeen years. S. REP. NO. 84-1095, at 3-4 (1955) (noting Senate bills that were introduced in 1938, 1941, 1945, 1947, 1949, 1953, and 1955).

and function.[77] The bill sought to give the Comptroller General the authority to conduct a complete audit of the Federal Reserve, specifically the twelve Federal Reserve banks and the Open Market Committee, none of which had been subject to a thorough audit for forty years since the creation of the Federal Reserve System.[78] During congressional hearings, the Federal Reserve stressed the importance of its independent judgment in controlling monetary policy and the needlessness of "[superimposing] a further budgetary and auditing review upon the existing procedures."[79] In order to preserve its independence and consolidate regulatory power, the Federal Reserve mobilized small banks to defeat Patman's audit bill and lobby for bank holding company legislation, thus securing its place as the principal regulatory agency for bank holding companies.[80]

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[77] *See* H.R. 7602, 83d Cong. (2d Sess. 1954) (indicating that Patman introduced the bill); *Hearings before the H. Comm. on Gov't Operations*, 83d Cong. 974 [hereinafter statement of Wm. McC. Martin, Jr.] (1954) (statement of William Martin, Jr., Chairman, Board of Governors of the Federal Reserve System.).

[78] *See Hearings before the H. Comm.. on Gov't Operations*, 83d Cong. 974 (2d Sess. 1952). In the wake of the recent financial crisis, the Federal Reserve came under similar pressure with Ron Paul's attempts to audit the Federal Reserve. *See* H.R. 4173, 111th Cong. § 1254(c) (as passed by House of Representatives, December 11, 2009). As a political compromise, the GAO was required to perform a one-time audit of the Federal Reserve's emergency assistance during the financial crisis, examining all loans and other financial assistance provided through the Federal Reserve's exercise of section 13(3) authority between December 1, 2007, and July 21, 2010. The Federal Reserve was required to publish the results of the audit and supporting documentation on its website. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1103, 124 Stat. 1376, 2118 (2010); *id.* § 1109.

[79] *See* statement of Wm. McC. Martin, Jr., *supra* note 77, at 3 ("Legislation to superimpose a further audit of these operations by another government agency would make for duplication and needless expense. Moreover, the audit might constitute an entering wedge in encroaching upon that independence of judgment which Congress sought to safeguard. Such independence of judgment is indispensable in the determination and execution of impartial credit and monetary policy.").

[80] WILLIAM JACKSON, CONG. RESEARCH SERV., RL 32767, INDUSTRIAL LOAN COMPANIES/BANKS AND THE SEPARATION OF BANKING AND COMMERCE: LEGISLATIVE AND REGULATORY PERSPECTIVES 3 (2005).

In 1956, after years of unsuccessful attempts, the advocates of bank holding company legislation had finally seized the right political moment, aided by the wave of renewed fear of holding companies creating financial-economic empires spanning across state borders. The political target of the BHCA was a single company, Transamerica Corp., the "archetypal bank holding company" and the much-maligned symbol of dangerous concentration of financial and economic power.[81] In the 1950s, Transamerica was a formidable presence in the national economy, especially in the Western part of the U.S. In addition to controlling the Bank of America[82] and other banks in Arizona, California, Nevada, Oregon and Washington, Transamerica owned several non-banking enterprises, including insurance companies, real estate and oil development operations, a fish packer, a metal fabricator, an ocean shipping enterprise and taxicab operations.[83] What made things appear especially ominous to the defenders of local banking markets was that Transamerica had allegedly begun planning to continue expanding its banking services eastward, reaching for a truly nationwide presence.[84]

The Federal Reserve targeted its efforts at Transamerica as early as 1948, when it alleged that Transamerica had violated federal antitrust laws prohibiting anticompetitive practices and the creation of monopolies.[85]In 1952, the Federal Reserve "ordered Transamerica to divest all of its subsidiary banks and dispose of all of its stock of

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[81] WILLIAM JACKSON & HENRY COHEN, CONG. RESEARCH SERV., 86-26E, THE BANK HOLDING COMPANY ACT: BACKGROUND, SUMMARY, AND ANALYSIS 4 (1986); *see also 1966 Hearings*, *supra* note 69, at 457 ("A very important reason on the part of the Board of Governors of the Federal Reserve System for seeking this legislation was the existence of the very large bank holding company, Transamerica Corp., which over many years owned control of the Bank of America . . . . Members of the Board of Governors felt that Federal control of this great organization was vitally necessary because of its rate of growth and its wide field of coverage.").

[82] By 1952, Transamerica no longer owned any stock in Bank of America. Transamerica Corp. v. Bd. of Governors of the Fed. Reserve Sys., 206 F. 2d 163, 166-67 (1953).

[83] JACKSON & COHEN, *supra* note 81, at 3; *Control of Bank Holding Companies: Hearing on S. 2577 Before the S. Comm. on Banking and Currency*, 84th Cong. 49, 49-52 (1956) [hereinafter *1956 Hearings*] (statement of F. N. Belgrano, Jr., President and Chairman, Transamerica Corp.).

[84] JACKSON & COHEN, *supra* note 81, at 3.

[85] HELLER & FEIN, *supra* note 1, at 17-14.

Bank of America,"[86] a move that was later overturned by the Third Circuit Court of Appeals.[87]While Transamerica won the case against the Federal Reserve, the attention that had built up around Transamerica "confirmed the need for a stronger bank holding company law to guard against such concentrations of banking resources."[88]Combined with the zealous lobbying efforts of independent bankers, the Federal Reserve was able to succeed in pushing for bank holding company legislation in 1956.[89]

As enacted on May 9, 1956, the BHCA excluded companies that owned or controlled only one bank—one-bank holding companies—from being designated as BHCs subject to the comprehensive consolidated regulation and supervision by the Federal Reserve.[90] This exclusion was a major political victory for

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[86] *Id*.

[87] *Transamerica Corp.*, 206 F.2d at 171. *See also* HELLER & FEIN, *supra* note 1, at 17-15.

[88] HELLER & FEIN, *supra* note 1, at 17-15.

[89] *See 1954 Hearings*, *supra* note 72, at 302 (Statement of Senator Robertson) ("[The] Independent Bankers Association, with a lot of members in Minnesota and in California, has been very insistent upon this type of legislation. The Independent Bankers generally over the Nation favor legislation of the proper kind, but they haven't been as insistent as the independent bankers of Minnesota and of California, where Transamerica operates and where this witness' bank operates. There is a very strong demand for legislation of this kind. . . . They spent a lot of time trying to convict Transamerica of violation of the antitrust laws, and finally lost their case in the circuit court of appeals.").

[90] The original version of the BHCA defined a BHC to exclude one-bank holding companies:

> "Bank holding company" means any company (1) which directly or indirectly owns, controls, or holds with power to vote, 25 per centum or more of the voting shares of each of two or more banks or of a company which is or becomes a bank holding company by virtue of this Act, or (2) which controls in any manner the election of a majority of the directors of each of two or more banks, or (3) for the benefit of whose shareholders or members 25 per centum or more of the voting shares of each of two or more banks or a bank holding company is held by trustees; and for the purposes of this Act, any successor to any such company shall be deemed to be a bank holding company from the date as

the small independent bank lobby, which prevailed over the strong objections of the Federal Reserve. The Federal Reserve pushed for the inclusion of one-bank holding companies within the original BHCA, as excluding them was "logically indefensible."[91] Congressional hearings for the BHCA suggest that certain Senators were not convinced of this logic.[92] Senator Robertson remarked:

> There are over 100 holding companies that have only 1 bank. They do not want more banks. They are not in the banking business. That is an investment, and that is all there is to it. But we cover the 50 that were not operating on that basis. They were in the position of constant expansion. We thought the time had definitely come to put some curb on that, and that is all this bill does."[93]

Importantly, however, members of Congress were also acutely aware of the political price of going against small independent banks and local business groups that sought to protect their ability to combine banking and commerce in their local markets. A later study found:

> The Independent Bankers Association was still after a death sentence, but only for companies controlling two or more banks. Its spokesman said the one-bank firms posed no threat to independent banking. Key Congressmen agreed, for a very practical reason:

> of which such predecessor company became a bank holding company.

Bank Holding Company Act, Pub. L. No. 84-511, § 2(a), 70 Stat. 133, 133 (1956).

[91] *1956 Hearings*, *supra* note 83, at 58 (statement of F. N. Belgrano, President and Chairman of the Board, Transamerica Corp.).

[92] *See 1956 Hearings*, *supra* note 83, at 60-61 (statement of Sen. Lehman) (stating that "in the minds of a number of members of the committee there was a reason for exempting the one-bank concerns").

[93] *1956 Hearings*, *supra* note 83, at 80 (statement of Senator Robertson). *See also 1956 Hearings*, *supra* note 83, at 59 (statement of F. N. Belgrano, President and Chairman of the Board, Transamerica Corp.) (stating that including one-bank holding companies in the definition of a BHC would bring about 117 companies within the scope of the BHCA).

> they were convinced that inclusion of the one-bank companies would lose votes needed for passage of any legislation.[94]

According to the accompanying Senate report, the BHCA was rooted in the belief that "bank holding companies ought not to manage or control nonbanking assets having no close relationship to banking."[95] The history of the one-bank holding company exemption demonstrates, however, that the principle of separation of banking and commerce applied rather selectively to prohibit commingling of these activities only by large banking groups. Small independent banks, on the other hand, were free to affiliate with local commercial businesses as long as they stayed within the one-bank holding company exclusion. Therefore, the original BHCA was, in fact, much more fundamentally driven by the belief that "adequate safeguards should be provided against undue concentration of control of banking activities."[96]

The independent bankers' political victory, however, proved to be a double-edged sword in the long run. A review of the BHCA by a prominent finance firm noted:

> It is ironic that the Bank Holding Company Act of 1956 stemmed originally from efforts by independent bankers to remove the holding company from the banking scene; what hasactually happened is that the holding company has received legislative approval. What some had hoped would be a death sentence has turned out to be a passport to the future.[97]

III. Who Is In? The Evolution of the Statutory Definition of "Bank"

The enactment of the BHCA in 1956 created a new institutional framework that favored the owners of small and local banks over the larger banks that sought to expand nationally. Not surprisingly, the results of that particular legislative bargain were not stable. Since the original enactment of the BHCA, Congress

[94] Eccles, *supra* note 60, at 93.
[95] S. REP. NO. 84-1095, at 1 (1955).
[96] *Id*.
[97] Eccles, *supra* note 60, at 96.

amended the statutory definition of the term "bank" three times: in 1966, 1970 and 1987. Each of these three amendments was an important milestone in the historical development of the statutory scheme, reflecting shifting policy priorities with respect to interstate banking, the scope of permissible non-banking activities of banks' corporate parents, or the separation of banking and commerce. Tracing the evolution of this key statutory definition helps to understand the broader economic and political dynamics that shaped bank holding company regulation in the second half of the twentieth century.

A. The 1966 Amendments

The main focus of the first Congressional action to amend the BHCA was the statutory definition of "company." Overall, the 1966 Amendments were favorable to regulated BHCs.[98] These amendments were enacted primarily to bring one financial institution—the Alfred I. duPont testamentary estate, which controlled numerous banks and non-banking enterprises through the duPont Trust—within the scope of the BHCA.[99]

The legislative history of the original BHCA shows that Congress was aware of the duPont Trust's size and activities, but had intentionally exempted it from the BHCA by excluding non-business trusts from the definition of "company."[100] The 1966 Amendments eliminated the exemption for long-term or perpetual trusts, as well as religious, charitable or educational institutions.[101] These entities were

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[98] Abrams, *supra* note 63, at 113.

[99] *1956 Hearings*, *supra* note 83, at 64-65.

[100] Congress placed significant weight on the duPont Trust's "testamentary trust" form and distinguished it from companies like Transamerica, based on the notion that duPont Trust was subject to the limitations of the trust instrument. Act of July 1, 1966, Pub. L. No. 89-485, § 2(b), 80 Stat. 236, 236 (1966).

[101] The 1966 Amendments retained the exemption for short-term non-business trusts. In order to be considered short-term, a non-business trust must "terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust." *Id.*

now considered "companies" that would become BHCs if they controlled two or more banks.[102]

The primary catalyst for the duPont Trust's inclusion within the BHCA was the labor union strike against the Florida East Coast Railway in 1963, a railway owned by the duPont Trust.[103] Following disputes over wage increases and other contractual changes, and a refusal by the Railway to conform to the terms of the national settlement, the unions orchestrated a strike that lasted a number of years and sought congressional action to pressure the Railway into settling.[104] Whether this strategy would have worked in reality is unclear. The labor unions seemed to believe that the Railway "had only been able to withstand the strike for so long because [it] had the whole vast Du Pont(sic) estate behind [it]," although the company executives testified that the Railway "[had] not received $1 of assistance from the Du Pont(sic) estate or from its banking and associated interests."[105] After the enactment of the 1966 Amendments, the duPont Trust sold the ownership stake in its banks to avoid becoming a BHC and continued operating its non-banking enterprises, including the Florida East Coast Railway.[106]

Although the 1966 Amendments were driven by Congress' resolve to bring the duPont Trust under the BHCA regulatory regime, ironically, the more significant long-term effect of these Amendments was to limit the reach of the BHCA by changing the key statutory definition of "bank."

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[102] Incidentally, the Federal Reserve also lobbied for eliminating the original exemption of one-bank holding companies from the BHCA but failed to get that amendment through Congress.

[103] *1966 Hearings*, *supra* note 69, at 572 (Statement of Sen. Wallace F. Bennett) ("[T]his issue [referring to the exemption of the duPont Trust from the BHCA] was still alive and in existence in 1956, when the original Bank Holding Company Act was passed and at that time it was decided it was no problem. It only became a problem when there was a strike on the Florida East Coast Railway Co.").

[104] *1966 Hearings*, *supra* note 69, at 497-511 (Statement of Winfred L. Thornton, President, Florida East Coast Railway Co.). The unions lobbied Congress to amend the BHCA as a way of exerting pressure on the duPont Trust and forcing a settlement of the strike on the Railway. *Id.*, at 501.

[105] *Id.* at 509.

[106] *Financial Timeline*, ALFRED I. DUPONT TESTAMENTARY TRUST, http://alfrediduPonttrust.org/trust/timeline_financial.html (last visited Oct. 30, 2011). The strike on the Railway ended on April 9, 1976. SETH H. BRAMSON, IMAGES OF RAIL: FLORIDA EAST COAST RAILWAY 112 (2006).

In its original form, the BHCA defined "bank" by charter type to mean "any national banking association or any State bank, savings bank, or trust company" and explicitly excluded only those entities that were organized by U.S. bank holding companies to operate offshore.[107] The 1966 Amendments narrowed the scope of the BHCA by redefining "bank" to refer only to institutions that accepted demand deposits, or deposits that may be withdrawn at any time and do not require prior notice of withdrawal to be given to the depository institution.[108]

The legislative history of the 1966 Amendments shows that Congress deliberately sought to narrow the scope of what it perceived to be an unnecessarily broad definition, given the key policy purposes of the BHCA.[109] More specifically, Congress narrowed the statutory definition to exclude corporate owners of certain types of financial institutions—savings banks, industrial banks and non-deposit trust companies—from regulation as BHCs.[110] Congress explained its decision:

> The purpose of the act was to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its nonbanking subsidiaries. This objective can be achieved without applying the act to savings banks, and there are at least a few instances in which the reference to "savings bank" in the present definition may result in covering companies that control two or more industrial banks. To avoid this result, the bill redefines "bank" . . . so as to exclude institutions

[107] That is, Edge Act and so-called agreement corporations. Bank Holding Company Act, Pub. L. No. 84-511, § 2(c), 70 Stat. 133, 133 (1956) (codified as amended at 12 U.S.C. § 1841(c) (2010)). These entities continue to be exempted from the definition of "bank."12 U.S.C. § 1841(c)(2) (2010). This Article, however, does not discuss these exemptions.

[108] Act of July 1, 1966, Pub. L. No. 89-485, § 3(c), 80 Stat. 236, 236 (1966) (codified as amended at 12 U.S.C. § 1841 (c) (2010)). By contrast, time deposits can only be withdrawn after a fixed period of time has passed, so that premature withdrawals typically result in a penalty. *See* 12 C.F.R. § 204.2(c)(1) (2011).

[109] S. REP. NO. 89-1179, at 7 (1966).

[110] *See id.* (defining bank as "an institution that accepts deposits payable on demand").

> like industrial banks and nondeposit trust companies.[111]

Congress chose to achieve its objective by narrowing the statutory definition instead of explicitly exempting individual categories of financial institutions that, in Congress' opinion, did not pose a real danger of undue concentration of control over the flow of commercial bank credit.[112]

This drafting choice, while successfully achieving the self-proclaimed congressional goal, inadvertently created an entirely new avenue for various non-banking entities to control deposit-taking and lending institutions without being subject to regulation and supervision by the Federal Reserve. As long as their quasi-banking subsidiaries refrained from accepting deposits that could be legally withdrawn on demand—a fairly narrowly defined technical requirement—these holding companies were free to engage in both commercial and *de facto* banking activities.

B. The 1970 Amendments

The catalyst for the next round of major revisions of the BHCA was the rapid proliferation, during the late 1960s, of one-bank holding companies, originally exempted from regulation as BHCs. The magnitude of the change was truly astounding:

> In 1956, there were an estimated 117 one-bank holding companies, with assets of $11 billion. In 1965, there were 550 one-bank holding companies, with commercial deposits of $15.1 billion. By the end of 1969, this number had grown to more than 890 one-bank holding companies with commercial deposits exceeding approximately $181 billion—a figure representing 43 percent of all deposits in insured commercial banks in the United States.[113]

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[111] *Id.*

[112] At the time, industrial banks, savings banks, and non-depository trust companies did not take what technically qualified as "demand deposits" and were small local institutions.

[113] Sax & Sloan, *supra* note 27, at 1201 (footnotes omitted).

However, it was not just the number of new unregistered bank holding companies that pushed Congress to act. In contrast to 1956, when a typical one-bank holding company combined a local commercial firm with a small local bank, this new generation of one-bank holding companies consisted of so-called "congenerics," or groups centered around a large bank seeking nationwide market presence.[114]

This explosion in the growth of congeneric holding companies in the late 1960s was attributable to several factors, including increased competition for deposits from non-banking financial institutions and advances in available technology.[115] Because the major advantage of being a one-bank holding company was the ability to engage freely in non-banking and non-financial activities, many such companies diversified their business and investment portfolios by moving into real estate, insurance, and a variety of other business lines typically impermissible for regulated BHCs.[116] Through this expansion into new product and geographic markets, one-bank holding companies were able to offer a wider range of financial and non-financial products to their clients and to increase their general profitability.[117]

By the end of 1968, thirty-four large commercial banks (including the six largest) had created or announced plans to create

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[114] Golembe, *supra* note 65, at 68-69.

