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COMMENTS

PERMITTING SALE OF INSURANCE BY BANK HOLDING COMPANY SUBSIDIARIES: A REVISED ANALYTIC FRAMEWORK

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The authors examine the history of the Bank Holding Company Act and the 1970 Amendments, particularly as they relate to the authorized nonbanking activity of insurance sales. After discussing present Federal Reserve Board attitudes toward bank holding company applications to engage in insurance activities, the authors identify inherent weakness in the Board's current policies and suggest a revised framework for analysis of such application.

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I. INTRODUCTION

Since the economic debacle of 1929, banking legislation has generally focused on ensuring bank stability. One method of ensuring stability has been to restrict the nonbank activities in which banks may engage either directly or through affiliation with a holding company.

One exception to this separation of banking from commerce is the sale of insurance by bank holding company ("BHC") subsidiaries. This practice has recently grown into "a huge commercial tug-of-war between the bank holding company industry on one hand and independent insurance agents and other insurance industry groups on the other."[1] After tracing the development of BHC regulation, this comment will examine that controversy. An analysis will then be made of the manner in which the Federal Reserve Board ("Board") has applied statutory tests to determine whether a nonbanking activity is permissible. A major conceptual modification of these tests will be suggested. Finally, recommendations are offered for a resolution of the controversy over BHC sale of insurance.

1. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 231 (5th Cir. 1976), *modified*, 544 F.2d 1245 (5th Cir.), *modifying opinion withdrawn*, 544 F.2d at xxv, *petition for rehearing and rehearing en banc denied*, 558 F.2d 729 (5th Cir. 1977).

II. PRE-1956 BHC REGULATION

A. *Historical Overview of Bank Regulation*

Federal regulation of banks originated with the National Banking Act of 1863.[2] National supervisory powers over the banking industry were later augmented through passage of the Federal Reserve Act of 1913,[3] Banking Act of 1933,[4] and the Banking Act of 1935.[5] These various pieces of legislation were designed to protect the public's deposits by preventing unsound bank practices which might have resulted in bank failures.[6]

In particular, the banking legislation of the 1930's, which still serves as the major source of contemporary bank regulation, was based upon a Congressional determination that one of the primary reasons for the general financial collapse during the 1930's was excessive competition in banking, which led to unsound banking practices.[7] Consequently, one facet of Congressional attempts to promote bank stability is manifested in statutory provisions designed to minimize unhealthy competition.[8] These statutes impose restraints on competition by preserving markets for existing banks and by reducing pressures on banks to generate income through unwise investments necessitated by excessive rivalry.[9]

Another factor traditionally cited as having contributed to the bank failures of the 1930's was bank involvement in the securities industry. Congressional response to this and other allegedly unsound banking practices involved prohibitions of and restrictions on specified activities[10] in order to separate banking from commerce.[11]

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2. Ch. 106, 13 Stat. 99 (1864) (codified in scattered sections of 5, 12, 18, 19, 28, 31 U.S.C.).

3. Ch. 6, 38 Stat. 251 (1913) (codified in scattered sections of 12, 31 U.S.C.).

4. Ch. 89, 48 Stat. 162 (1933) (codified in scattered sections of 12, 18 U.S.C.).

5. Ch. 614, 49 Stat. 684 (1935) (codified in scattered sections of 12, 18 U.S.C.). For an overview of the development of American banking see J. COCHRAN, MONEY, BANKING, AND THE ECONOMY 59-69 (2d ed. 1967). *See also* AMERICAN BANKERS ASSOCIATION, THE COMMERCIAL BANKING INDUSTRY (1962); M. FRIEDMAN & A. SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES 1867-1960 (1963); L. HILDERMAN, NATIONAL AND STATE BANKS: A STUDY OF THEIR ORIGINS (1931); P. STUDENSKI & H. KROOSS, FINANCIAL HISTORY OF THE UNITED STATES (2d ed. 1963).

6. Leavitt, *The Philosophy of Financial Regulation*, in THE BANK HOLDING COMPANY 4 (R. Johnson ed. 1973).

7. COCHRAN, *supra* note 5, at 90.

8. *See, e.g.*, 12 U.S.C. § 36 (1970) ("need" test for chartering new branches); 12 U.S.C. § 371a (1970) (prohibition of interest payments on demand deposits); 12 U.S.C. § 371b (1970) (limiting maximum interest payable on time and savings deposits).

9. Leavitt, *supra* note 6, at 5.

10. *See, e.g.*, 12 U.S.C. § 24 (1970) (limitation on acquisition of investment obligations); 12 U.S.C. § 51 (1970) (increased capital requirements); 12 U.S.C. § 82 (1970) (limitation on aggregate indebtedness); 12 U.S.C. § 371c (1970) (limitation on operations through and

B. *Growth of the BHC Form*

From 1920 to 1930, the initial growth period of the holding company form, the banking industry experienced a general movement toward consolidation.[12] This phenomenon enabled financially weak banks to join a group system and thereby acquire access to sources of funds readily available to holding companies on capital markets.[13] Inevitably, other banks joined holding companies to maintain their competitive positions.[14]

The financial difficulties of the early 1930's retarded holding company growth: widespread bank failures caused many large groups to suspend operations.[15] Thereafter, the remedial legislation

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relations with affiliates); 12 U.S.C. § 378 (1970) (severe restrictions on acting as an underwriter of securities); 12 U.S.C. § 603 (1970) (restriction on banks purchasing stock in corporations doing foreign business).

The primary limitation on and power source for national banks is contained in the "incidental powers clause." 12 U.S.C. § 24 (seventh) (1970). That section provides in part that an authorized national bank shall have power to "exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking." This statutory language has been interpreted by some as a broad grant of powers and by others as a restriction on the power of national banks. J. WHITE, BANKING LAW 300 (1976). *See also* Huck, *What is the Banking Business*, 21 BUS. LAW. 537 (1966); J. KNOX, HISTORY OF BANKING IN THE UNITED STATES (rev. ed. 1900).

During the 1960's the Comptroller of the Currency promulgated numerous regulations under which national banks were authorized to engage in seemingly "nonbank" activities. *See, e.g.*, 12 C.F.R. § 7.1 (1959), *superseded by*, 12 C.F.R. § 7.7475 (1972) (national banks acting as travel agents) *cited in* Arnold Tours, Inc., v. Camp, 472 F.2d 427, 428 (1st Cir. 1972). The courts subsequently invalidated many of the Comptroller's regulations. *See, e.g.*, Investment Co. Inst. v. Camp, 401 U.S. 617 (1971); First Nat'l Bank v. Dickinson, 396 U.S. 122 (1969); Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972); M & M Leasing Corp. v. Seattle-First Nat'l Bank, 391 F. Supp. 1290 (W.D. Wash. 1975).

In Georgia Ass'n of Independent Ins. Agents v. Saxon, 268 F. Supp. 236 (N.D. Ga. 1967), *aff'd*, 399 F.2d 1010 (5th Cir. 1968), the court struck down a Comptroller's ruling which authorized banks to carry on the business of insurance agents when incidental to a banking transaction. For a discussion of judicial invalidation of a similar regulation promulgated by the Federal Reserve Board in the context of bank holding companies see Part VI *infra*. These judicial constraints may have fostered the growth of the holding company form.

11. It should be noted that to the extent that a BHC and its subsidiaries, both bank and nonbank, are viewed as a single entity and the Bank Holding Company Act, 12 U.S.C. § 1843 (1970), permits nonbanking subsidiaries to exist, the Bank Holding Company Act may be inconsistent with the traditional regulatory concept of separation of banking from commerce. *See, e.g.*, Letter from Board of Governors of the Federal Reserve System to Counsel for Investment Company Institute (March 8, 1974), *reprinted in* [Current] FED. BANKING L. REP. (CCH) ¶ 96,202.