[115] Sax & Sloan, *supra* note 27, at 1209 ("Throughout the 1960's, competition for savings from other types of financial institutions had grown so intense, and technological developments had so changed the nature of banking, that the congeneric holding company was a logical outgrowth of failure to include the one-bank holding company under the 1956 Act."). Thus, the advent of the computer along with other advances in technology enabled banking organizations to offer a broad range of new customer services, including "record keeping, computer service, lease financing and credit cards." *Id.* (quoting Note, *Banks and Banking: The 1956 Bank Holding Company Act and the Development of One Bank Holding Companies*, 23 OKLA. L. REV. 73, 83 (1970)). These developments encouraged banks to diversify their businesses and "enter new and potentially more profitable areas of the economy" (i.e., non-banking activities). Sax & Sloan, *supra* note 27, at 1209.

[116] *Id.* at 1208.

[117] *See id.* at 1209-10 (discussing the growth of one-bank holding companies, as well as stating the view that such companies "had been [the] most energetic in responding to the needs of the public for expanded financial services").

one-bank holding companies.[118] Like their multibank counterparts, one-bank holding companies had become a matter of "grave concern"[119] to many small and community banks, symbolizing the "continuing threat of big business to break out of the regulatory bonds which purportedly protect the public against the economic tyrannies of the nineteenth century business cartels."[120] Congress faced pressure from the Federal Reserve,[121] the Treasury Department,[122] the FDIC[123] and the Nixon Administration[124] to

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[118] *Id.* at 1209; *see also* S. REP. NO. 91-1084, at 1-3 (1970) (discussing the growth and history of one-bank holding companies).

[119] Sax & Sloan, *supra* note 27, at 1210.

[120] *Id.* (quoting Franklin R. Edwards, *The One-Bank Holding Company Conglomerate: Analysis and Evaluation*, 22 VAND. L. REV. 1275, 1275-76 (1969)).

[121] S. REP. NO. 91-1084, at 3 (1970); *see also One-Bank Holding Company Legislation of 1970: Hearing on S. 1052, S. 1211, S.1664, S. 3823, and H.R. 6778 Before the S. Comm. On Banking and Currency*, 91st Cong. 140 [hereinafter *1970 Hearings*] (1970) (Statement of Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System) ("In 1956 and again in 1966, your committee decided not to apply this principle to companies that only own one bank. In scheduling the present hearings you have recognized, however, the need to reconsider this decision in the light of the new wave of one-bank holding companies formed in the past 2 years. . . . Whatever the reasons for exempting one-bank holding companies may have been in 1956 or in 1966, the time is clearly at hand when Congress must decide whether the rules against mixing banking and other businesses in a holding company system should apply to one-bank holding companies or should be abandoned. It is discriminatory to apply these rules solely to the registered bank holding companies, which have fewer banks and a much smaller share of deposits than the exempt companies."). See *id.* for detailed statistics on one-bank holding companies from the mid-1960s to 1970s.

[122] *1970 Hearings*, *supra* note 121, at 7-8 (Statement of Charls E. Walker, Under Secretary, Dep't of the Treasury) ("The Bank Holding Company Act of 1956, which provided the first comprehensive Federal regulation of companies holding 25 percent or more of the stock of two or more commercial banks, was deliberately not made applicable to companies owning only one bank. There was no need at that time to cover one-bank holding companies. Beginning in 1968, the situation changed markedly. Banks themselves, including many of the largest banks, began to form one-bank holding companies in large numbers so that there are now more than 900 one-bank holding companies controlling about 40% of all commercial bank deposits. . . . Under existing law, there are no restrictions upon acquisitions by the newly formed one-bank holding companies, nor are

amend the BHCA to apply to one-bank holding companies. Interest groups and trade associations, like the IBAA[125] and the National Association of Insurance Agents,[126] also played a large role in pushing for this amendment.[127]

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there any prohibitions on the activities in which they may engage, except, of course, that they may not engage in the securities' business. The proposed Bank Holding Company Act of 1970 . . . would rebuild the wall separating diverse economic interests. Under the legislation: The Bank Holding Company Act of 1956 would be amended to extend Federal regulation of bank holding companies to those companies which control one bank.").

[123] *1970 Hearings*, *supra* note 121, at 168 (Statement of Frank Willie, Chairman, Federal Deposit Insurance Corporation) ("The Federal Deposit Insurance Corporation believes that the activities of one-bank holding companies should be brought promptly under effective regulatory control at the Federal level in order to prevent an unhealthy concentration of the Nation's economic resources and to control possible anticompetitive practices in the allocation of credit and financial services within the Nation's economy.").

[124] Sax & Sloan, *supra* note 27, at 1210 n.70 (quoting Statement of President Richard Nixon, March 24, 1969) ("The strength of our economic system is rooted in diversity and free competition. The strength of our banking system depends largely on its independence. Banking must not dominate commerce or be dominated by it. To protect competition and the separation of economic powers, I strongly endorse the extension of Federal regulation to one-bank holding companies, and urge the Congress to take prompt and appropriate action."). *See also Recent Changes in the Structure of Commercial Banking*, 56 FED. RESERVE BULL. 199, 200 (1970) (discussing one-bank holding company statistics and motivations); R. D. III, *supra* note 74, at 952 n.4 (1969).

[125] *1970 Hearings*, *supra* note 121, at 986 (Statement of Rod L. Parsch, President, Independent Banks Association of America) ("Concentrated control of banking in giant holding company and branching systems is a constant threat to these objectives [preserving competition]. Therefore, our association consistently favors any legislation designed to regulate and control bank holding companies . . . .").

[126] The one-bank holding company structure had become vital to the preservation of small banks in some areas, notably the Midwest, as it allowed individuals to purchase majority stakes in small community banks. *See 1970 Hearings*, *supra* note 121, at 687 (Statement of J. Rex Duwe, President, Farmers State Bank) ("In purchasing these banks . . . we found it necessary to borrow substantial sums of money. The repayment of these debts would have been impossible had we acquired the banks individually. . . . However, by using the one-bank holding company arrangement . . . , repayment is possible over quite a period of years."). In

On the other side of the debate, advocates of the one-bank holding company structure argued that it strengthened the competitiveness of the banking system by allowing banks to adapt better to the changing market conditions and to take advantage of economies of scale.[128] Not surprisingly, this fight over the role of one-bank holding companies reignited the broader debate over the proper scope of bank holding company regulation in the United States.[129]

After two years of intense struggle, the multitude of forces lobbying for eliminating the one-bank holding company exemption prevailed.[130] In 1970, Congress significantly amended the original language of the BHCA to bring one-bank holding companies within the scope of the BHCA.[131] According to the Senate Committee's

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order to use the one-bank holding company form, however, at least forty percent of the holding company's adjusted gross income had to be derived from sources other than bank dividends. As a result, many of these one-bank holding companies satisfied this requirement through the use of an insurance agency. The competition that this gave independent insurance agents threatened to put many out of business. *See 1970 Hearings*, *supra* note 121, at 461 (statement of Morton V. V. White, Vice Chairman, National Association of Insurance Agents, Inc.) ("I cannot overstate our concern for the effect that bank holding companies can have upon the livelihood of our members and the welfare of the insuring public when bank holding companies engage in the sale of insurance.").

[127] This reflected a significant change in the landscape of the U.S. banking industry by the early 1970s. In effect, local business elites and state bankers had to give up their own ability to run commercial enterprise and own one local bank, out of the fear of being swallowed by the large financial-industrial groups.

[128] *See* Sax & Sloan, *supra* note 27, at 1210 (stating that advocates "claimed that holding companies were likely to yield economics of scale in production, distribution, research and associated product development, and management").

[129] Sax & Sloan, *supra* note 27, at 1211.

[130] For a detailed analysis of the political struggle and Congressional negotiations over that issue, see Abrams, *supra* note 63, at 108-144 (discussing the evolution of one-bank holding company legislation).

[131] *See* Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, § 101(a), 84 Stat. 1760, 236 (1970) ("'[B]ank holding company' means any company which has control over any bank . . . ."). One of the most heated debates in Congress concerned the grandfathering clause for the existing one-bank holding companies. Thus, the IBAA lobbied for a provision that grandfathered only those one-bank holding companies that

Report, the primary purpose of Congressional action was "to guard against the possible future perpetration of abuses occasioned by a company's unregulated control of a single bank."[132]

The 1970 Amendments made several significant changes to the BHCA.[133] Importantly, Congress once again narrowed the scope of the BHCA by amending the statutory definition of "bank." The 1970 Amendments added a second prong to the statutory test for what constituted a "bank," requiring an institution to both accept demand deposits and make commercial loans (essentially, loans for

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were in existence in 1965, before the large banks began setting their congeneric structures. That approach would have grandfathered mostly the original one-bank holding companies that combined small local banks with local commercial companies. On the other hand, the American Bankers Association, representing the wider banking interests, argued for a 1969 grandfathering date. The ultimately adopted grandfathering clause permitted one-bank holding companies to retain, for a ten-year period, activities lawfully conducted as of June 30, 1968. This political compromise benefitted a substantial swath of one-bank holding companies owning both small and large banks. *See* Sax & Sloan, *supra* note 27, at 1215-16 (outlining arguments by proponents and detractors of the grandfathering clause); Abrams, *supra* note 63, at 123-124 (describing the positions taken by lobbying groups). One study found the total deposits of one-bank holding companies in existence by the end of 1968 dwarfed those of registered BHCs:

> During the eighteen months ending December 31, 1968, approximately seventy-five commercial banks organized one-bank holding companies. Included in the number were seven of the nation's ten largest institutions. Their total deposits of some \$100 billion dwarfed the \$51 billion held by registered bank holding companies.

Eccles, *supra* note 60, at 101.

132 S. REP. NO. 91-1084, at 4 (1970).

133 For instance, Congress deliberately expanded the scope of the BHCA by revising the definition of "control." Under the 1970 Amendments, if a company "directly or indirectly exercises a controlling influence over the management or policies of the bank," the Federal Reserve could simply designate the company as a BHC, even if it did not own twenty five percent or more of a class of voting securities or control the election of directors. Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, § 101(a), 84 Stat. 1760, 1760 (1970). The 1970 Amendments also relaxed the original statutory standards for permissible non-banking activities of BHCs and added the anti-tying provisions that continue to exist today.

business rather than personal purposes) in order to fall within the BHCA's definition.[134]

According to the legislative history, by narrowing the definition of a "bank," Congress sought to further ensure that the BHCA applied only to companies controlling commercial banks and not financial institutions that did not make commercial loans and made only consumer loans.[135] While Congress did not explicitly define a commercial bank as one that made exclusively commercial (as opposed to personal) loans, it was understood that the concerns underlying the BHCA, notably fears of anticompetitive behavior, were mainly targeted at banks that provided credit to businesses rather than individual consumers. The Federal Reserve held a similar view, noting that "there [was] less need for concern about preferential treatment in extending credit where no commercial loans [were] involved."[136]

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[134] The 1970 Amendments redefined the term "bank:"

> "Bank" means any institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans.

Id. § 101(c).

[135] S. REP. NO. 91-1084, at 24.

[136] *1970 Hearings*, *supra* note 121, at 137 (Letter from J. L. Robertson, Board of Governors, Federal Reserve System). This emphasis on preventing excessive concentration of commercial, as opposed to consumer, credit raises an interesting question, especially in light of the financial crisis of 2007-09 that originated in residential mortgage markets. On its face, the focus on commercial lending may be viewed as reflecting the importance of assuring fair access to credit for productive economic activity as one of the underlying policy concerns driving the U.S. bank regulation. However, there were probably important market factors that explained policy-makers' exclusive preoccupation with potential conflicts of interest and other evils of monopoly in the commercial credit market. It may very well be that Congress considered consumer credit markets inherently diverse, localized, and comprising a large number of small lenders, including thrifts, credit unions, industrial banks and other entities. It is also possible that, in the 1950s and 1960s, commercial borrowers were particularly concerned about having access to bank credit because it was the main source of loan financing.

At the time the 1970 Amendments were passed, the BHCA's new definition of a bank was thought to have little effect, as most of the institutions that were considered banks under the BHCA were, indeed, in the business of making commercial loans.[137] In fact, there is evidence that the 1970 Amendments were deliberately designed to exempt only one company from the definition of a bank: the Boston Safe Deposit and Trust Company.[138] The Boston Company was a holding company that owned one of the oldest fiduciary banks in the nation, the Boston Safe Deposit and Trust Company, which "maintain[ed] no commercial bank department" and was "primarily engaged in the fields of investment and property management and . . . other fiduciary services usually identified with the personal trust business."[139] As it did not operate a commercial bank, the Boston Company strongly urged Congress to exempt it from the BHCA, a move that the Federal Reserve agreed to in 1970 by adding the "commercial loan" prong to the definition of a bank.[140]

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[137] Davis W. Turner, Note, *Nonbank Banks: Congressional Options*, 39 VAND. L. REV. 1735, 1740-41 (1986) (explaining that "critics argue that the 1970 amendments were designed to benefit only one company[,]" relying "on statements made during the debate on the amendment indicating that Boston Safe [Deposit and Trust Company] was virtually the only bank at the time that did not make commercial loans"). *See also* Harvey N. Bock, *Opportunities for Nonbanking Companies to Acquire Depository Institutions in the Wake of the Competitive Equality Banking Act of 1987*, 44 BUS. LAW. 1053, 1056 (1989) ("[T]he [1970] amendment was viewed as technical in nature and as having only very limited application.").

[138] Turner, *supra* note 137, at 1740. *See also Hearings Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins. of the H. Comm. on Banking, Fin. and Urban Affairs,* 99th Cong. 14 (1985) (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System) ("As you know, the present Bank Holding Company Act has been amended through the years to define a bank as an institution that both accepts demand deposits and makes commercial loans. I think in practice that was done to exempt some very limited purpose institutions, specifically trust companies, but as time has passed, as technology has changed, it is that particular definition which is being exploited, such that a very large volume of ordinary banking business potentially can be done in the guise of a nonbank.").

[139] *1966 Hearings*, *supra* note 69, at 732 (Letter from William W. Wolbach, President, The Boston Co.).

[140] *See Executive Session: Tuesday, June 23, 1970, Hearing Before the S. Comm. on Banking and Currency*, 91st Cong. 10 (1970) ("On the first, in regard to engaging in the business of making commercial loans, we have

The 1970 Amendments' use of a conjunctive test in defining a bank had a significant, and largely unforeseen, practical impact on the development of the U.S. banking industry in the next seventeen years. In effect, it created a significant new opportunity for regulatory arbitrage, whereby a company could establish a so-called "nonbank bank" and effectively offer banking services without becoming a BHC. Functionally, these nonbank banks were very much like regular commercial banks. They had bank charters but did not fall within the scope of the BHCA's definition of "bank" because they restricted their activities to either accepting demand deposits or making commercial loans.[141] Since, as a technical matter, these companies did not own what the BHCA defined as banks, they were not subject to the interstate or activity restrictions imposed by the BHCA. Control of these nonbank banks potentially enabled financial and commercial companies to offer a wide variety of banking and

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received a report again from the Federal Reserve Board saying there is no objection to this particular provision; that it would probably only affect one institution located in the State of Massachusetts; and this is a trust company in Boston which just incidentally finds itself brought under the definition of a bank holding company without some provision such as this. And the Fed agrees there is no real reason this particular outfit should be regulated."); *Executive Session: Tuesday, July 7, 1970, Hearing Before the S. Comm. on Banking and Currency*, 91st Cong. 293 (1970) ("The first commercial loan exemption was tentatively agreed to earlier by the Committee, and deals with the Boston Trust Company situation that would otherwise be held a bank holding company, but is not really engaged in the business of banking. The Federal Reserve Board has seen no reason to deem them a bank holding company, and *it is suggested this would be the way to exempt them from provisions of the Act*.") (emphasis added).

[141] For a discussion of the factors leading to the rise of nonbank banks and the desirability of possessing a nonbank bank, see Bock, *supra* note 137. *See also* William M. Isaac & Melanie L. Fein, *Facing the Future: Life Without Glass-Steagall*, 27 CATH. U. L. REV. 281, 291-96 (1988) (discussing the "technological, economic, and competitive forces [that shifted] financial markets away from traditional banking channels toward increased use of the securities markets for financial intermediation."); CATHERINE ENGLAND, CATO INST., CATO INSTITUTE POLICY ANALYSIS NO. 85: NONBANK BANKS ARE NOT THE PROBLEM 4-5 (1987) (discussing in detail the economic and technological changes that had occurred in the financial services industry).

non-banking products and services, generally impermissible for BHCs, on an effectively nationwide basis.[142]

During the 1970s, relatively few companies sought to take advantage of the nonbank bank opportunity.[143] But the situation drastically changed in the turbulent 1980s. As one commentator explains,

> What could not be foreseen in 1970 was the dramatic rise in interest rates that later in the decade, together with rapid technological changes and greatly increased international competition, was to cause enormous turmoil in the nation's financial marketplace and a major restructuring of the financial services industry. One of the consequences of those developments was a new interest in the acquisition of depository institutions by companies whose other activities did not qualify them for bank ownership under the BHCA. The 1970 redefinition of the term "bank" provided such companies with precisely the means they needed to surmount that obstacle.[144]

It was not until the 1980s, when commercial firms, securities firms and insurance companies began acquiring FDIC-insured nonbank banks, that the nonbank bank model appeared to pose a serious threat to the separation of banking and commerce and prohibitions on interstate banking.[145] The statutory definition of

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[142] *See Hearings Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins. of the H. Comm. on Banking, Fin. and Urban Affairs*, *supra* note 138, at 88 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System) ("[T]hese financial organizations may . . . expand their primary financial services, such as securities, insurance, or real estate services, on a nationwide basis whereas the primary activities of banking organizations may not be so expanded.").

[143] Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539, 1569 (2007) ("During the 1970s, few other institutions [besides the Boston Safe Deposit and Trust Company] sought to take advantage of this 'nonbank bank loophole.'").

[144] Bock, *supra* note 137, at 1056 (footnote omitted).

[145] *See* Wilmarth, *supra* note 143, at 1569 ("[C]ommercial conglomerates, securities firms and insurance companies acquired FDIC-insured banks in the 1980s and caused those banks to stop engaging in one of the designated

"bank" allowed these commercial companies to gain direct access to federally-insured retail deposits that served as a cheaper source of financing because of the public subsidy.[146]

Companies from a wide variety of industries acquired nonbank banks: retailing giants such as Sears[147] and J.C. Penney; financial institutions such as Merrill Lynch and Prudential Bache Securities; insurance companies such as Aetna Life and Casualty Company; and conglomerates such as Gulf & Western.[148] The majority of nonbank banks that arose during the 1980s took demand deposits and made consumer loans, but did not make commercial loans. By 1987, more than two hundred nonbank banks had been established, with over two hundred additional applications for nonbank banks pending.[149] The reasons for acquiring nonbank banks at this time were similar: Gulf & Western, for example, used its nonbank bank to facilitate its credit card and consumer lending services, while Merrill Lynch used its nonbank bank to move check and credit card transaction processing in-house.[150] Regulated BHCs also used nonbank banks in order to operate deposit-taking facilities without violating interstate branching restrictions.[151]

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functions, thereby avoiding regulation under the BHC Act By 1987, two major retailers—Sears and J.C. Penney–and many other large commercial firms owned FDIC-insured 'nonbank banks.'").