12. Chase, *The Emerging Financial Conglomerate: Liberalization of the Bank Holding Company Act*, 60 GEO. L.J. 1225, 1228 n.9 (1972). *See also* G. FISCHER, AMERICAN BANKING STRUCTURE 95 (1968); *see generally* 23 OKLA. L. REV. 73 (1970).

13. Chase, *supra* note 12, at 1228 n.9.

14. *Id.* This "snowballing effect" also may be attributed to the common practice of circumventing restrictions on branching as well as the widely shared belief that Congress was going to limit holding company growth through remedial legislation. *Id.*

15. *Id.* at 1229.

foreseen by many bankers became a reality in 1933 with the enactment of the Banking Act of 1933.[16]

The Banking Act of 1933[17] did not restrict purchase of bank stock. It merely required that BHCs desirous of acquiring voting stock in member subsidiary banks obtain a voting permit from and submit to scrutiny by the Board. This legislation, however, did not restrict the growth of BHCs. Therefore, in 1938, President Roosevelt sought legislation to regulate the unchecked growth of BHCs.[18] Although the need for such legislation was both pressing and clear,[19] Congressional efforts to enact regulatory statutes proved unsuccessful for eighteen years.[20] The dangers of BHC involvement in nonbanking organizations were brought to Congress' attention as early as 1947.[21] Holding company involvement in nonbanking activity was characterized as a threat to the "disinterested judgment necessary to the sound extension of credit and the protection of the depositor's money."[22] In 1950, this fear was articulated with a greater sense of urgency.

> Whenever a holding company thus controls both banks and nonbanking businesses, it is apparent that the holding company's nonbanking businesses may thereby occupy a preferred position [over] that of their competitors in obtaining bank credit. It is also apparent that in crucial times the holding company which operates nonbanking businesses might be subjected to strong temptation to cause the banks which it controls to make loans to its nonbanking affiliates even though such loans may not at that time be entirely justified in the light of current banking standards. In either situation the public interest becomes directly involved.[23]

Proponents of restrictive legislation also expressed concern over potential conflicts of interest.[24] Furthermore, the fear was expressed that banks would disclose a customer's confidential information to

16. Banking Act of 1933, 48 Stat. 162.

17. *Id.*

18. S. Doc. No. 173, 75th Cong., 3d Sess. 8-9 (1938); Chase, *supra* note 12, at 1230, 1231 n.19.

19. S. REP. No. 300, 80th Cong., 1st Sess. 1 (1947).

20. The Bank Holding Company Act of 1956 was the culmination of the period. Ch. 240, 70 Stat. 133 (1956), *as amended by* Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat: 1760 (codified in scattered sections of 12, 26, 31 U.S.C.).

21. *See A Bill to Provide for Control and Regulation of Bank Holding Companies: Hearings on S. 829 Before the Sen. Comm. on Banking & Currency*, 80th Cong., 1st Sess. 1 (1947).

22. *Id.* at 33.

23. *Bank Holding Bill: Hearings on S. 2318 Before the Subcomm. on Fed. Reserve Matters of the S. Comm. on Banking & Currency*, 81st Cong., 2d Sess. 59 (1950).

24. *Hearings on S. 829, supra* note 21, at 32-33.

a nonbanking holding company affiliate,[25] giving this affiliate an unfair competitive advantage.

With these concerns as a background, the bills introduced in Congress prior to 1956 shared a common purpose: divorcing banking from commerce through forced divestiture of BHC nonbanking interests.[26] The Bank Holding Company Act of 1956[27] ("BHCA") was designed to accomplish this objective.