[146] U.S. depository institutions receive what amounts in practice to a significant public subsidy through their access to federal deposit insurance and the Federal Reserve's backup liquidity facilities and payment system. Because their creditors consider them less risky, access to this federal safety net lowers the cost of borrowing for insured depository institutions. Banks receive this public subsidy because they perform important public utility functions. *See, e.g.*, E. GERALD CORRIGAN, FED. RESERVE BANK OF MINNEAPOLIS, ANNUAL REPORTS 1982: ARE BANKS SPECIAL? (1982), *available at* http://www.minneapolisfed.org/pubs/ar/ar1982a.cfm.

[147] Greenwood Trust Company of Delaware, Sears' nonbank bank, was the fastest growing bank in 1986, increasing its deposits from $27 million to $1.05 billion within the span of a year. ROBERT E. LITAN, WHAT SHOULD BANKS DO? 49 (1987).

[148] *Id.* at 49; ENGLAND, *supra* note 141, at 2.

[149] *Id.* at 4.

[150] *Id.* at 2.

[151] F. JEAN WELLS, CONG. RESEARCH SERV., IB87071, NONBANK BANKS 2 (1987); *Hearings Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins. of the H. Comm. on Banking, Fin. and Urban Affairs*, *supra* note 138, at 94 (statement of James G. Cairns, Jr., American Bankers Association).

C. The Competitive Equality Banking Act of 1987

As the number of companies seeking to exploit the nonbank bank model increased, the same actors that historically had championed regulation of bank holding companies increased pressure on Congress to remedy the situation and restore the competitive status quo ante.[152]

The Federal Reserve was a particularly important force in the political battle against nonbank banks. Vehemently opposing the establishment of nonbank banks, it actively lobbied Congress to revise the statutory definition of "bank."[153] The Federal Reserve's open animosity toward nonbank banks reflected its belief that these institutions were used deliberately to avoid restrictions on interstate expansion and to combine banking with impermissible commercial activities, thus gaining an unfair advantage over regulated banks.[154] The Federal Reserve also viewed the rapid growth of nonbank banks operated by commercial companies as a significant threat to the efficacy of its monetary policy.[155]

In the early 1980s, the Federal Reserve denied applications to form nonbank bank subsidiaries, which led to contentious litigation.[156] In 1984, the Federal Reserve took the dramatic step of redefining the terms "demand deposit" and "commercial loan" by regulation.[157] The revised Regulation Y expanded the definition of "demand deposit" to apply to all deposits that were effectively payable on demand,[158] including negotiable order of withdrawal

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[152] *See generally Hearings Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins. of the H. Comm. on Banking, Fin. and Urban Affairs*, *supra* note 138.

[153] *See* Turner, *supra* note 137, at 1746 ("The Board consistently has opposed the widespread establishment of nonbank banks and has lobbied heavily for a change in the definition of 'bank'.").

[154] *Id.*

[155] *Id.*

[156] *See, e.g.,* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3rd Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982) (holding that "[t]he BHC Act was enacted to prevent the possibility of a holding company abusing its control over commercial bank credit for the benefit of its non-banking operations . . . .").

[157] Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, 49 Fed. Reg. 794, 818 (Jan. 5, 1984) (codified at 12 C.F.R. Part 225).

[158] *Id*. at 818. The revised Regulation Y defined deposits that a depositor had a legal right to withdraw on demand as "any deposit with transactional

("NOW") accounts.[159] Similarly, the definition of a "commercial loan" was also broadened to include a wide variety of investments in money market instruments.[160] The Federal Reserve argued that these revisions were necessary in order to "carry out the purposes and prevent evasion of the [BHCA]."[161]

In short order, the Federal Reserve's revisions to Regulation Y were challenged in court.[162] In a landmark 1986 decision, *Board of Governors v. Dimension Financial Corp.*, the Supreme Court of the United States invalidated the Federal Reserve's actions as exceeding its authority to interpret the statute.[163] The Court held that the statutory language made clear that NOW accounts could not be

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capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument . . . ." *Id.*

159 NOW accounts are interest-bearing savings accounts on which drafts may be written. Because the deposit-taking institution reserves the legal right to require notice before funds may be withdrawn, NOW accounts technically do not constitute "demand deposits." NOW accounts were first offered in Massachusetts in 1972 and quickly became popular as a means by which savings banks and other types of financial institutions could compete with the transfer services and third-party payment options offered by commercial banks. *See generally* P. James Riordan, *Negotiable Orders of Withdrawal*, 30 BUS. LAW. 151 (1974). In 1981, NOW accounts were authorized on a national level for commercial banks, savings associations and mutual savings banks. PAUL R. WATRO, FED. RESERVE BANK OF CLEVELAND, ECONOMIC COMMENTARY: THE BATTLE FOR NOWS (1981).

160 *See* Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, 49 Fed. Reg. at 818 (The Federal Reserve redefined a "commercial loan" as "any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.").

161 *Id.* at 798-99.

162 *See* Turner, *supra* note 137, at 1749-53 (detailing the holdings in several federal cases).

163 474 U.S. 361, 374 (1986) ("The [BHCA] may be imperfect, but the Board has no power to correct flaws that it perceives in the statute it is empowered to administer. Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute.") (footnote omitted).

defined as "demand deposits," regardless of actual practice.[164] Similarly, the Court struck down the Federal Reserve's decision to include commercial loan substitutes in the statutory definition of "commercial loan" as impermissibly altering the common meaning of the term as used in the financial services industry.[165] While noting that there were possibly good policy reasons to regulate nonbank banks, the Court stressed that the statutory definition reflected the political compromise reached in Congress and that altering that definition required an act of Congress.[166]

Independent and community banks, which had historically benefitted from interstate banking and branching restrictions, were also adamant that Congress close the nonbank bank option. During congressional hearings in 1985 on the issue of nonbank banks, the IBAA was strongly supportive of legislation designed to stop the creation of further nonbank banks and pushed against the inclusion of any grandfathering clauses in the legislation.[167] The insurance industry[168] and the small business community[169] also actively lobbied for the amendments to the BHCA.

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[164] *See id.* at 368 ("Institutions offering NOW accounts do not give the depositor a legal right to withdraw on demand; rather, the institution itself retains the ultimate legal right to require advance notice of withdrawal. The Board's definition of 'demand deposit,' therefore, is not an accurate or reasonable interpretation of § 2(c) [of the BHCA].").

[165] *See id.* at 373 ("Nothing in the statutory language or the legislative history, therefore, indicates that the term 'commercial loan' meant anything different from its accepted ordinary commercial usage. The Board's definition of 'commercial loan,' therefore, is not a reasonable interpretation of § 2(c) [of the BHCA].").

[166] *Id.* at 374.

[167] *See Hearings Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins. of the H. Comm. on Banking, Fin. and Urban Affairs*, *supra* note 138, at 110 (statement of Charles T. Doyle, President-Elect, Independent Bankers Association of America) ("We believe that this bill should not grandfather any nonbank banks . . . . Those who sought nonbank bank charters knew what they were taking—at that time, a significant legal risk—when they established those institutions. We do not think that Congress should bail them out with any kind of grandfather clause.").

[168] *Id.* at 346 (letter from Roger N. Levy, Vice-President of Government Affairs, Independent Insurance Agents of America) ("[W]e support committee approval of H.R. 20 to close the non-bank bank loophole . . . .").

[169] *Id.* at 316 (Statement of Small Business Legislative Council and the National Small Business Association) ("[We] support [] H.R. 20 and your efforts to close the non-bank loophole.").

Faced with pressure from the Federal Reserve and increasing uncertainty surrounding the continuing legal status of nonbank banks, Congress considered amending the BHCA during its ninety-eighth and ninety-ninth sessions.[170] As the controversy grew, however, members of Congress could not agree on the proper scope of the amendments and whether to aim for more comprehensive reform than simply closing the nonbank bank possibility.[171] When it became clear that broader reforms were not feasible at the time, Congress passed the Competitive Equality Banking Act of 1987 ("CEBA") as a stopgap measure, which amended the BHCA's definition of a bank for a third time.[172]

Under the CEBA definition, which remains in force today, an institution is considered a "bank" for the purposes of the BHCA, if it is either (1) an FDIC-insured institution,[173] or (2) an institution that accepts demand deposits and makes commercial loans.[174] As a

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[170] Mary Jo Wetmore, Note, *Banking and Commerce: Are They Different? Should They Be Separated?* 57 GEO. WASH. L. REV. 994, 1007 (1998).

[171] *Id*. at 1007-08.

[172] Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 101, 101 Stat. 552, 554 (1987). It is important to note that CEBA was not passed primarily in response to the controversy surrounding the nonbank bank phenomenon. The main impetus for the passage of CEBA was the need to recapitalize the Federal Savings and Loan Insurance Company ("FSLIC"), which had suffered great losses during the S&L crisis of the 1980s. *See infra* note 302 and accompanying text. The term "competitive equality" refers to competitive equality between thrifts, or savings associations, and banks.

[173] The FDIC insurance scheme covers all deposit accounts, including savings accounts, checking accounts, money market savings or checking accounts, and certificates of deposit. *See FDIC Insurance Coverage Basics,* FDIC.GOV, http://www.fdic.gov/deposit/deposits/insured/basics.html (last visited on Nov. 12, 2011). Investment accounts and investment products—such as mutual funds, stocks, bonds and annuities—are not insured by the FDIC. Currently, FDIC deposit insurance covers up to $250,000 per depositor, per insured bank and per account ownership category. Before 2008, the ceiling was $100,000. *Insured Deposits*, FDIC.GOV, http://www.fdic.gov/deposit/deposits/insured/ownership.html (last visited on Nov. 6, 2011).

[174] Competitive Equality Banking Act of 1987 § 101(a)(1); *see also* S. REP. NO. 100-19, at 29 (1987) ("This section redefines the term "bank" to include an FDIC-isured [sic] institution whether or not it accepts demand deposits or makes commercial loans. The new definition also includes non-

result, all FDIC-insured institutions that had enjoyed "nonbank bank" status under the 1970 Amendments became "banks" under the CEBA, unless grandfathered.[175]

In addition to closing the possibility for regulatory arbitrage through the use, or abuse, of the nonbank bank form, CEBA also included explicit exemptions from the definition of "bank" for certain specific categories of financial institutions, including industrial loan corporations, credit card banks, limited purpose trust companies, credit unions and savings associations (or thrifts).[176] As a practical matter, all of these institutions had previously been exempted—albeit not explicitly—from the BHCA's definition of a bank.[177] However, CEBA solidified and gave a firm legal footing to their status as institutional alternatives to banks and, accordingly, potential forms of entry into the market for banking services by the non-banking and commercial entities that control them.[178]

FDIC insured institutions that both accept demand deposits or transaction accounts and are engaged in the business of making commercial loans.").

[175] CEBA included a provision that grandfathered existing nonbank banks. *See* Bock, *supra* note 137, at 1057 ("Congress did not attempt to stuff the genie entirely back in the lamp, however; section 101(c) of CEBA grandfathered companies that controlled nonbank banks on March 5, 1987, subject to significant limitations on those companies and their banks.").

[176] 12 U.S.C. § 1841(c) (2006). This is not an exhaustive list of the explicit exemptions from the definition of a bank under CEBA. For the purposes of this Article, we will only be looking at the five exemptions listed. Other institutions that are currently exempted include:

> (A) A foreign bank which would be a bank within the meaning of [the BHCA] solely because such bank has an insured or uninsured branch in the United States[;] . . .
> (C) An organization that does not do business in the United States except as an incident to its activities outside the United States[; . . . and]
> (G) An organization operating under section 25 or section 25(a) of the Federal Reserve Act.

Id. § 1841(c)(2).

[177] Competitive Equality Banking Act of 1987 § 101(a)(1).

[178] One broad category of financial institutions that did not make it into the coveted list of explicit CEBA exemptions—but nevertheless continued to enjoy their implicitly exempt status—is a diverse group of finance companies, including various consumer and mortgage lenders. These institutions have always remained outside the BHCA definition of a bank because they do not finance their operations through demand deposits, instead raising

IV. Who Is Out? Exemptions from the Definition of "Bank" under the BHCA

This Part examines the evolution and practical impact of the five principal exemptions from the definition of "bank" under the BHCA: industrial banks and industrial loan corporations, credit card banks, limited purpose trust companies, credit unions and savings associations. These financial institutions were, despite their differences, consistently exempted from the statutory definition—at first, implicitly and, after 1987, explicitly—based on the same policy rationale. Thus, at every juncture between the passage of the BHCA in 1956 and the enactment of CEBA in 1987, these institutions were viewed as relatively small local institutions with a specialized focus and limited range of activities, centering primarily on consumer financial services.

A. Industrial Loan Corporations

Industrial banks and industrial loan corporations (collectively referred to as "ILCs") began in the early twentieth century as "small, state-chartered loan companies that primarily served the borrowing needs of industrial workers unable to obtain non-collateralized loans from banks."[179] At the time, commercial banks focused primarily on serving the financial needs of businesses and were largely unwilling to provide loans to low- and moderate-income individuals, typically

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funds primarily in capital markets. In 1987, long before the markets for mortgage-backed securities ("MBSs") and collateralized debt obligations ("CDOs") dramatically altered the role and risk profile of these institutions, Congress did not appear to believe they posed an appreciable risk from the perspective of the BHCA's policy objectives. Ironically, however, it was these financial institutions that significantly contributed to the implosion of the global financial system twenty years later. For example, before its demise in the fall of 2008, Lehman Brothers used two mortgage-lending subsidiaries to originate the bulk of its mortgage assets for in-house securitization. Report of Anton R. Valukas, Examiner, at 44, In re Lehman Brothers Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Mar. 11, 2010).

[179] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-621, INDUSTRIAL LOAN CORPORATIONS: RECENT ASSET GROWTH AND COMMERCIAL INTEREST HIGHLIGHT DIFFERENCES IN REGULATORY AUTHORITY 1, 5 (2005) [hereinafter the 2005 GAO REPORT].

industrial workers.[180] ILCs emerged as a new type of financial institution catering to this growing but underserved market, functioning as a new form of financial self-help for working-class borrowers with stable jobs but no access to credit.[181] Initially, many ILCs did not accept any deposits and funded themselves instead by issuing investment certificates.[182]

As commercial banks expanded their consumer lending business and gradually took over that segment of the market, they forced ILCs and industrial banks to redefine their business focus.[183] One hundred years after its birth, an ILC effectively "reemerged as a way for commercial and financial firms to offer banking services without being subject to the ownership restrictions and parent company supervision that typically apply to other companies owning depository institutions."[184] As a result of this transformation, by the mid-2000s, the ILC industry has evolved from a collection of "small niche lenders" into a distinct sector comprising some of "the nation's largest and more complex financial institutions."[185] The key factor driving this functional transformation was the special exempt status

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[180] *See* Kenneth Spong & Eric Robbins, *Industrial Loan Companies: A Growing Industry Sparks a Public Policy Debate*, 2007 FED. RESERVE BANK OF KAN. CITY ECON. REV. 41, 42-43 (2007). Industrial banks filled a void in the banking market:

> This market developed because commercial banks were generally unwilling to offer uncollateralized loans to factory workers and other wage earners with moderate incomes. Much of the early success of industrial banks can be attributed to Arthur J. Morris, who chartered the first ILC in 1910 and established the basic framework for Morris Plan banks. Morris Plan banks spread to over 140 cities by the early 1930s and became the leading providers of consumer credit to lower-income workers.

Id. at 42-43 (footnote omitted).

[181] *See* JAMES R. BARTH & TONG LI, MILKEN INSTITUTE, INDUSTRIAL LOAN COMPANIES: SUPPORTING AMERICA'S FINANCIAL SYSTEM 11 (2011) (explaining that instead of relying on collateral, these new financial institutions extended loans on the basis of "recommendations from creditworthy individuals who knew the [borrower]").

[182] *Id.*

[183] Spong & Robbins, *supra* note 180, at 43.

[184] *Id.*

[185] 2005 GAO REPORT, *supra* note 179, at 1.

that ILCs—and, accordingly, business entities that control them—received under the BHCA.

It is not apparent that Congress ever intended to include ILCs in the universe of "banks" whose corporate owners had to be regulated as BHCs. In 1956, ILCs were not included in the BHCA's original charter-based definition of a bank. Moreover, ILCs effectively continued to be exempt from the revised definitions of "bank" under both the 1966 and 1970 Amendments, primarily because they did not accept demand deposits, within the meaning of the statute.[186] Since the 1970s, however, many ILCs offer NOW accounts that are functionally similar to demand deposits.[187] There are also a number of ILCs that are non-depository in nature, and thus do not offer any transaction account services.[188] Some ILCs, but not all, are also engaged in commercial lending, as well as real estate and consumer lending.[189]

To be eligible for the CEBA exemption from the BHCA definition of "bank," an ILC must either not engage in any activity it was not lawfully engaged in as of March 5, 1987,[190] or it must be chartered in a State that required ILCs to be FDIC-insured as of March 5, 1987, and meet one of the following criteria: (1) not accept

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[186] In fact, the definition of "bank" in the1966 Amendments was designed specifically to exempt ILCs, along with certain other institutions. S. REP. NO. 89-1179, at 7 (1966) ("To avoid this result, the bill redefines 'bank' [sic] as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank so as to exclude institutions like industrial banks and nondeposit trust companies."). Even before the 1966 Amendments, the Federal Reserve, in an interpretive ruling, indicated that it did not consider ILCs to be "banks" within the meaning of the BHCA, as they did not accept demand deposits and therefore did not constitute commercial banks. *1966 Hearings*, *supra* note 69, at 157 (statement of Ralph L Zaun, President, Indep. Bankers Ass'n).

[187] 2005 GAO Report, *supra* note 179, at 6 ("[M]any ILCs offer Negotiable Order of Withdrawal (NOW) accounts—similar in some respects to demand deposits and are, therefore, able to offer a service similar to demand deposits without their holding companies being subject to supervision under the BHC Act."). For a description of NOW accounts, see *id.*

[188] BARTH & LI, *supra* note 181, at 57 (see Figure 25: from the sample of ILCs surveyed, it seems that a majority of ILCs are non-depository).

[189] *Id*. (see Figure 25 for data on the loan composition of ILCs).

[190] 12 U.S.C. § 1841(c)(2)(H)(ii) (2006).

demand deposits; (2) have total assets of less than $100 million; or (3) have been acquired prior to August 10, 1987.[191]

The first prong of the CEBA exemption effectively grandfathered the exempt status for ILCs existing at the time of its enactment but froze their permissible activities on a going-forward basis. The second prong of the statutory test exempts any FDIC-insured ILC, as long as it meets one of the three requirements. These three requirements were presumably designed to exempt ILCs that did not function as commercial banks (in that they did not take demand deposits); ILCs that were not economically significant (with assets less than $100 million); or ILCs that could not provide commercial or financial companies a means to acquire a nonbank bank (by forbidding changes in ownership after the date of the CEBA's enactment). Thus, the most important practical effect of the statutory language, as added by the CEBA, was to allow ILCs with FDIC-insured retail deposits to remain outside the definition of a bank, as long as none of their deposits qualified technically as "demand deposits." Since 1987, this exemption has not been amended.

The need for an explicit exemption for ILCs arose as a result of the interplay between the CEBA and an earlier piece of banking legislation, the Garn-St Germain Depository Institutions Act of 1982 (the "Garn-St Germain Act"), which made deposits taken by ILCs eligible for FDIC insurance.[192] In response to the Garn-St Germain Act, several states—notably, California, Colorado, Hawaii and Utah—enacted laws requiring all locally chartered deposit-taking ILCs to obtain federal deposit insurance.[193] Political pressure from these states to have Congress exempt such FDIC-insured ILCs from the newly expanded definition of "bank" was evident in CEBA's legislative history.[194] Thus, CEBA exempts ILCs from the definition of a "bank" if the ILC is chartered in a state that, as of March 5, 1987, had in effect or under consideration a law mandating their ILCs to obtain FDIC insurance for their deposits. As of 2010, only six states had active ILC charters, with most ILCs chartered in Utah.[195]

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[191] *Id.* § 1841(c)(2)(H)(i).
[192] Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 703(a), 96 Stat. 1469, 1538 (1982).
[193] BARTH & LI, *supra* note 181, at 4.
[194] 130 Cong. Rec. 24,966 (1984) (statement by Sen. Matsunaga).
[195] BARTH & LI, *supra* note 181, at 14. Few states currently charter ILCs:

At the time of CEBA's enactment, congressional understanding was such that ILCs would not be used by large commercial companies to offer banking services to their commercial customers.[196] By and large, ILCs were still small, state-chartered financial institutions that had limited deposit-taking powers and engaged primarily in making consumer loans to low- and middle-income individuals.[197] Total ILC assets in 1987 were $4.2 billion, and the largest ILC had assets of only $420 million.[198] Compared to commercial banks and trust companies, which at the time held $3.5 trillion in assets, ILCs were a minor player in the U.S. financial system.[199]

In more than three decades since the passage of the CEBA, the ILC industry has undergone considerable changes. To enhance the value of their ILC charters, state authorities gradually increased ILC powers to the extent where ILCs can essentially function like

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> In the early years of the ILC industry, at least 40 states chartered or licensed depository and/or non-depository ILCs. During the past decade, however, this number declined to seven states. And as of mid-2010, only six states still had active FDIC-insured ILCs. This situation is due to the enactment of the Competitive Equality Banking Act (CEBA) of 1987. CEBA specifies that only ILCs chartered in states that had in effect or under consideration a statute requiring ILCs to be FDIC-insured as of March 5, 1987, were exempt from the definition of "bank" in the Bank Holding Company Act (BHCA). This means that only ILCs chartered in "grandfathered" states, as determined by the Federal Reserve, are eligible for the ILC exemption from the BHCA. Until 2009, there were seven such states, but the last ILC in Colorado became inactive that year. There are currently only six grandfathered states with active depository ILCs.

Id. In addition to Utah, states chartering ILCs include California, Nevada, Hawaii, Minnesota and Indiana. Some states, such as California, have enacted laws prohibiting commercial ownership of ILCs. In California, this law was adopted after Wal-Mart attempted to acquire an ILC there. All commercially-owned ILCs are located in either Utah or Nevada. *See* Spong & Robbins, *supra* note 180, at 43.

196 Wilmarth, *supra* note 143, at 1572-73.

197 *Id.*

198 *Id.*

199 *Id.*; *see also* BARTH & LI, *supra* note 181, at 2 (comparing the holdings of ILCs with other financial institutions).

FDIC-insured state-chartered banks, offering a full range of banking services.[200] An explicit exemption from the BHCA definition of a bank made ILCs a particularly attractive option for securities firms and other non-bank financial institutions, as well as commercial companies that sought access to lending and deposit-taking.[201] Notably, General Motors was the first commercial company to acquire an ILC charter in 1988, shortly after the enactment of CEBA that closed the nonbank bank loophole.[202] In many respects, ILCs have become a post-CEBA version of a nonbank bank.[203]

Although ILCs continued to be dwarfed by commercial banks and other depository institutions in terms of the sheer numbers

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[200] Spong & Robbins, *supra* note 180, at 43 ("ILCs, for instance, can generally engage in a full range of consumer and commercial credit operations and other standard banking activities.").

[201] While many ILCs originated as small, community-based stand-alone institutions, the majority of currently active ILCs are owned and operated by a corporate parent—either a financial institution or a commercial enterprise. *See* BARTH & LI, *supra* note 181, at 16 (providing summary data on major ILCs and their parent holding companies). Before the recent crisis, financial ILC parent companies, included securities firms (UBS, Goldman Sachs, Lehman Brothers), credit card companies (American Express Company, Advanta Corporation) and insurance companies (United States Automobile Association, Well Point, Inc.). *Id.* at 51.

[202] *See The FDIC's Supervision of Industrial Loan Companies: Historical Perspective*, FDIC.GOV, http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html (last visited Nov. 13, 2011); *see also* BARTH & LI, *supra* note 181, at 16 ("Throughout the industry's history, most ILCs were either stand-alone entities or their parents were financial firms. In 1988, however, General Motors acquired an ILC charter.").

[203] Financially-owned ILCs continue to dominate commercially-owned ILCs with respect to both the number of ILCs and total assets. In 2010, financially-owned ILCs accounted for eighty-six percent of total assets and roughly three quarters of all ILCs between 2000 and 2010. *Id.* at 18. As of 2010, the two largest financially-owned ILCs—American Express Centurion Bank (owned by American Express) and UBS Bank USA (owned by UBS AG)—controlled about $30 billion in total assets each, while the largest commercially-owned ILC—BMW Bank of North America, owned by BMW AG—had only $8.2 billion in total assets. *Id.* at 20-24 (see Table 2 and Table 3).

and size,[204] the ILC industry experienced rapid growth in its total asset base and increased concentration.[205] This trend has become especially pronounced in the decade preceding the financial crisis of 2007-09. Thus, in 1998, there were roughly ninety ILCs controlling $28.6 billion in total assets.[206] Total assets tripled in the span of two years to $92.6 billion in 2000.[207] From 2000 to 2005, total assets steadily increased by approximately $10 billion each year, reaching $160.9 billion in 2005, spread over approximately ninety-six ILCs.[208] From 2005 to 2007, the ILC industry experienced tremendous growth: while the number of ILCs did not change dramatically, total assets shot up from $160.9 billion in 2005 to $219.9 billion in 2006, and then to a staggering all-time high of $270.3 billion in 2007.[209]

Most of this growth was the result of a small number of "securities firms converting the cash management accounts held by their clients into insured ILC deposits."[210] This allowed securities firms, in effect, to get cheaper financing of their activities and to develop formidable in-house lending capability to support their traditional securities underwriting and dealing and investment advice

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[204]As of 2010, ILCs accounted for approximately 0.5% of total insured institutions, and one percent of total insured deposits and total assets of insured institutions. BARTH & LI, *supra* note 181, at 14.

[205] *See* BARTH & LI, *supra* note 181, at 11-15. According to that study,

> ILCs grew rapidly after the 1930s, eventually reaching a high of 254 institutions with $408 million in assets in 1966 (still relatively small when compared to more than 13,000 commercial banks with $403 billion in assets in that same year). After 1966, the number of ILCs declined steadily to 130 in 1977, before increasing again to 155 in 1983. Once again, the number then declined, falling to 78 ILCs in the second quarter of 2010. In terms of total assets, . . . ILCs grew sharply from $3.8 billion in 1983 to $9 billion a decade later and eventually an all-time high of $270 billion in 2007, before declining to $122 billion in the second quarter of 2010. (This decline was almost entirely due to some fairly large ILCs converting to bank charters in response to the financial crisis.)

Id. at 13.

[206] BARTH & LI, *supra* note 181, at 78 (Appendix 4).

[207] *Id.*

[208] *Id.*

[209] *Id.*

[210] Spong & Robbins, *supra* note 180, at 46.

business. Ownership of ILCs allowed securities firms to become a one-stop-shop for all of their customers' financing and investment needs, significantly increasing their profitability and permitting them to compete more successfully with commercial banks. Indirectly, it also contributed to the growth of available credit outside the traditional banking system.[211]

Thus, before the latest crisis, the largest ILC was Merrill Lynch Bank USA with assets of $78.1 billion in 2007.[212] Merrill Lynch Bank USA was first established in 1988 and became inactive in 2009 following Bank of America's takeover of Merrill Lynch.[213] During the run-up to the crisis, Merrill Lynch Bank USA's total assets steadily increased. From 2000 to 2007, its total assets grew from $43.2 billion to $78.1 billion.[214] The second largest ILC before the financial crisis was Morgan Stanley Bank.[215] Morgan Stanley Bank was established in 1990, and became inactive in 2008 when it

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[211] This Article does not argue that there was a direct and tangible link between the activities of ILCs owned by Wall Street investment banks and the financial crisis of 2007-09. It is difficult to corroborate such a claim without further research, which merits a separate treatment. Nevertheless, the ability of large investment banks to utilize the federal subsidy to increase the volume and scope of their *de facto* banking activities was an important trend in the pre-crisis development of the U.S. financial sector.

[212] As an ILC, Merrill Lynch Bank USA offered a variety of deposit accounts, including money market deposit accounts, certificates of deposit, individual retirement accounts and market participation certificates. By the end of 2008, Merrill Lynch Bank USA's total assets fell from $78.1 billion to $61 billion (with an all-time low of $58 billion in mid-2008). *See* Spong & Robbins, *supra* note 180, at 48 (concluding that the rapid growth of Merrill Lynch Bank can be attributable to its decision to "[sweep] balances out of cash management accounts at the brokerage subsidiary and into MLB, thereby providing brokerage customers with deposits insured up to $100,000 at rates competitive with, or even exceeding, money market mutual funds. This practice is typical of ILCs owned by securities firms."); MERRILL LYNCH BANK USA, 2008 ANNUAL REPORT 3 (2008), *available at* http://files.shareholder.com/downloads/MER/0x0x275905/7353c968-d0e6-4080-b06d-5eab26f24706/ MLBUSA_Annual_Report_2008_final.pdf.

[213] BARTH & LI, *supra* note 181, at 81. Following the takeover, it converted to a commercial bank charter. *Id.* at 45.

[214] *Merrill Lynch Bank USA*, FDIC.GOV, http://www2.fdic.gov/idasp/main.asp (Find FDIC Certificate # "27374"; then follow "Generate Report" hyperlink) (last visited Nov. 14, 2011).

[215] BARTH & LI, *supra* note 181, at 51.

converted to a bank charter.[216] Its total assets in 2000 were $1.9 billion, which grew to $8.7 billion in 2005, then jumped to $21 billion in 2006, and finally reached $35.1 billion before the crisis.[217]

The third largest ILC before the crisis was Ally Bank (formerly GMAC Automotive Bank), owned by General Motors.[218] Ally Bank was established in 2004 and converted into a commercial bank charter in 2009.[219] Ally Bank reported total assets of $1.2 billion in 2004, a number that jumped to $20 billion in 2006 and then to $28.4 billion in 2007.[220] It exemplified a typical commercially-owned ILC, which served primarily to finance purchases of the commercial parent's products.[221] In 2006-07, however, the bulk of Ally Bank's assets were residential mortgages and related assets.[222] This shift in the business profile of Ally Bank reflected a larger trend toward financialization of the U.S. economy in the pre-crisis era, when large manufacturing and other commercial companies derived an increasingly high share of their profits from providing various financial services, often through their ILC subsidiaries.[223]

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[216] *Id.* at 81. This conversion was part of the reorganization of Morgan Stanley as a BHC in the midst of the rapidly unfolding financial crisis.

[217] *Id.* at 51. These numbers raise potentially interesting questions about the pre-crisis uses of the ILC charter by big investment banks. As noted above, however, answering these questions would require additional research and is beyond the scope of this Article.

[218] *Id.*

[219] *Id.* at 81. This conversion was a part of the crisis-driven reorganization of GMAC as a BHC.

[220] *Ally Bank*, FDIC.GOV, http://www2.fdic.gov/idasp/main.asp (Find FDIC Certificate # "57803"; then follow "Generate Report" hyperlink) (last visited Nov. 14, 2011). Following the crisis, Ally Bank continued to report increases in total assets: between 2008 and 2011, total assets grew from $32.9 billion to $72.5 billion. *Id*.

[221] Thus, Ally Bank provided financing for consumers purchasing GM cars from the dealers, as well as so-called floor financing for GM dealerships. Other automotive companies, such as Toyota, BMW, and Harley-Davidson, also used their ILCs in a similar fashion. *See* Spong & Robbins, *supra* note 180, at 52.

[222] *See id.* (stating that, in 2007, $13.4 billion out of $16.4 billion in Ally Bank's total loans consisted of residential mortgages).

[223] GMAC's aggressive move into residential mortgage lending and trading of mortgage-backed securities was one of the causes that led it to the brink of failure and the federal bailout of GM and GMAC in 2009. *See* CONG. OVERSIGHT PANEL, THE UNIQUE TREATMENT OF GMAC UNDER THE TARP

Interestingly, the greatest political controversy over comercial ownership of ILCs was not related to the transformation of household names like General Motors or General Electric into financial service providers. It arose in 2005, when the retail giant Wal-Mart attempted to form a Utah-chartered ILC.[224] The primary activity of Wal-Mart's proposed ILC was to "act as a sponsor for the processing and settlement of credit card payments, debit card payments, and check payments made by customers at Wal-Mart stores."[225] Yet, the public outcry that resulted was unprecedented.[226]

39-41 (2010), *available at* http://frwebgate.access.gpo.gov/cgibin/getdoc.cgi?dbname=110_senate_hearings&docid=f:54875.pdf.

[224] This was not the first time that Wal-Mart had attempted to enter the banking industry. On June 29, 1999, Wal-Mart applied to acquire an Oklahoma federal savings association. This attempt was later blocked by the GLBA, which closed the unitary thrift holding company possibility that Wal-Mart had sought to use. *See* Zachariah J. Lloyd, *Waging War with Wal-Mart: A Cry for Change Threatens the Future of Industrial Loan Corporations*, 14 FORDHAM J. CORP. & FIN. L. 211, 223-24 (2008) ("Wal-Mart commenced its quest to own a bank in June 1999 when it applied to purchase a small thrift in Broken Arrow, Oklahoma named the Federal Bank Center."); Kevin Nolan, *Wal-Mart's Industrial Loan Company: The Risk to Community Banks*, 10 N.C. BANKING INST. 187, 191 (2006) ("Wal-Mart's first attempt to enter banking was an effort to purchase a small thrift institution named Federal BankCenter in Broken Arrow, Oklahoma."). On September 10, 2001, Wal-Mart entered into an agreement with TD Bank, by which TD Bank would offer banking products and services in Wal-Mart stores. This plan was eventually blocked by the OTS, which objected to Wal-Mart's plan to share the profits with TD Bank and to have its retail store employees perform banking transactions for TD Bank in its Wal-Mart stores. *Id.* In April 2002, Wal-Mart tried to purchase a $2.5 million California-chartered industrial bank named Franklin Bank. The California legislature quickly responded to this by enacting a law prohibiting non-financial institutions from acquiring state-chartered industrial banks, with certain exceptions. *Id.*at 192; Riva D. Atlas, *Wal-Mart is Seeking Approval to Buy a California Bank*, N.Y. TIMES, May 16, 2002, at C9.

[225] Wilmarth, *supra* note 143, at 1541-42, 1544; *see also* Nolan, *supra* note 224, at 189 ("Wal-Mart processes about 140 million transactions a month, roughly $288 billion in sales for 2004 . . . . The transaction costs that would be saved from processing its own Visa and MasterCard credit and debit transactions are estimated to be around $650 million.").

[226] In response to its invitation for public comments on Wal-Mart's application, the FDIC received approximately 13,800 comment letters, most of which vehemently opposed the idea. Lloyd, *supra* note 224, at 229.

In response to widespread opposition from community bankers,[227] the Federal Reserve, labor unions, retail stores and members of Congress,[228] the FDIC placed a six-month moratorium on Wal-Mart's application and all other pending applications to obtain federal deposit insurance for ILCs. This moratorium was later extended for an additional year, but only with respect to applications by commercial firms for ILC ownership. Ultimately, on March 16, 2007, Wal-Mart withdrew its application for an ILC bank charter.[229]

[227] Interest group pressure from community bankers was critical in preventing Wal-Mart from acquiring an ILC. One commentator described the sources of concern about Wal-Mart establishing an ILC:

> Wal-Mart's possible foray into the world of ILCs has caught the attention of many trade organizations such as the Independent Community Bankers of America, the United Food and Commercial Workers International Union, the National Grocers Association, and the National Association of Convenience Stores. These groups believe that if Wal-Mart charters an ILC, and the charter is later expanded to include full retail banking services, it would put many businesses at substantial risk, in particular small community banks. The approval of an ILC for Wal-Mart could significantly compromise the status of community banks and upset the historic separation in our economy between banking and commerce.

Nolan, *supra* note 224, at 187-88.

[228] The widespread fear at the time was that Wal-Mart would eventually expand its banking services after the initial three-year period. ILCs are bound to its original business plan for the first three years. Afterwards, an ILC may seek permission to amend its charter and expand its business into full-service banking. Thus, it was conceivable that Wal-Mart, if permitted to acquire an ILC, could engage in full-service banking and establish additional branches in other states in a matter of years. *See* Lloyd, *supra* note 224, at 225-26; Nolan, *supra* note 224, at 189-90 (concluding that the chief concern was the Wal-Mart would launch an expanded business plan within a few years after receiving charter approval).

[229] Wal-Mart appears to have found other methods of engaging in banking activities. On June 20, 2007, Wal-Mart unveiled its plan to open "MoneyCenters" in its stores, which are financial services centers that allow customers to cash checks, pay bills and obtain prepaid Visa cards. *See generally* Jonathan Birchall, *Walmart Extends its Banking Interests*, FIN. TIMES (June 16, 2010), http://www.ft.com/intl/cms/s/0/71f9ec4e-78b4-11df-a312-00144feabdc0.html?dbk# axzz1dtrqamjt; Charles Kabugo-Musoke, *Consumer Focus: A Walmart Owned ILC: Why Congress Should Give the*

Even before the Wal-Mart ILC controversy, members of Congress had attempted to pass legislation to block commercial companies from owning depository institutions.[230] The financial crisis of 2007-09 pushed that issue to the background of the political debate. The crisis also fundamentally altered the landscape of the ILC industry, as many ILCs, including the three largest ones, closed or converted to commercial banks.[231] Nevertheless, commercial ownership of ILCs remains a potentially controversial matter.[232]

B. Credit Card Banks

Credit cards function as a form of typically unsecured revolving loan.[233] They did not exist when the BHCA was enacted in

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Green Light, 15 N.C. BANKING INST. 393 (2011) (examining in detail Wal-Mart's efforts to offer financial services).