III. THE BANK HOLDING COMPANY ACT OF 1956

A. *The Statute*

A BHC was defined by the BHCA as any company[28] which owned or controlled twenty-five percent of the voting shares of two or more banks.[29] Companies owning or controlling one bank were excluded. Numerous reasons were proffered to justify this omission. First, the relatively small size of these organizations did not pose a great threat of an undue concentration of economic resources. Second, there was no evidence that holding companies consisting of one bank manifested the evil tendencies of their larger cousins, the multi-bank BHCs. Third, many small banks were owned by family corporations with interests in local businesses other than banks. Inclusion of such one-bank holding companies in the statutory definition would have required divestiture of either the bank or the other business interests. In most situations, the only economically feasible alternative would have been to sell the bank. This would have resulted in decreased competition, since these small banks most likely would have been acquired by multi-bank holding companies.[30]

Under the BHCA, formation of a BHC without prior approval by the Board was deemed unlawful.[31] Subsidiary banks were prohibited from lending to or investing in their parent holding companies or fellow subsidiary banks.[32] Criminal penalties were imposed for

25. *E.g., id.* at 33.

26. *Id.* at 18. *See also* S. 829, 80th Cong., 1st Sess. § 2 (1947) (declaration of policy).

27. Ch. 240, §§ 1-12, 70 Stat. 133, *as amended*, 12 U.S.C. §§ 1841-50, 1971-78 (1970).

28. Company was defined as "any corporation, business trust, association or similar organization" but specifically excluded partnerships. Bank Holding Company Act of 1956, ch. 240, § 2(b), 70 Stat. 133 (1956) (current version at 12 U.S.C. § 1841(b) (1970)). Subsequently, partnerships and similar organizations were included. Act of Dec. 31, 1970, Pub. L. No. 91-607, § 101(c), 84 Stat. 1760.

29. Ch. 240, § 2(a), 70 Stat. 133 (1956) (current version at 12 U.S.C. § 1841(a) (1970)).

30. *See* Chase, *supra* note 12, at 1232 & n.30, 1233 & n.31. *See also* S. REP. No. 1095, 84th Cong., 1st Sess. (1955); Haywood, *Structural and Competitive Objectives*, in THE BANK HOLDING COMPANY (R. Johnson ed. 1973).

31. Ch. 240, § 3(a), 70 Stat. 134 (1956) (current version at 12 U.S.C. § 1842(a) (1970)).

32. Ch. 240, § 6, 70 Stat. 137 (1956) (repealed by Pub. L. No. 89-485, § 9, July 1, 1966,

willful violations of either the BHCA or any regulation or order issued by the Board.[33] Additionally, parties aggrieved by orders of the Board were permitted to obtain judicial review of such orders in the United States Courts of Appeals.[34]

The most important of the features of the BHCA was its proscription, with eight exceptions,[35] of BHC acquisitions, control, or retention of nonbanking concerns.[36] The exception under which insurance agency activity by a BHC subsidiary was permitted provided that:

> (c) The prohibitions in this section shall not apply—
>
> . . . .
>
> (6) to shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board after due notice and hearing, . . . by order has determined to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act.[37]

This provision must be examined in light of the BHCA's legislative history to understand its scope and effect.

B. *Pertinent Legislative History*

The general philosophy of the BHCA of 1956 was "that bank holding companies ought to confine their activities to the management and control of banks and that such activities should be conducted in a manner consistent with the public interest."[38] With regard to nonbanking activities, it was thought that "bank holding companies ought not to manage and control nonbanking assets having no *close relationship* to banking."[39]

William McChesney Martin, Jr., then Chairman of the Board

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80 Stat. 240 (1966)). *See* 12 U.S.C. § 371c (1970) (loans to or purchases of securities of affiliates).

33. Ch. 240, § 8, 70 Stat. 138 (1956) (current version at 12 U.S.C. § 1847 (1970)). Criminal enforcement of the act has been deemed exclusive, precluding the assertion of any rights in civil actions. South Dakota v. National Bank, 335 F.2d 444 (8th Cir. 1964), *cert. denied*, 379 U.S. 970 (1965).