[230] Lloyd, *supra* note 224, at 231-32. In March 2004, the House of Representatives backed an amendment sponsored by Representatives Barney Frank and Paul Gillmor, as part of the proposed Financial Services Regulatory Relief Act, which sought to prohibit interstate branching by ILCs that were owned by commercial firms. The amendment did not gain support in the Senate and was never enacted into law. *Id.* In 2006, Representatives Frank and Gillmor proposed another bill, the Industrial Bank Holding Company Act, to impose reporting requirements on ILC holding companies, and to prohibit commercial control of ILCs. *Id.* After failing to make it out of committee in 2006, the bill emerged again in 2007, but also failed to garner enough support. *Id.*

[231] BARTH & LI, *supra* note 181, at 45. In 2007, the total assets of the five largest ILCs stood at $192.7 billion; in 2010, the figure was $90.4 billion. *Id.* at 51.

[232] Today, many commercially owned ILCs are in the automotive industry, with parents companies like Toyota, BMW and Harley-Davidson. Other commercial companies with ILCs include GE, Target and Fry's Electronics. BARTH & LI, *supra* note 181, at 67.

[233] *Credit Cards Activities Manual,* FDIC.GOV, http://www.fdic.gov/regulations/examinations/credit_card/ch2.html (last updated June 12, 2007). Card issuers make money per credit card transaction, called an "interchange fee", that is roughly two percent of the transaction charge. Adam J. Levitin, *The Credit Card Industry's Business Model Encourages Irresponsible Lending*, CREDITMATTERSBLOG.COM (Dec. 1, 2008), http://www.creditmattersblog.com/2008/12/credit-card-industrys-business-model.html. They typically fund their credit card activities through a process of securitization, whereby the credit card debt is transformed into "a pool of assets used to pay off bonds." *Id*.

1956.[234] In 1966, Bank of America introduced the general-purpose credit card by creating the BankAmerica Service Corporation, which franchised the BankAmericard brand to other banks.[235] In the same year, a group of banks established a national credit card system now known as MasterCard Worldwide.[236] These developments effectively created the modern credit card industry.

BHCs have historically used specialized credit card banks to "seek relief from onerous usury restrictions" in their home state.[237] Because credit card banks were not considered "banks," establishing credit card banks in states with favorable usury laws did not violate interstate banking restrictions or the Douglas Amendment of the BHCA.[238] Thus, the creation of credit card banks allowed their parent BHCs to engage in lucrative interest rate arbitrage: by locating itself in a state with favorable or no usury laws, a credit card bank could set interest rates above the rates that its parent BHC could set in its home state. Moreover, a 1978 Supreme Court case, *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*,[239] permitted credit card banks to "export nationally whatever interest rate was allowed in the state in which they were headquartered."[240] This interest rate would apply to customers nationwide, even if it exceeded the interest rate cap in the customer's home state. This led a number of states, such as South Dakota and Delaware, to adopt

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[234] *See* Emily Starbuck Gerson & Ben Woolsey, *The History of Credit Cards*, *available at* http://www.creditcards.com/credit-card-news/credit-cards-history-1264.php (stating that the first credit card with a revolving balance was produced in 1959).

[235] *Id.* (quoting Stan Sienkiewicz, Credit Cards and Payment Efficiency 4 (August 2001) (unpublished manuscript), *available at* http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2001/PaymentEfficiency_092001.pdf)).

[236] *Id.*

[237] Anita Boomstein, *Credit Card Banks Get Back to Basics*, 4 CREDIT CARD MGMT. 24, 25 (1991). Usury laws specify the maximum interest rate that can be charged for different types of loans. These laws function as a form of consumer protection aimed at preventing abusive lending practices.

[238] *See supra* note 32 and accompanying text.

[239] Marquette Nat'l Bank v. First of Omaha Corp., 439 U.S. 299 (1978).

[240] Pat Curry, *How a Supreme Court Ruling Killed off Usury Laws for Credit Card Rates*, CREDITCARDS.COM (Nov. 12, 2009), http://www.creditcards.com/credit-card-news/marquette-interest-rate-usury-laws-credit-cards-1282.php.

very liberal (or not have any) usury laws.[241] This ability to take advantage of favorable usury laws in specific states is one of the key reasons for the continuing existence of specialized credit card banks.[242]

Since credit card banks did not exist in 1956, Congress could not have intended to include them within the BHCA's original definition of a bank. Beginning with the 1966 Amendments, however, credit card banks were implicitly exempted from the definition of a bank, because they did not accept demand deposits.[243] In 1987, CEBA explicitly excluded credit card banks from the BHCA's definition of a bank, subject to certain limitations.[244] Under CEBA, an institution qualifying for the credit card bank exemption must (1) engage only in credit card operations; (2) not accept demand deposits; (3) not accept any savings or time deposit of less than \$100,000, unless they are used as collateral for extended credit card loans;[245] (4) maintain only one office that accepts deposits;[246] and

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[241] *Id.*

[242] In addition, there may be important funding and operational reasons for regulated BHCs to maintain specialized credit card banks. Concentrating all of the group's credit card assets in a single corporate entity may make it easier to securitize such assets. For a thorough discussion of the special nature of credit card loan securitization, see Adam J. Levitin, *Skin-in-the-Game: Risk Retention Lessons from Credit Card Securitization*, 80 GEO. WASH. L. REV. (forthcoming 2012). For an earlier study of the profitability of specialized credit card banks, see Joseph F. Sinkey, Jr. & Robert C. Nash, *Assessing the Riskiness and Profitability of Credit-Card Banks*, 7 J. FIN. SERV. RES. 127, 127 (1993) (arguing that specialized credit card banks, defined as institutions with at least three-quarters of their assets in credit cards and related plans, "earned extraordinary accounting returns over [the] sample period 1984 to 1991").

[243] The 1970 Amendments continued to exempt credit card banks because they neither accepted demand deposits nor made commercial loans (only consumer loans). Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, §101(c). 84 Stat. 1760, 1762 (1970).

[244] 12 U.S.C. § 1841(c)(2)(F)(1988).

[245] Originally, CEBA's exemption prohibited credit card banks from accepting deposits of less than \$100,000 for any purpose. In 1996, Congress added the proviso allowing exempted credit card banks to hold such deposits as collateral. Economic Growth and Regulatory Paperwork Reduction Act, Pub. L. No. 104-208, §2304(b), 110 Stat. 3009-345, 3009-425 (1996). It appears that, by prohibiting credit card banks from accepting demand deposits and time deposits of less than \$100,000, Congress intended to prevent credit card banks from shifting their primary operations to

(5) not engage in the business of making commercial loans.[247] In effect, the statutory exemption restricts the deposit-taking capability of credit card banks and prevents them from expanding their activities beyond the traditional credit card loan business.[248] As long as credit card banks limited their activities to consumer credit card operations and did not stray into making commercial loans, they would not be considered commercial banks subject to the regulations of the BHCA.[249]

CEBA exempted credit card banks from the BHCA definition of a bank primarily because these institutions offered very limited and highly specialized *consumer* financial services and did not pose the risk of monopolizing *commercial* credit markets. This exemption has been largely uncontroversial and rarely, if ever, challenged. Part of the explanation here may be the fact that these specialized institutions, which emerged after the BHCA was adopted, did not create significant competitive frictions within the financial services industry. Thus, an archetypal credit card bank that meets the CEBA exemption requirements is a specialty institution affiliated with a commercial company, often a retailer, and offering that company's customers private label or co-branded credit cards. Moreover, credit card banks owned or controlled by BHCs are already subject to the "umbrella" supervision by the Federal Reserve.[250] In addition, under the Dodd-Frank Act, credit card banks are also subject to direct regulatory oversight by the newly created Bureau of Consumer Financial Protection ("CFPB").[251]

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accepting deposits. Deposits accepted by certain credit card banks, chartered as limited purpose national banks or thrifts, are eligible for FDIC insurance.

[246] The word "office" refers only to deposit-taking offices and does not limit offices engaged in "back-room activities typically associated with a credit card operation." H.R. REP. NO. 261, at 121 (1987).

[247] 12 U.S.C. § 1841(c)(2)(F).

[248] H. REP. NO. 99-175, at 11 (1985).

[249] S. REP. NO. 91-1084, at 24.

[250] *See supra* note 20 and accompanying text.

[251] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §1091, 124 Stat. 1376, 2094 (2010). In recent years, high charges and fees associated with credit cards and other questionable credit card industry practices became the subject of intense political controversy that led to the enactment of the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat.1734 (2009). It is unclear what impact, if any, these issues will have on the continuing existence and operation of CEBA credit card banks.

C. Limited Purpose Trust Companies

Trust companies generally engage in the business of holding and managing money in a fiduciary or representative capacity, and their specific permissible activities largely depend on the applicable state statutes. Under CEBA, institutions functioning solely in a trust or fiduciary capacity[252] are explicitly exempt from the BHCA's definition of a bank, if the following requirements are met: (1) all or substantially all of the deposits are in trust funds and are received in a bona fide fiduciary capacity; (2) no FDIC-insured deposits of such institution are offered or marketed by or through an affiliate; (3) such institution does not accept demand deposits; and (4) the institution does not obtain payment or payment-related services from any Federal Reserve Bank or exercise Federal Reserve discount or borrowing privileges.[253]

A "trust company" was explicitly included within the original BHCA's definition of a bank.[254] However, the 1966 Amendments effectively exempted from that definition trust companies that did not accept demand deposits.[255] In fact, the legislative history of the 1966 Amendments indicates that Congress specifically intended to exclude "non-deposit trust companies."[256] Under the 1970 Amendments, such limited purpose trust companies remained outside the scope of the statutory definition of a bank, because they did not accept demand deposits or make commercial loans. Thus, long before CEBA made the exemption explicit, these types of limited-service fiduciary institutions were deliberately excluded from the universe of "banks" and, accordingly, allowed entities that owned or controlled them to escape regulation as BHCs.[257] The rationale behind this exemption is

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[252] According to the accompanying Conference Report, "trust or fiduciary capacity" "includes serving as trustee, executor, custodian, administrator, registrar of stocks and bonds, guardian of estates, or committee of estates of incompetents." H.R. REP. NO. 100-261, at 120 (1987).

[253] 12 U.S.C. § 1841(c)(2)(D) (2006).

[254] Bank Holding Company Act, Pub. L. No. 84-511, §2(c), 70 Stat. 133, 133 (1956).

[255] S. REP. NO. 89-1179, at 7 (1966).

[256] *Id*.

[257] For example, securities firms often acquired limited purpose trust companies in order to diversify their product offerings and level the playing field with trust companies that aggressively moved into the securities business. Regulated BHCs also used limited purpose trust companies to

based on the notion that the fiduciary and trust services performed by limited purpose trust companies do not constitute a strictly "comercial banking" activity.[258]

D. Credit Unions

Credit unions are not-for-profit financial cooperatives owned by their member-customers.[259] Their principal purpose is to provide deposit-taking and lending services exclusively for their members rather than the general public.[260] Credit unions engage in a limited set of financial activities tailored to consumer credit needs of their members.[261] Credit unions can be federally or state chartered, and their deposits are insured.[262] Federal credit unions are regulated by

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establish additional locations through which trust services can be provided, without running afoul of interstate banking restrictions.

[258] In fact, the Federal Reserve explicitly included the operation of a limited purpose trust company in its list of non-banking activities permissible for BHCs under Regulation Y in 1987. *See* 12 C.F.R. § 225.2(c)(3) (1987) ("Unless the Board finds that the trust is being operated as a business trust or company, a trust is presumed not to be a company . . . .").

[259] NATIONAL CREDIT UNION ADMINISTRATION, NCUA FACT SHEET 2 (2011), *available at* http://www.ncua.gov/NewsPublications/quick_facts/Facts2007.pdf.

[260] Nicholas Ryder & Clare Chambers, *The Credit Crunch: Are Credit Unions Able to Ride Out the Storm?*, 11 J. BANKING REGULATION 76, 76 (2009).

[261] For more details on the activities of credit unions, see William R. Emmons & Frank A. Schmid, *Credit Unions and the Common Bond*, 81 FED. RESERVE BANK OF ST. LOUIS REV. 41 (1999). According to their study:

> Credit unions play a limited role in the U.S. financial system, catering to the basic saving, credit, and other financial needs of well-defined consumer groups. More than 95 percent of all federal credit unions offer automobile and unsecured personal loans, while a similar proportion of large credit unions (more than $50 million in assets) also offer mortgages; credit cards; loans to purchase planes, boats or recreational vehicles; ATM access; certificates of deposits; and personal checking accounts.

Id. at 43.

[262] *Frequently Asked Questions*, NCUA.GOV, http://www.ncua.gov/Resources/Cnsmrs/Pages/FAQ.aspx (last visited Nov. 14, 2011) (stating that

the National Credit Union Administration ("NCUA") and insured by the National Credit Union Share Insurance Fund ("NCUSIF").[263]

Similar to ILCs and thrifts, credit unions were originally formed to serve the credit needs of the working class.[264] Membership criteria for credit unions began with the use of the "common bond" requirement, which first arose in 1914.[265] In 1934, the Federal Credit Union Act (the "FCUA") stated that credit union membership was to be limited to groups having a "common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district."[266] The idea behind the common bond requirement is that "credit worthiness is evaluated on the basis of knowledge that the members have of each other."[267] In 1982, the NCUA loosened the common bond requirement to "broaden credit union access to groups that were too small to support a viable credit union."[268] By the late 1990s, "the demographic characteristics of credit-union members have become more like the median American."[269]

Congress has consistently treated credit unions and banks as different categories of institutions. The enactment of the FCUA in 1934 was based on Congress's belief that credit unions were "mutual or cooperative organizations operated entirely by and for their members," and thus meaningfully different from banks.[270] In 1937,

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charter numbers are assigned based on the categories of federal, federally insured state-chartered and non-federally insured).

[263] *Id*. State-chartered credit unions are regulated by an agency of the chartering state, but must also report to the NCUA if they are federally insured. *Id.* Currently, there are fewer than 500 non-federally insured state-chartered credit unions that do not report to the NCUA. These non-federally insured state-chartered credit unions are located in Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio and Puerto Rico. *Id.*

[264] *See* Ryder & Chambers, *supra* note 260, at 77. Following the Great Depression and the subsequent loss of faith in commercial banks, credit unions became an extremely popular banking alternative. *Id*.

[265] *Id.* at 80.

[266] Federal Credit Union Act, Pub. L. No. 105-219, § 9, 48 Stat. 1216, 1219 (1934).

[267] Ryder & Chambers, *supra* note 260, at 80.

[268] *See id.* at 81. In 1982, the NCUA "permitted federal credit unions to expand their membership . . . to include multiple unrelated employer groups." BROOME & MARKHAM, *supra* note 23, at 91.

[269] Emmons & Schmid, *supra* note 261, at 43.

[270] H. REP. NO. 75-1579 at 2 (1937).

Congress' decision to make credit unions tax exempt was also based on the view that credit unions were not the same as commercial banks.[271] In 1998, Congress reiterated its belief in the distinction between credit unions and commercial banks in the Credit Union Membership Access Act.[272]

In light of this congressional view, it is unsurprising that credit unions were exempted from the definition of "bank" under the BHCA. Credit unions did not satisfy the original charter-based definition in 1956 because of their mutual form of ownership. They continued to be implicitly exempted from the statutory definition under both functional tests in the 1966 and the 1970 Amendments to the BHCA, as they did not accept demand deposits or make commercial loans.[273] In 1987, CEBA simply made the exemption for credit unions from the BHCA's definition of a bank explicit.[274]

Credit unions continue to be restricted in their lending authority. Credit unions may only lend to credit union members, other credit unions and credit union organizations.[275] Credit unions

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[271] *Id.*

[272] Congress explained the key differences between credit unions and commercial banks:

> Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most state taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.

Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 914, 914 (1998).

[273] With regard to the inability of credit unions to make commercial loans during this period of time, see *La Caisse Populaire Ste. Marie (St. Mary's Bank) v. United States*, 425 F. Supp. 512, 517 (D.N.H. 1976), *aff'd*, 563 F. 2d 505 (1st Cir. 1977) ("The Federal Credit Union Act limits the loans which can be made and the assets which can be held by an institution chartered under its auspices. The most important limitation is that a credit union may only make loans to its members. Congress has also strictly limited the authority of credit unions to make long-term, real estate and other loans.").

[274] Competitive Equality Amendments of 1987, Pub. L. No. 100-86, §101, 101 Stat. 554. 554 (1987).

[275] 12 U.S.C. § 1757(5) (2006).

are allowed to make commercial loans to members, but the net loan balance is limited to the lesser of 1.75 times the credit union's actual net worth or 12.25% of the credit union's total assets.[276] In the wake of the recent financial crisis, some credit unions started to grow their commercial lending business.[277] Credit unions also offer checking and savings accounts and credit card services.

The total number of credit unions has decreased in the last few decades, falling from a peak of 23,687 credit unions in 1970 to 7,605 credit unions at the end of 2010.[278] At the same time, the number of credit union members has steadily increased each year since 1950; by the end of 2010, there were over 92 million credit union members.[279] Total assets of credit unions have also steadily increased, from $17.8 billion in 1970 to over $934 billion as of December 2010.[280] In terms of the relative size of the industry, at the end of 2010, credit union assets made up three-quarters of total FDIC-insured savings institution assets and approximately eight percent of total FDIC-insured commercial bank assets.[281]

In general, consumer-owned credit unions emerged relatively unscathed from the recent financial crisis.[282] Both total assets and membership levels increased during the crisis.[283] However, so-called

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[276] *Id.* § 1757a(a); 12 C.F.R. § 723.16 (2005); *see also* BROOME & MARKHAM, *supra* note 23, at 116. *See generally Magazine, Forbes blog in Favor of Increased CU MBL*, CREDIT UNION NATIONAL ASSOCIATION (June 23, 2011), http://www.cuna.org/newsnow/11/system062211-14.html (discussing recent efforts to raise the member business lending (MBL) caps to 27.5% of assets from the current level of 12.5%).

[277] Adam Belz, *Credit Unions Growing Commercial Lending Business*, USA TODAY (July 10, 2011, 3:57 PM), http://www.usatoday.com/money/industries/banking/2011-07-11-credit-unions-small-business_n. htm.

[278] CREDIT UNION NAT'L ASS'N, CREDIT UNION REPORT: YEAR-END 2010 7 (2010), *available at* http://www.cuna.org/research/download/curepd10.pdf [hereinafter, 2010 CUNA CREDIT UNION REPORT].

[279] *Id.*

[280] *Id.* In 2010, the asset growth rate of 3.3% was the slowest since the 1940s, but still remained considerably higher than the asset growth rate for FDIC-insured banks, which stood at 1.9%. *Id.* at 4.

[281] *Id.* at 5.

[282] Linda Eagle, *Banker's Academy Briefings: The Impact of the Financial Crisis on Credit Unions*, BANKER'S ACADEMY 1 (Sept. 30, 2010), http://bankersacademy.com/pdf/Impact_of_Financial_Crisis_on_CUs.pdf.

[283] *See* 2010 CUNA CREDIT UNION REPORT, *supra* note 278, at 7. Between June 2007 and June 2009, total assets steadily increased from $763.8 billion

corporate credit unions[284] were "in imminent danger of insolvency" due to an "over-concentration in what were once highly rated mortgage-backed securities"[285] and required government rescue.[286]

The exclusion of credit unions from the definition of "bank" in the BHCA has been uncontroversial, primarily because of their ownership structure, focus on consumer credit in localized markets, and the existence of an alternative regime for their supervision and regulation. As a result, credit union activities have not directly triggered any major issues in the political struggles over interstate branching and banking, concentration in commercial credit, or separation of banking and commerce.[287]

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to $889.3 billion, and memberships increased from 89.1 million to 91.8 million. *Id.*

[284] *See* NAT'L CREDIT UNION ADMIN., STABILITY THROUGH THE CRISIS: NATIONAL CREDIT UNION ADMINISTRATION 2008-2009 ANNUAL REPORT 6 (2009), *available at* http://www.ncua.gov/Resources/Reports/NCUA2008-2009AnnualReportFINAL.pdf (referring to the "corporate credit union system" as "the network of correspondent credit unions that provide liquidity, payment systems, and investments for nearly 7,500 consumer-owned credit unions.").

[285] *Id.*

[286] *See* Claude R. Marx, *NCUA Files Another MBS Lawsuit*, CREDIT UNION TIMES (July 27, 2011), http://www.cutimes.com/2011/07/24/ncua-files-another-mbs-lawsuit (reporting that after the NCUA took over five corporate credit unions, including Southwest Corporate FCU, Members United Corporate FCU, and Constitution Corporate FCU, the NCUA held bonds once worth $50 billion). On May 20, 2009, Congress amended the FCUA to create the Temporary Corporate Credit Union Stabilization Fund ("TCCUSF"). Helping Families Save Their Home Act of 2009, Pub. L. No. 111-22, § 204(f), 123 Stat. 1632, 1651-53 (2009). The TCCUSF borrowed funds from the Treasury Department, to be repaid with assessments on federally insured credit unions over a period of seven years. WILLIAM DESARNO, OFFICE OF INSPECTOR GENERAL, NAT'L CREDIT UNION ADMIN., OIG-11-01, MATERIAL LOSS REVIEW OF MEMBERS UNITED CORPORATE FEDERAL CREDIT UNION 9 n.11 (May 4, 2011).

[287] There is, however, a long history of economic competition between credit unions and commercial banks in the markets for consumer financial services, accompanied by a bitter political struggle over the expansion of credit unions' "common bond" requirement, their tax-exempt status and other issues. *See generally* Emmons & Schmid, *supra* note 261, at 42-45.

E. Savings Associations

The first savings associations, or "thrifts," emerged in the United States before the Civil War.[288] Thrifts began as state-chartered institutions whose purpose was to encourage savings and help "persons belonging to a deserving class, whose earnings [were] small, and with whom the slowness of accumulation discourage[d] the effort . . . to become . . . owners of homesteads."[289] During the Great Depression, a sizable fraction of these institutions failed,[290] spurring the creation of a new regulatory regime for savings institutions under the Home Owners' Loan Act of 1933 ("HOLA").[291] Administered by the newly created Federal Home Loan Bank Board ("FHLBB"),[292] this separate regulatory regime ran parallel to the regulatory regime created for banks because of the functional distinction that Congress had drawn between commercial banks and thrifts, which focused on home mortgage lending and did not engage in the general business of banking.[293] The original HOLA prohibited thrifts from accepting deposits or issuing certificates of indebtedness and allowed them to "raise their capital only in the form of payments on such shares as are authorized in their charter."[294] The

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[288] JULIE L. WILLIAMS & SCOTT ZESCH, ESQ., SAVINGS INSTITUTIONS: MERGERS, ACQUISITIONS AND CONVERSIONS 1-4 [hereinafter WILLIAMS] (Law Journal Press ed., 2010).

[289] BROOME & MARKHAM, *supra* note 23, at 73 (quoting *Wash. Nat'l Bldg., Loan & Inv. Ass'n v. Stanley*, 63 P. 489, 491-92 (Ore. 1901)).

[290] *Id.* (stating that more than 1,700 of those institutions failed).

[291] Home Owners' Loan Act of 1933, Pub. L. No. 73-43, 48 Stat. 128 (1933).

[292] *Id.* § 2(1). The FHLBB was created under the Federal Home Loan Bank Act of 1932. Federal Home Loan Bank Act, Pub. L. No. 72-304, § 3, 47 Stat. 725, 726 (1932).

[293] *See, e.g.*, *La Caisse Populaire Ste. Marie (St. Mary's Bank)*, 425 F. Supp. at 516 ("Savings and loan associations, in contrast with national banks and other commercial banks, were formed by Congress: '[i]n order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes."); N. Arlington Nat'l Bank v. Kearny Fed. Sav. & Loan Ass'n, 187 F. 2d 564, 567 (3d Cir. 1951).

[294] Home Owners' Loan Act of 1933 § 5(b) (codified as amended at 12 U.S.C. §1464 (2006)).

lending capacity of thrifts was also restricted primarily to secured residential mortgages.[295]

The original charter-based definition of "bank" in the BHCA explicitly included a "savings bank."[296] As a practical matter, however, control or ownership of thrifts rarely triggered regulation under the BHCA, as most of these institutions at the time were held in mutual form or through a unitary holding company.[297] Under both the 1966 and 1970 Amendments to the BHCA, thrifts generally did not meet the functional test for a "bank" and thus were implicitly exempted from the reach of the statute. Only in 1980, when federal regulators started loosening traditional constraints on thrifts' business activities in an ill-fated attempt to boost the sector's profitability, were thrifts permitted to make commercial loans, issue credit cards and offer NOW accounts.[298] In 1982, the Garn-St Germain Act permitted thrift institutions to "raise capital in the form of such

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[295] *See id.* § 5(c) ("Such associations shall lend their funds only on the security of their shares or on the security of first liens upon homes or combination of homes and business property within fifty miles of their home office: *Provided*, That not more than $20,000 shall be loaned on the security of a first lien upon any one such property; except that not exceeding 15 per centum of the assets of such association may be loaned on other improved real estate without regard to said $20,000 limitation, and without regard to said fifty-mile limit, but secured by first lien thereon: *And provided further*, That any portion of the assets of such associations may be invested in obligations of the United States or the stock or bonds of a Federal Home Loan Bank.").

[296] Bank Holding Company Act of 1956, Pub. L. No. 84-511, § 2(c), 70 Stat. 133, 133-134 (1956) ("'Bank' means any national banking association or any State bank, savings bank, or trust company . . . . ") (codified as amended at 12 U.S.C. § 1841 (2006)). The term "savings bank" referred to a subset of thrifts different from savings and loan ("S&L") associations. The first savings banks were established in 1816 in Massachusetts and Pennsylvania, and accepted deposits in amounts less than one dollar. Until recently, state-chartered savings banks existed only in seventeen Northeastern states. No federal charter was available before 1978. BROOME & MARKHAM, *supra* note 23, at 82.

[297] *Historical Framework for Regulation of Activities of Unitary Savings and Loan Holding Companies,* OFFICE OF THRIFT SUPERVISION, http://www.ots.treas.gov/_files/48035.html [hereinafter *Historical Framework*] (last visited Oct. 31, 2011).

[298] Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, §§ 401-402, 94 Stat. 132, 151-156 (1980) (codified as amended at 12 U.S.C. § 1464 (2006)).

savings deposits, shares, or other accounts, for fixed, minimum, or indefinite periods of time . . . or in the form of such demand accounts of those persons or organizations that have a business, corporate, commercial, or agricultural loan relationship with the association" and to issue "passbooks, time certificates of deposit, or other evidence of accounts as are so authorized."[299] Thus, while thrift institutions could not accept demand deposits in the same way that commercial banks could, they could accept them from commercial entities if they were in connection with a commercial loan relationship.[300]

Both the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA") and the Garn-St Germain Act were part of concerted legislative and regulatory efforts in the 1980s to reverse the declining profitability of thrifts in the highly competitive and volatile market environment. These deregulatory measures, however, encouraged excessive risk-taking that ultimately resulted in massive losses and failures of savings institutions during the S&L crisis of the 1980s.[301] In 1987, in response to the ongoing crisis, Congress enacted CEBA, which authorized a $10.8 billion recapitalization of the FSLIC and prescribed forbearance measures to prevent or postpone closures of thrifts.[302] As discussed above, CEBA

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[299] Garn-St Germain Depository Institutions Act, Pub. L. 97-320, § 312, 96 Stat. 1469, 1496-97 (1982) (codified as amended at 12 U.S.C. § 1464 (2006)).

[300] Prior to the passage of the Garn-St Germain Act, mutual savings banks had been permitted to accept demand deposits in connection with a commercial relationship pursuant to the Depository Institutions Deregulation and Monetary Control Act of 1980. Depository Institutions Deregulation and Monetary Control Act of 1980 § 408.

[301] The S&L crisis had a profound effect on the entire thrift industry. *See generally* DIVISION OF RESEARCH AND STATISTICS, FEDERAL DEPOSIT INSURANCE CORPORATION, HISTORY OF THE EIGHTIES – LESSONS FOR THE FUTURE (1997), *available at* http://www.fdic.gov/bank/historical/history/index.html; *The S&L Crisis: A Chrono-Bibliography*, FDIC.GOV, http://www.fdic.gov/bank/historical/s&l/ (last updated Dec. 20, 2002).

[302] George Hanc, *The Banking Crises of the 1980s and Early 1990s: Summary and Implications, in* HISTORY OF THE EIGHTIES—LESSONS FOR THE FUTURE 3, 10 (1997) *available at* http://www.fdic.gov/bank/historical/history/3_85.pdf. In 1989, Congress passed the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), which abolished the FHLBB and FSLIC, created the OTS, and established the Resolution Trust Corporation to deal with failed assets. *See generally*

amended the BHCA definition of "bank" and created an explicit exemption from that definition for savings associations, which remains in force today.[303]

Historically, Congress has treated savings associations differently from banks, distinguishing between the traditional savings associations' focus on home mortgage lending and the more expansive business-oriented services provided by banks.[304] In enacting the 1966 Amendments, Congress recognized that the objectives of the BHCA could be achieved without applying the BHCA to "savings banks."[305] Legislation targeting thrift holding companies has traditionally been aimed at "reinforcing the residential and consumer lending mission of their subsidiary associations" instead of "curbing the unrelated business activities of thrift holding companies," which further highlights the distinction Congress has drawn between savings associations and banks.[306]

The first piece of legislation to address thrift holding companies directly was the Spence Act of 1959, which prohibited existing holding companies from acquiring additional thrifts out of a fear that local thrifts would be "swallowed up by interstate holding company conglomerates."[307] This moratorium was lifted by the Savings and Loan Holding Company Amendments of 1967 ("SLHCA").[308] The SLHCA prohibited thrift holding companies

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Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989); *see also* DAVID LAWRENCE MASON, FROM BUILDINGS AND LOANS TO BAIL-OUTS: A HISTORY OF THE AMERICAN SAVINGS AND LOAN INDUSTRY, 1831-1995 241-55 (2004).

303 Competitive Equality Banking Act of 1987, Pub. L. 100-86, § 101, 101 Stat. 552, 554 (1987) (codified as amended at 12 U.S.C. § 1841 (2006)). Under 12 U.S.C. § 1841(c)(2)(B) (2006), "(1) any Federal savings association or Federal savings bank; (2) any building and loan association, savings and loan association, homestead association, or cooperative bank if such association or cooperative bank is a member of the Deposit Insurance Fund; and (3) any savings bank or cooperative bank which is deemed by the Director of the Office of Thrift Supervision to be a savings association under section 1467a(l) of this title" is exempt from the BHCA's definition of a "bank." 12 U.S.C. § 1841(j) (2006).

304 *Historical Framework*, *supra* note 297.

305 S. REP. NO. 89-1179, at 7 (1966).

306 *Historical Framework*, *supra* note 297.

307 WILLIAMS, *supra* note 288, at 2-4.

308 OFFICE OF THRIFT SUPERVISION, HOLDING COMPANIES IN THE THRIFT INDUSTRY: BACKGROUND PAPER 4 [hereinafter OTS BACKGROUND PAPER]

from "engaging in commercial and industrial enterprises, as well as certain financial activities such as underwriting insurance or securities."[309] Importantly, the activity restrictions promulgated by the SLHCA only applied to multiple thrift holding companies that owned two or more thrifts and not to unitary thrift holding companies that owned or controlled only one thrift.[310]

A significant change took place in 1987, when Congress introduced the Qualified Thrift Lender ("QTL") test in CEBA.[311] The QTL test was designed to make sure all thrifts held a minimum percentage of their assets in qualified thrift investments.[312] If a thrift failed the QTL test, the holding company would subsequently be treated as a BHC.[313] Failure of the QTL test would likely have an enormous impact on most thrift holding companies, as "the confinement of their unrelated business activities to those permissible for bank holding companies . . . [meant the] forced sale of either the subsidiary thrift or other profitable entities."[314] Because BHCs are not permitted to own non-banking interests, a thrift holding company whose subsidiary thrift fails the QTL test would be required to divest its non-banking interests to comply with the BHCA.[315] The FIRREA, passed in the wake of the S&L crisis, enhanced the QTL test and imposed stricter penalties for thrifts that failed the test.[316]

(1997). *See generally* Savings and Loan Holding Company Amendments of 1967, Pub. L. No. 90-255, 82 Stat. 5 (1967).

[309] OTS BACKGROUND PAPER, *supra* note 308, at 4.

[310] *Id*.

[311] Competitive Equality Banking Act of 1987, Pub. L. 100-86, § 104(c), 101 Stat. 554, 571 (1987) (repealed 1989).

[312] *Id.* Under CEBA, thrifts had to maintain at least sixty percent of their total assets in "qualified thrift investments," which include primarily residential mortgage loans and related assets. *Id.*

[313] *Id.*

[314] *Historical Framework, supra* note 297.

[315] *See id.* (recognizing that "[i]mplicit in the QTL test is a Congressional determination that ownership of a single savings association by a firm engaged in commercial activities does not raise the types of concerns regarding the mixture of banking and commerce and the monopolization, or discriminatory availability, of commercial credit that led to enactment of the BHCA of 1956 and its extension to one-bank holding companies by the BHCA Amendments of 1970.").

[316] WILLIAMS, *supra* note 288, at 2-16. Under the FIRREA's QTL test, a thrift must hold at least seventy percent of its assets in qualified investments. Financial Institutions Reform, Recovery, and Enforcement Act

Importantly, however, unitary thrift holding companies were treated differently from multiple thrift holding companies. Under the original BHCA, unitary thrift holding companies were exempt from the BHC registration requirement (as a thrift holding company would have to own two or more "savings banks" in order to be considered a BHC).[317] After the one-bank holding company option was closed, thrift holding companies remained outside the scope of the BHCA to the extent their thrift subsidiaries were exempt from the BHCA definition of a "bank." Instead, thrift holding companies were subject to the parallel regulatory regime under the SLHCA. The SLHCA generally exempted unitary thrift holding companies from the activity restrictions imposed upon multiple thrift holding companies.[318] These activity restrictions included prohibitions against engaging in non-banking activities, certain financial activities (such as underwriting insurance and securities), and activities not closely related to the savings and loan industry.[319]

As a result of this exemption, a commercial company could become a unitary thrift holding company without running afoul of either the SLHCA or the BHCA. This was a deliberate move by Congress to encourage the acquisition of single thrifts by commercial and financial companies.[320] In the late 1990s, Ford Motor Company, Sears Roebuck and Company, ITT Corporation and Weyerhaeuser

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of 1989, Pub. L. No. 101-73, § 303, 103 Stat. 183, 344 (1989). The FIRREA also narrowed the pool of qualified investments, but allowed thrifts to double the value of certain investments for the purposes of the QTL test. *Id.* Thrifts that failed the QTL test were required to obtain a bank charter and their parent companies were required to register as BHCs one year after the date of non-compliance. *Id.*

317 Bank Holding Company Act of 1956, Pub. L. No. 84-511, § 2(a), 70 Stat. 133, 133 (1956).

318 *See supra* note 310 and accompanying text.

319 Kabugo-Musoke, *supra* note 229, at 397 (citing Joseph G. Haubrich & Joào A. C. Santos, *Alternative Forms of Mixing Banking with Commerce: Evidence from American History*, 12 FIN. MARKETS, INST. & INSTRUMENTS 121, 144 (2003)); *see also* WILLIAMS, *supra* note 288, at 2-28 to 2-29 ("Unitary holding companies generally were not subject to limitations on activities of the holding company and its non-savings institution subsidiaries; multiple holding companies and their non-savings institution subsidiaries were confined to a statutory list of activities regarded as closely related to the savings and loan business, augmented by a list of permissible activities contained in regulations of the FHLBB.").

320 *Historical Framework, supra* note 297.

Company were among the many commercial companies that owned thrift institutions.[321]

After the deposit insurance fund for thrifts was recapitalized in 1996, applications to establish unitary thrift holding companies by commercial companies increased significantly.[322] Between 1997 and 1999, the OTS approved more than eighty applications for unitary thrift holding companies, a substantial portion of which were from retailers and other commercial firms.[323]By the end of October 1999, shortly before the enactment of the GLBA, more than fifty additional applications were pending before the OTS, which included Wal-Mart's proposal to acquire a thrift in Oklahoma.[324] By the late 2000s, most thrift holding companies were unitary, rather than multiple.[325]

In 1999, the GLBA expressly prohibited new holding companies from owning a single savings association and a commercial enterprise.[326] Legislative history of the GLBA indicates that this measure was due to the immense pressure from community banks and trade associations, which argued that unitary thrift companies enjoyed an unfair advantage over banks and presented a serious

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[321] OTS BACKGROUND PAPER, *supra* note 308, at 9.

[322] Wilmarth, *supra* note 143, at 1584-85; *see also id.* at 1584 n.264 ("In 1989, Congress abolished the FSLIC and established within the FDIC two separate deposit insurance funds- the Bank Insurance Fund (BIF) for banks and the Savings Association Insurance Fund (SAIF) for thrifts. Many banks subsequently acquired SAIF-insured deposits by purchasing thrift institutions. In 1996, Congress required all thrifts and all banks holding SAIF-insured deposits to pay a one-time special assessment to recapitalize the SAIF. The recapitalization of SAIF greatly reduced the cost of future deposit insurance premiums for thrift institutions and maintained the credibility of deposit insurance for thrifts. In addition, Congress liberalized the QTL by expanding the amounts of commercial and consumer loans that would qualify for QTL treatment. Both measures made the thrift charter much more attractive, especially for non-banking companies that were barred from acquiring banks under the BHC Act.").

[323]*Id.* at 1584-85.

[324] *Id*.

[325] OFFICE OF THRIFT SUPERVISION, OTS HOLDING COMPANY HANDBOOK § 400.2 (2008).

[326] Financial Services Modernization Act, Pub. L. 106-102, § 401, 113 Stat. 1338, 1434-36 (1999); *see also* WILLIAMS & ZESCH, *supra* note 288, at 2-17 (describing GLBA limitations imposed on holding companies, including disallowing ownership of both a commercial enterprise and a savings institution).

danger to the principle of separation of banking and commerce.[327] The Federal Reserve also supported the prohibition on commercial activities of unitary thrift holding companies.[328]

Importantly, however, the GLBA grandfathered the exemption for the existing unitary thrift companies.[329] Thus, in the post-GLBA era, only the grandfathered unitary thrift holding companies retained their ability to engage in commercial activities, as long as there was no change in their control.[330]

In the period between the enactment of the GLBA and the financial crisis of 2007-09, thrifts experienced a period of growth. In 2005, there were 484 thrift holding companies under OTS

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327 *See H.R. 10 – The Financial Services Modernization Act of 1999: Hearings before the Comm. on Banking and Financial Servs.*, 106th Cong. 42-43 (1999) (statement of R. Scott Jones, President, American Bankers Association) ("For many banks and particularly community banks, the unitary thrift issue is critical. The crux of the unitary thrift issue is whether to mix banking and commerce. If Congress does not make a decision soon, the marketplace will make it for us, and we will have permanently crossed the bridge into full banking and commerce. For example, Microsoft could buy a small thrift with their spare change, merge it with a large bank and run the combined firm as a unitary thrift. While technically having a thrift charter for all practical purposes, it would, of course, be a bank. And that is the critical point. There is very little, if any, difference between a bank and a thrift. However, there is a big difference in how their holding companies are regulated. . . . By not dealing with the unitary thrift issue, Congress will have blessed two parallel banking systems, one with a much stricter regulatory standard than the other, and we know that basic economics tells us the flow of capital will move to the lesser regulated entity."); *id.* at 44 (statement of William L. McQuillan, President, Independent Bankers Association of America (stating that the "unitary thrift holding company loophole . . . allows any commercial firm to get into the banking business by buying a unitary thrift.").

328 *Id.* at 104 (statement of Alan Greenspan, Chairman, Board of Governors, Federal Reserve System).

329 *See* Financial Services Modernization Act § 401 (stating that activity and affiliation restrictions do not apply to existing unitary thrift holding companies as long as they were a thrift holding company on May 4, 1999 (or had an application pending on or before that date), and continue to control that thrift).

330 Under the GLBA, a change in control would result in termination of the grandfathered unitary thrift holding company status. *Id*. Under the GLBA, more than one hundred unitary thrift holding companies received grandfathered status. *See* Muckenfuss & Eager, *supra* note 48, at 42.

supervision with $7.2 trillion in total U.S. assets, controlling 451 thrifts with total assets of $1.2 trillion.[331] The recent crisis, however, significantly weakened the industry.[332] As a result, by 2010, there were 437 thrift holding companies under OTS supervision with $4.2 trillion in total U.S. assets, controlling 399 thrifts with total assets of $723 billion.[333]

The Dodd-Frank Act significantly reformed the structure of thrift regulation by eliminating the OTS and transferring its authority to regulate thrifts and thrift holding companies to the OCC and the Federal Reserve, respectively, and by taking other steps to effectively erase regulatory differences between thrifts and banks. Under the Dodd-Frank Act, unitary thrift holding companies that were grandfathered by the GLBA generally retain their exempt status and ability to engage in commercial activities. However, the new legislation requires grandfathered unitary thrift holding companies to place all of their financial activities in a separate intermediate holding company that is subject to regulation and supervision by the Federal Reserve as a SLHC.[334] The ultimate parent entity is obligated to serve as a "source of strength" to such an intermediate holding company and is subject to limited examination and enforcement by the Federal Reserve.[335] All other thrift holding companies—the "non-exempt" SLHCs, whether unitary or multiple—are now limited to conducting activities permitted to BHCs and "financial in nature"

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[331] OFFICE OF THRIFT SUPERVISION, 2010 FACT BOOK: A STATISTICAL PROFILE OF THE THRIFT INDUSTRY 80 [hereinafter, OTS 2010 FACT BOOK] (2011).

[332] The failure of Washington Mutual, the country's largest savings association based in Seattle, was a critical blow to the thrift industry. In September 2008, the federal government seized Washington Mutual, which was heavily exposed to risky mortgage-backed assets and suffered from a creditor run, and struck a controversial deal to sell its assets to J.P. Morgan. *See* Robin Sidel et al., *WaMu is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History,* WALL ST. J., Sept. 26, 2008, at A1; *see also* Dain C. Donelson & David Zaring, *Requiem for a Regulator: The Office of Thrift Supervision's Performance During the Financial Crisis*, 89 N.C. L. REV. 1777, 1779 (2011) (discussing the impact the failure of Washington Mutual had on the U.S. economy as part of the larger financial crisis).

[333] OTS 2010 FACT BOOK, *supra* note 331, at 69.

[334] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 626, 124 Stat. 1376, 1604 (2010).

[335] *Id.*

activities permissible to FHCs.[336] Thus, the Dodd-Frank Act kept the GLBA exemption from activity limitations for grandfathered unitary thrift holding companies, while at the same time eliminating most, if not all, meaningful differences between regulation of BHCs and thrift holding companies.

This example raises a broader question whether the definitional boundaries between "banks" and various groups of financial institutions specifically determined not to be "banks" under the BHCA scheme are going to retain their practical importance in the emerging post-Dodd-Frank regulatory regime.

V. Looking Back, Thinking Forward: Lessons of History and Regulatory Reform

A closer look at the history of the BHCA provides a contextual framework for understanding current trends in the financial sector regulation reform. This Part discusses some of these trends. First, it examines the potential impact of the Dodd-Frank Act on the continuing practical relevance of the BHCA definition of "bank" and the statutory exemptions from that definition. Moving to broader issues of regulatory process and design, this Part offers some general observations on potential lessons of the history of the BHCA for the ongoing regulatory reform.

A. What's in a Name? Exemptions from the BHCA Definition of "Bank" after Dodd-Frank

The existence of statutory exemptions for certain bank-like institutions from the BHCA definition of "bank," and the resulting exemption for their parent companies from regulation under the BHCA, continues to be a matter of concern to lawmakers.

The recent controversy over Wal-Mart's attempt to acquire an ILC reignited the broader debate on the continuing utility of these exemptions shortly before the latest financial crisis brought forth more pressing policy issues.[337] In 2009-10, the International Monetary Fund ("IMF") conducted its first Financial Sector Assessment Program ("FSAP") review of the consolidated regulation and supervision in the United States and, among other things,

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336 *Id.* For a list of "financial in nature" activities, see 12 U.S.C. § 1843(k)(4) (2006).

337 *See supra* notes 328-333 and accompanying text.

recommended the elimination of all existing exemptions from the BHCA definition of "bank."[338] The IMF's FSAP report was completed on July 23, 2010, shortly after Congress passed the Dodd-Frank Act.[339] Although the legislative history of the Dodd-Frank Act shows that Congress debated eliminating at least some of the exemptions,[340] the final version of the legislation did not go that far. Instead, the Dodd-Frank Act imposed a three-year moratorium on the FDIC's approval of deposit insurance applications by ILCs, credit card banks, or trust banks controlled by commercial firms.[341] The moratorium also extends to the approval by the relevant federal banking regulators of any change in control of these entities.[342]

In addition, the Dodd-Frank Act directed the GAO to conduct a study and develop policy recommendations with respect to the continuing desirability of the existing exemptions from the definition of "bank" under the BHCA.[343] Under the Dodd-Frank Act, the GAO study has to identify which exempted institutions are controlled or affiliated with commercial companies; determine whether the existing regulatory framework adequately addresses the risks associated with these institutions' activities and affiliations; and evaluate potential consequences of eliminating these exemptions and subjecting their parent companies to the BHCA.[344]

The inclusion of these provisions in the Dodd-Frank Act illustrates Congress' continuing concern over the practical impact of

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[338] *See* INT'L MONETARY FUND, *supra* note 8, at 3. The IMF FSAP report recommended the creation of a single federal program of consolidated regulation and supervision, which would be administered by the Federal Reserve and cover "all holding companies that own one or more FDIC-insured depository institutions, regardless of the charter type and without exception, plus any other financial firms deemed to be potentially systemic." *Id*. at 4. Moreover, the report recommended that all groups subject to consolidated regulation and supervision be prohibited from "engaging in most commercial activities." *Id*. at 14.

[339] *Id.* at 3.

[340] *Id.* at 16.

[341] Dodd-Frank Act § 603(a)(2). "Commercial firm" is defined as any entity that derives less than fifteen percent of its consolidated annual gross revenues from activities that are financial in nature, as defined in section 4(k) of the BHCA, or from ownership or control of insured depository institutions. *Id.* § 602.

[342] *Id.* § 603(a)(2).

[343] *Id.* § 603(b)(1).

[344] *Id.* § 603(b)(2).

breaching the wall between banking and commerce.[345] As the landscape of the U.S. financial industry changes in response to the crisis and post-crisis legislation, Congress is signaling its resolve to reaffirm this foundational principle of U.S. regulatory framework and to reinforce the central importance of the BHCA within that framework.

It remains to be seen whether Congress will take any legislative action to amend or limit exemptions from the BHCA in the near future or to foreclose the existing avenues for commercial ownership of deposit-taking institutions, including ILCs or trust companies. Placing Congress's actions in the context of the historical evolution of the BHCA, however, raises a broader question about the continuing significance of the statutory definition of "bank," and the exemptions from that definition, in the post-crisis regulatory environment.

The regulatory reform envisioned in the Dodd-Frank Act has potentially profound consequences in this respect. The explicit exemptions under CEBA were ultimately traceable to the same policy rationale that the exempted institutions did not pose risk of excessive concentration of commercial credit and, more generally, economic and political power. An additional rationale for the exemptions was the fact that some of these entities, such as thrifts and credit unions, were subject to parallel regulatory regimes. Despite their differences, ILCs, thrifts, credit unions, limited purpose trust companies and credit card banks were perceived to be small- or medium-size entities that generally operated in local markets and offered a limited set of specialized services. As the functions and business operations of these institutions changed in response to legal and market developments, however, the statutory exemptions remained frozen in their 1987 form. This made ILCs and thrifts particularly attractive to non-bank financial and commercial companies that sought access to FDIC-insured deposits and wanted to develop lending capabilities without triggering the BHCA's registration requirements.

The creation of an integrated oversight of all SIFIs, including systemically significant non-bank financial companies, potentially

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[345] In fact, the legislative history of Section 603 of the Dodd-Frank Act shows that the House version explicitly contemplated significantly limiting the scope of the existing exemptions for savings associations and ILCs from the definition of "bank" under the BHCA. *See* H.R. 4173, 111th Cong. §§ 1301(a)(4)(A), 1301(a)(4)(D) (2009).

eliminates the key incentive for large financial institutions to avoid being regulated as a BHC. Under the Dodd-Frank Act, systemically important non-bank financial companies, SLHCs, and companies that voluntarily register as SHCs will be subject to consolidated regulation and supervision by the Federal Reserve under somewhat differing schemes that essentially mirror those applicable to BHCs. Accordingly, whether or not any such institution controls an entity that falls within the statutory definition of "bank," or qualifies for an exemption from that definition, becomes far less critical than it was before the passage of the Dodd-Frank Act. For example, the Volcker Rule is part of the BHCA but it applies to all "banking entities," defined as any insured depository institution or its affiliates.[346] Thus, technically, the Volcker Rule applies to companies that own or control FDIC-insured ILCs, thrifts, limited purpose trust companies or credit card banks.

A related development is the increasing convergence between the regulatory regime governing thrifts and thrift holding companies and the regulation of commercial banks and BHCs. With the elimination of the OTS and the transfer of regulatory authority over thrifts and SLHCs to the OCC and the Federal Reserve, the practical differences between these once parallel regulatory schemes are disappearing.[347] The only continuing exceptions are the unitary thrift holding companies grandfathered by the GLBA, which may still be owned or controlled by commercial entities.[348]

Despite the continuing uncertainty associated with the Dodd-Frank implementation process, it is possible to hypothesize about the future of the exemptions from the BHCA definition of "bank" under the emerging systemic risk regulation regime. To the extent any ILC, thrift, credit union, any other financial institution exempted from the definition of "bank," or such institution's parent company is deemed to be a systemically important non-bank financial company, the parent company will become subject to the Federal Reserve's consolidated supervision, regulation and enforcement authority in a manner similar to BHCs. Commercial companies that own these institutions will still be able to carry on their commercial activities but may be required to consolidate all of their financial activities

[346] Dodd-Frank Act § 619.
[347] *See supra* notes 56-58 and accompanying text.
[348] *See supra* note 329 and accompanying text.

under a single intermediate holding company subject to the Federal Reserve's supervision.[349]

The Dodd-Frank Act is probably going to alter most drastically the role of thrifts. Even leaving aside the impact on systemically important thrifts or SLHCs, the advantages of owning a thrift, as opposed to a commercial bank, are likely to erode significantly, as the two previously parallel regulatory regimes continue to converge.[350] As the implementation of the Dodd-Frank Act continues, many large, systemically important SLHCs may choose to convert their thrifts into commercial banks that have broader powers.

With respect to other exemptions, the key factor is whether a particular institution is designated as systemically important. For all systemically significant non-bank financial companies, the exemptions from the definition of "bank" are likely to lose practical relevance. It does not seem likely that many credit unions, limited purpose trust companies or credit card banks will be designated as systemically important financial institutions for the purposes of consolidated regulation by the Federal Reserve. These institutions generally operate in certain clearly delineated market niches, primarily by virtue of membership or activity limitations. These limitations also render them less likely to threaten either the old statutory objective of separating banking and commerce or the new goal of systemic risk prevention.

By contrast, however, an ILC that is not systemically important may remain a convenient vehicle for non-banking financial and commercial companies to access federally insured deposits without having to register with the Federal Reserve as a BHC. Because today's ILCs effectively function as full-fledged state-chartered commercial banks, control of an ILC may still be a valuable opportunity for a non-banking financial or commercial company.

It is not clear yet whether Congress will take legislative action to amend or limit exemptions from the BHCA or to prohibit commercial ownership of ILCs and other deposit-taking institutions. It is clear, however, that any such action by itself is likely to fall short of addressing the more fundamental policy issues in financial regulation reform. Understanding the evolution of the BHCA

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[349] Dodd-Frank Act § 167(b).

[350] *See supra* notes 334-336 and accompanying text.

definition of "bank" and the broader shifts in the statute's policy focus helps to outline some of these issues.

B. Reflections on Regulatory Reform Issues

Several interrelated themes relevant to today's policy debates emerge from our discussion.

The history of the BHCA definition of "bank" illustrates the fundamental dynamics of financial sector regulation as a constantly evolving product of the complex interaction between the government and industry actors. Scholars have long recognized the cyclicality of the regulatory process in various contexts.[351] The familiar discourse of "deregulation vs. re-regulation," however, tends to be heavily normative.[352] Tracing the evolution of the definition of "bank" in the BHCA paints a more subtle picture of how law shapes the developments in the financial markets and how it is, in turn, shaped by the changing market practices and institutions.

The story presented in this Article reveals an inherent conceptual tension in the statutory scheme. On the one hand, the BHCA seeks to restrict permissible activities of entities affiliated with commercial banks (the restrictive element). On the other hand, it seeks to allow such bank-affiliated entities to conduct a broader range of business activities than those permissible for a commercial

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351 *See, e.g.,* Amy L. Chua, *The Privatization-Nationalization Cycle: the Link between Markets and Ethnicity in Developing Countries*, 95 COLUM. L. REV. 223 (1995); ALAN GART, REGULATION, DEREGULATION, REREGULATION: THE FUTURE OF THE BANKING, INSURANCE AND SECURITIES INDUSTRIES (1994).

352 *See, e.g.,* Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1 (2011) (arguing that deregulation of derivatives under the Commodity Futures Modernization Act of 2000 caused the financial crisis of 2008); Joseph Karl Grant, *What the Financial Services Industry Puts Together Let No Person Put Asunder: How the Financial Services Modernization Act of 1999 - the Gramm-Leach-Bliley Act - Contributed to the 2008-2009 American Capital Markets Crisis*, 73 ALB. L. REV. 371 (2010) (arguing that deregulation of the U.S. financial sector brought by the GLBA was one of the direct causes of the recent financial crisis); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521 (2005) (arguing that the Sarbanes-Oxley Act is an example of ill-conceived over-regulation).

bank (the permissive element).[353] The history of the BHCA is a series of congressional attempts to find an elusive balance between these two opposite intentions under intense pressure from various interest groups. Congress periodically revisited the statute and strengthened its restrictive element in the name of high-level policy goals, such as preventing excessive concentration of financial and economic power or ensuring safety and soundness of the banking system. At the same time, between 1956 and the enactment of CEBA in 1987, Congress also gradually loosened statutory restrictions by redefining the key term "bank" and creating implicit or explicit exemptions from its scope.

As this Article demonstrates, every cycle of restrictive legislation also created unforeseen opportunities for private industry actors to avoid the BHCA's restrictions, often by exploiting definitional technicalities. In the heavily regulated banking industry, private market actors constantly search for ways to escape onerous regulatory requirements that limit their profitability potential. Extensive restrictions on their activities, investments and geographic footprint gave commercial banks and BHCs particularly strong incentives to expand their product offerings and market reach to compete successfully with less intrusively regulated financial intermediaries entering traditional banking business lines. The twin forces of technological progress and financial innovation enabled firms to deliver financial services in ways that defied existing legal and regulatory boundaries. In response, Congress embarked upon the next round of statutory amendments that tightened some provisions of the BHCA but compromised on others, creating a new set of unforeseen regulatory arbitrage opportunities.

Revisiting this history puts the process of implementation of the Dodd-Frank Act in a sobering perspective. History shows that any legislation imposing restrictions on financial institutions' activities creates conditions for the emergence of new methods of regulatory arbitrage, as the affected institutions respond to new constraints on their business. Statutory and regulatory definitions and exemptions often play a critical role in determining the scope of the restrictions and, accordingly, the nature of the industry's response. Statutory definitions often become the frontline in political and

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[353] Thus, the GLBA is the most important example of expanding the permissive element of the bank holding company regulation in the United States.

economic battles, as the constant interplay of government action and industry reaction shapes the path of financial innovation.

Thus, one of the lessons of history for today's policymakers is the importance of adopting a dynamic view of regulatory reform, which aims to anticipate potential market responses to legislative action and to build adjustment mechanisms into the regulatory regime. Effective regulatory design has to incorporate an assumption that some degree of arbitrage in reaction to regulation is inevitable and, under certain circumstances, may even be desirable as a correction signal. The Dodd-Frank Act's approach to this issue seems to focus primarily on regulatory jurisdiction. In the Dodd-Frank Act, Congress delegated to regulatory agencies the authority to fill in numerous gaps and ambiguities in the statutory language. Conceivably, as market conditions change over time, regulators will exercise their authority to adjust the regulatory regime accordingly. The Federal Reserve in particular received unprecedented powers to regulate and supervise all systemically significant financial institutions under its newly expanded jurisdiction.[354] By actively exercising its oversight responsibilities, the Federal Reserve is, in effect, expected to act as the key watchman protecting the system against the undesirable effects of regulatory arbitrage. In addition, the Dodd-Frank Act created the Financial Stability Oversight Council ("FSOC"), an interagency systemic risk regulator,[355] and the Office of Financial Research ("OFR"), an office inside the Treasury Department that supports FSOC by identifying and analyzing data relevant to systemic risk prevention.[356] The FSOC and the OFR are expected to operate as the structural and informational center of the new regulatory architecture and to provide a unified regulatory perspective on the developments in financial markets.

In theory, this may be viewed as a strong built-in adjustment mechanism that should provide the necessary flexibility for the regulatory regime to respond to changes in market conditions. In practice, however, it remains to be seen how effectively these regulatory agencies will use their statutory powers to achieve the stated goals. Financial regulators' ability to implement their official mandate depends greatly on complex organizational, political, and ideological factors and incentives.

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[354] *See supra* note 20 and accompanying text.
[355] Dodd-Frank Act § 111.
[356] *Id.* § 152.

The history of the BHCA underscores the central role interest group politics and economic pluralism play in creating incentives for regulators and Congress to react to changes in the marketplace. Both the enactment of the BHCA and its subsequent amendments were, to a great extent, a result of intense lobbying by independent community bankers and small local businesses seeking to protect their market share from the big "money-center" banks. In 1956, these local elites were the real winners because the original version of the BHCA effectively allowed them to combine the ownership of a local bank and a variety of commercial businesses, while protecting them from out-of-state competition.[357] Later, when large money-center banks discovered that the use of a one-bank holding company structure allowed them to offer banking services across state lines, the same coalition of independent community banks and local businesses successfully lobbied Congress to close that "loophole" in the BHCA.[358] By the mid-1980s, the combination of high interest rates, inflation and intensified competition among financial intermediaries created strong incentives for large BHCs and other companies to use FDIC-insured "nonbank banks" to avoid the increasingly stifling legal and regulatory constraints. In 1987, the independent community banks again succeeded in pushing through Congress an amended definition of "bank" in the BHCA, which brought all FDIC-insured institutions within its scope but created several explicit exemptions, primarily for deposit-taking institutions that were locally-owned niche service providers.[359]

Since the late 1980s, though, the balance of economic and political power between community banks and large financial institutions has fundamentally changed. The wave of consolidations in the banking industry, globalization, rapid financial innovation, the growth of complex financial product markets, and the repeal of the Glass-Steagall Act's prohibition on affiliations between banks and other financial institutions led to the increased concentration of assets and capital among the country's largest bank conglomerates.[360] Today it is a relatively small group of large diversified financial

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[357] *See supra* notes 67-72 and accompanying text.
[358] *See supra* notes 90, 94, 97 and accompanying text.
[359] *See supra* notes 161, 173, 179 and accompanying text.
[360] *See generally* Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215 (2002) (discussing the rapid rise and expansion of large financial services firms).

companies, rather than the far more numerous group of small and community banks, that plays the critical role in shaping the regulatory and legislative dynamics in the financial services sector.[361]

How does that shift in political power affect the dynamics and potential substantive outcomes of the current regulatory reform in the financial sector? Scholars have argued that massive bailouts of large banks and investment banks during the 2007-09 crisis exacerbated the moral hazard and "too big to fail" problems.[362] Others go as far as claiming that the Dodd-Frank Act effectively created a new corporatist regime that solidifies government partnership with the largest financial institutions and makes future bailouts of such institutions inevitable.[363] On the other hand, it is hard to deny that, in the immediate aftermath of a major crisis, the weakened political clout of the country's largest financial institutions led them to lose many political battles over the new legislation.[364] Developing a thorough understanding of the political dynamics of the adoption and ongoing implementation of the Dodd-Frank Act would require careful research and analysis that go beyond the scope of this Article.[365] An examination of the role of interest group politics in

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[361] *See, e.g.*, Binyamin Appelbaum, *On Finance Bill, Lobbying Shifts to Regulations*, N.Y. TIMES, June 27, 2010, at A1 (describing the financial industry's lobbying efforts seeking to influence the implementation of the Dodd-Frank Act); John Plender, *How to Tame the Animal Spirits*, FIN. TIMES (London), Sept. 30, 2009, at 11 (stating that, in 2007, there were five financial industry lobbyists per member of Congress). Of course, this is not to say that small- and medium-sized banks do not have any lobbying power and do not exert any political influence today. Wal-Mart's unsuccessful attempts to establish an ILC provide a recent example of their continuing ability to protect their group interests. *See supra* notes 224-229 and accompanying text.

[362] *See, e.g.*, SIMON JOHNSON & JAMES KWAK, THIRTEEN BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2010) (arguing that government bailouts of large financial services firms created conditions for future financial crises).

[363] *See generally* DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2010) (arguing that the key theme in the Dodd-Frank Act is the creation of a partnership between the government and the largest financial institutions).

[364] The creation of the CFPB and the adoption of the Volcker Rule are examples of such political battles.

[365] *See, e.g.*, Kim Krawiec, Don't "Screw Joe the Plummer:" The Sausage-Making of Financial Reform (Nov. 11, 2011) (unpublished manuscript),

shaping BHC regulation, however, may potentially enrich that debate by placing it in a broader historical context.

Conclusion

This Article does not purport to present an exhaustive and detailed analysis of the entire political or economic history of bank holding company regulation in the United States. Rather, its goal is to examine one particular aspect of that history—the evolution of the BHCA definition of "bank" and the principal exemptions from that definition. Incomplete as it may be, this story highlights some of the key economic, social and political factors that shaped the current institutional structure of the U.S. financial services market and regulation. Without a thorough understanding of the genesis of that structure, it is difficult to envision an effective method of redesigning it to meet today's regulatory challenges. By revisiting the past, this Article ultimately seeks to contribute to the emergence of a more self-reflexive and context-sensitive approach to financial regulation reform.

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available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1925431 (providing an example of this type of analysis).

PROVING RACIAL DISCRIMINATION AND MONITORING FAIR LENDING COMPLIANCE: THE MISSING DATA PROBLEM IN NONMORTGAGE CREDIT

WINNIE TAYLOR*

Introduction

Lending discrimination litigation has proliferated as a result of the recent subprime mortgage crisis.[1] The plaintiffs in most of these lawsuits claim racial discrimination in violation of the Equal Credit Opportunity Act (ECOA), a federal law prohibiting credit discrimination on the basis of race, gender, age or other personal attributes.[2] This accelerating ECOA litigation has helped to focus national attention on public and private efforts to eliminate racial inequality in the credit industry.[3] Yet, a central controversy

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[1] During the crisis, some subprime lenders aggressively targeted minority neighborhoods for the purpose of making unaffordable home loans that were destined for delinquency, default or foreclosure. *See generally* Winnie F. Taylor, *Eliminating Racial Discrimination in the Subprime Mortgage Market: Proposals for Fair Lending Reform,* 18 J.L. & POL'Y 263 (2009).

[2] *See generally* 15 U.S.C. § 1691-1691f (2006). The ECOA also prohibits discrimination on the basis of national origin, religion, color, marital status, receipt of public assistance income, and good faith exercise of rights under the Consumer Credit Protection Act.

[3] *See generally* THE ATTORNEY GENERAL'S 2010 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 (April 5, 2011); *see also* Consent Judgment and Order at 7-8, 10, FTC v. Countrywide Financial Corp., No. CV10-4193 (C.D. Cal. 2010) (enjoining Countrywide Financial Corp. from servicing loans); Mayor of Baltimore v. Wells Fargo Bank, 631 F.Supp. 2d 702, 704 (D. Md. 2009) (denying banking institution's motion to dismiss for lack of standing in claims that predatory residential mortgage loans targeting black neighborhoods caused city damages); Consent Order at 4, United States v. AIG Federal Savings Bank, No. 10CV178-JJF (D. Del. 2010) (consent order enjoining AIG Federal Savings Bank from engaging in any wholesale home mortgage lending that discriminates on the basis of race or color); *NAACP alleges Wells Fargo, HSBC mortgage bias*,

concerning litigation of such claims involves the uncertainty of whether ECOA plaintiffs may legally use employment law evidentiary standards, like disparate impact analysis, to prove lending discrimination in court.[4]

This article does not focus upon the continuing debate over the suitability of employment law analysis for credit cases.[5] Instead,

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REUTERS, http://www.reuters.com/article/2009/03/13/naacp-banks-lawsuit-idUSN1344141220090313 (last visited Nov. 8, 2011) (describing lawsuits brought in Federal court accusing Wells Fargo and HSBC of subjecting African American borrowers to onerous loan terms in comparison to those offered to white borrowers).

[4] In 2005, the United States Supreme Court decided that the disparate impact analytical framework that originated in employment law jurisprudence is appropriate to use in proving age discrimination. Smith v. City of Jackson, Miss. 544 U.S. 228, 239-240 (2005). However, the Court has yet to decide whether such analysis can be used in lending discrimination claims. Although most federal courts allow ECOA plaintiffs to use statistical impact proof methods, whether the Supreme Court would or should reverse these decisions if given the opportunity remains a hotly debated topic. *See, e.g.,* Osborne v. Bank of America, Nat'l. Ass'n., 234 F. Supp. 2d 804, 812 (M.D. Tenn. 2002) ("[T]he Court rejects the argument that [plaintiffs are barred] from proceeding under the ECOA on a disparate impact claim."); Smith v. Chrysler Fin. Co., No. Civ.A. 00-6003, 2003 WL 328719, at *6 (D.N.J. Jan. 15, 2003) ("It is clear . . . that disparate impact theory is present in the ECOA . . ."); Faulker v. Glickman, 172 F. Supp. 2d 732, 737 (D.Md. 2001) ("The credit applicant may prove discrimination in violation of the ECOA by relying on . . . disparate impact analysis . . . ."); Gross v. U.S. Small Bus. Admin., 669 F. Supp. 50, 52 (N.D.N.Y. 1987) ("The plaintiff may ground her case on . . . a disparate treatment analysis . . ."); Thomas v. First Fed. Sav. Bank of Indiana, 653 F. Supp. 1330, 1340 (N.D. Ind. 1987) (concluding that disparate impact analysis is an "avenue of recovery . . . available in the context of the Fair Housing Act . . . ."); Peter N. Cubita & Michelle Hartmann, *The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually Are There,* 61 BUS. LAW. 829, 830-33 (2006) (arguing that Congress did not intend for the disparate impact method of proving discrimination claims to apply in ECOA litigation because neither the ECOA's statutory discrimination proscription nor its legislative history supports a finding that the Act prohibits facially neutral practices that disparately affect protected class members).

[5] *See* Thomas P. Vartanian et al., *Disparate Impact Discrimination: Fair Lending At The Crossroads,* 49 CONSUMER FIN. L. Q. REP. 76, 77 (1995) (discussing the non-uniform manner in which various federal courts have applied disparate impact theory in lending discrimination cases).

it assumes that employment law analogies are appropriate in the credit context and addresses whether race data limitations in non-mortgage credit create barriers to monitoring fair lending compliance and proving prohibited discrimination. As explained below, ECOA plaintiffs need race data to prove racial discrimination claims, whether the claim alleges a difference in treatment on the basis of race or lender conduct that has discriminatory racial effects.[6] However, race data sources are largely unavailable in nonmortgage credit markets. The absence of this data hinders effective litigation of race-based ECOA claims and impedes federal regulatory efforts to identify discriminatory lending patterns in nonmortgage credit transactions.

Pursuant to the Home Mortgage Disclosure Act (HMDA),[7] mortgage lenders have collected and reported information on applicants for decades.[8] In order to implement the HMDA, the

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Admittedly, the suitability issue is an unresolved question that needs to be addressed. Until that issue is resolved, however, the current evidentiary standards will continue to be used to accomplish ECOA antidiscrimination policy objectives.

[6] *See infra* notes 31-40 and accompanying text (arguing that ECOA plaintiffs need race data to prove a *prima facie* case for disparate treatment discrimination).

[7] *See generally* Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, 89 Stat. 1125 (1975) (codified at 12 U.S.C. §§ 2801-2810 (2006)). Congress enacted the HMDA in 1975 to address the issue of whether minority borrowers were denied mortgage loans more frequently than white borrowers and whether those disparities, if any, reflected discrimination in financial institutions' lending practices. Taylor, *supra* note 1, at 281. At first, mortgage lenders only had to collect and report geographic information on loan originations and purchases to federal regulatory agencies and the general public. Home Mortgage Disclosure Act of 1975 § 304(a). Congress later amended the HMDA in 1989 to require lenders to collect and report further information about the race, sex and income of applicants for home mortgage loans. *See* Home Mortgage Disclosure, 54 Fed. Reg. 51,356, 51,359-60 (1989) (codified at Equal Credit Opportunity Act (Regulation B), 12 C.F.R. § 203.4(a)(10) (2011)) (stating that the HMDA had been amended to require "reporting of data on the race, sex, and income of applicants and borrowers, in addition to the geographic itemization of loans that is currently required").

[8] *See* 12 C.F.R. § 203.4(a)(10). Since 1992, HMDA data has been collected for a consistent set of census tracts on virtually all home-loan applications. These data constitute a unique record of the flows of credit in geographic areas of the United States from which the possible presence of

Federal Reserve Board (FRB) drafted Regulation C, which included a race data collection requirement.[9] Federal Reserve analysts study the collected race data to determine whether it indicates unlawful practices that violate the ECOA.[10] Although HMDA data, standing alone, do not prove racial discrimination,[11] ECOA plaintiffs have

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discriminatory patterns can be discerned. Importantly, the HMDA does not require all financial institutions to collect and report data for all loan applications, but provides certain exemptions based on size, location, volume, and loan characteristic considerations. *See, e.g.*, 12 U.S.C. § 2803(g)(1) (2006) (exempting mortgage banking subsidiaries of bank holding companies or savings and loans holding companies or any savings and loan service corporation that originates or purchases mortgage loans). Banks, credit unions and savings associations with total assets of $30 million or less as of the most recent full fiscal year are also exempt from providing census tract, income level, racial or gender data, though they are still required to report the number and dollar amount of mortgage loans. *Id.* § 2803(j). Depository institutions which originate, purchase or receiver fewer than five applications for a mortgage loan in any given metropolitan statistical area where such institutions do not maintain an office are also exempt from reporting those applications and related data as required by the Act. *Id.* § 2803(a)(2); *see generally* Jason Dietrich, *Missing Race Data in HMDA and the Implications for the Monitoring of Fair Lending Compliance* (Office of the Comptroller of the Currency, OCC Econ. Working Paper No. 2001-1) (arguing that missing race data from many institutions is systemically lost and introduces bias and efficiency problems into fair lending exams).

[9] *See generally* 12 C.F.R. §§ 203.4(a)(10)-(b)(1).

[10] Taylor, *supra* note 1, at 282. It is a matter of debate as to whether racial disparities in home mortgage application denial rates indicate illegal discrimination or whether they reflect economic conditions or other factors; nonetheless, disparities cannot be ignored. *See* Glenn B. Canner & Delores Smith, *Home Mortgage Act: Expanded Data On Residential Lending,* 77 FED. RES. BULL. 859, 976-78 (1991) (discussing how new racial data will assist bank regulators in determining whether racial discrimination exists in home mortgage lending); Anne P. Fortney, *Fair Lending Developments,* 54 BUS. LAW. 1329, 1330 (1999) (suggesting that racial data indicates continued racial disparity).

[11] The extent to which HMDA data actually proves or disproves racial discrimination is an issue that has made mortgage credit a controversial fair lending topic. *See generally* Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291 (1993) (investigating alternatives to the CRA and advocating its repeal); George J. Benston, *Discrimination in Mortgage Lending: Why HMDA and CRA Should Be Repealed*, 19 J. RETAIL BANKING SERVICES 47 (1997)

used this data in regulatory enforcement actions and private litigation to support race-based claims against mortgage lenders.[12] Additionally, banking regulators have used HMDA data to assist in identifying institutions, loan products or geographic areas that show racial disparities significant enough to require investigation under antidiscrimination statutes.[13] Some commentators agree that HMDA data have improved compliance with and enforcement of fair lending laws that prohibit racial discrimination in the housing market, even though the data do not conclusively prove illegal lending practices.[14]

(arguing that HMDA data are both useless and often misleading and advocating the repeal of the HMDA). Most commentators agree, however, that without more, the data provide insufficient information about borrowers to definitely prove the presence or absence of racial discrimination in the sense of arbitrary denials based on an applicant's race. This is because HMDA data do not consider credit reports or debt-to-income ratios, factors that many lenders consider when evaluating mortgage loan applications. *See* Robert B. Avery et al., *New Information Reported Under HMDA and Its Application in Fair Lending Enforcement,* 91 FED. RESERVE BULL. 344, 385-87 (2005) (discussing "many relevant facts to underwriting and pricing [that] are not included in the HMDA data . . .").

[12] *See generally* Settlement Agreement, United States v. Long Beach Mortgage Co., No. 96-CV-6159 (C.D. Cal. 1996) (settlement agreement between government and mortgage lender reached upon claim of statistically-demonstrated discrimination against African Americans, Hispanics, women and the elderly); Settlement Agreement, United States v. Fleet Mortgage Corp., No. 96-CV-2279 (E.D.N.Y. 1996) (settlement agreement reached upon claim of discriminatory pricing by mortgage lender against African Americans and Hispanics); Settlement Agreement, United States v. Huntington Mortgage Co., No. 95-CV-2211 (N.D. Ohio 1995) (settlement agreement reached upon claim of discriminatory pricing against African Americans).

[13] *See, e.g.*, THE ATTORNEY GENERAL'S 2007 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 1-4, 6 (2008) (describing how regulatory agencies, such as the Federal Deposit Insurance Corporation (FDIC) have used racial data to refer potential ECOA claims to the Department of Justice); THE ATTORNEY GENERAL'S 2008 ANNUAL REPORT TO CONGRESS PURSUANT TO THE EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS OF 1976 2-4, 6 (2009) (updating Congress as to the number of referrals for potential ECOA claims from numerous regulatory agencies).

[14] *See Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Lending Enforcement: Hearings Before the Subcomm. On Oversight and Investigations of the H. Comm. On Financial Services.,* 110th Cong. 37, 42 (2007) (statements of Sandra L. Thompson, Director of