34. Ch. 240, § 9, 70 Stat. 138 (1956) (current version at 12 U.S.C. § 1848 (1970)).

35. Ch. 240, § 4(c)(1)-(8), 70 Stat. 135 (1956) (current version at 12 U.S.C. § 1843(c) (1970)).

36. Ch. 240, § 4(a), 70 Stat. 135 (1956) (current version at 12 U.S.C. § 1843(a) (1970)).

37. Ch. 240, § 4(c)(6), 70 Stat. 137 (1956).

38. S. Rep. No. 1095, 84th Cong., 1st Sess. 1 (1955), *reprinted in* [1956] U.S. Code Cong. & Ad. News 2482.

39. *Id.* (emphasis added).

of Governors of the Federal Reserve System, noted that the principal problems in the BHC field had arisen from two circumstances:

> (1) The unrestricted ability of a bank holding company group to add to the number of its banking units, making possible the concentration of commercial bank facilities in a particular area under a single control and management; and
> (2) The combination under single control of both banking and nonbanking enterprises, permitting departure from the principle that banking institutions should not engage in business wholly unrelated to banking.[40]

Requiring prior Board approval of BHC formation or acquisitions[41] was directed at solving the first problem. Requiring BHC divestiture of nonbanking interests went to the second.[42] Generally, the legislation represented an attempt to regulate expansion of BHCs and to require divestiture of their nonbanking interests.[43] As indicated above, several exceptions were made to the Act's divestiture requirement.[44] One such exception involved insurance agency activities.

In discussing the exception under which nonbank subsidiaries of BHCs might conduct insurance agency activities, the Senate Committee on Banking and Currency reported that:

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40. *Id.* at 2, [1956] U.S. CODE CONG. & AD. NEWS at 2483.

41. *See* note 31 *supra* and accompanying text.

42. *See* notes 35-37 *supra* and accompanying text.

43. S. REP. No. 1095, 84th Cong., 1st Sess. 4 (1955), *reprinted in* [1956] U.S. CODE CONG. & AD. NEWS 2482, 2485. It should be reiterated that when Congress enacted the BHCA of 1956, it was aware of possible tying problems created through BHC involvement in nonbanking activities. The Senate Report on the bill indicated that:

> The committee was informed of the danger to a bank within a bank holding company controlling nonbanking assets, should the company unduly favor its nonbanking operation by requiring the bank's customers to make use of such nonbanking enterprises as a condition to doing business with the bank. The bill's divestment provisions should prevent this fear from becoming a reality.

S. REP. No. 1095 at 5, [1956] U.S. CODE CONG. & AD. NEWS at 2486. The House Committee on Banking and Currency expressed similar sentiments.

> If banks were permitted to own nonbanking businesses they would be compelled in many instances to extend credit to such businesses to the detriment of other competitive businesses in the community and possibly also to a degree which would be unsound from a banking viewpoint. A bank should always be at arms' length with its borrowers and such a position could not be maintained were banks permitted to own nonbanking businesses and make credit available to them. Through the bank holding company device these restraints which are placed on banks generally are absent.

H. REP. No. 609, 84th Cong., 1st Sess. 7 (1955).

44. In the words of the Senate Committee: "Appropriate exceptions are made in the bill in order to enable bank holding companies to retain ownership and control of nonbanking assets in cases where such retention will not violate the purposes of the bill." S. REP. No. 1095, *supra* note 38, at 2, [1956] U.S. CODE CONG. & AD. NEWS at 2493.

> Exemption (6) has been included by the committee as a necessary provision to enable the administering authority under this bill to permit the retention by a bank holding company of activities found to be closely related to banking . . . . For example, the operation of a credit life-insurance program in connection with bank loans is clearly within the scope of banking operations *as presently conducted*. So is the operation of an insurance program under which the insurance proceeds retire the outstanding balance of the mortgage upon the death of the mortgagor in cases where the bank holds the mortgage. However, there are many other activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity.[45]

This language suggests that the drafters of the BHCA envisioned the closely related test to function in two ways. Certain activities, by their very nature, would be deemed, a priori, closely related to the business of banking and, therefore, within the exemption. Other activities *might* be deemed closely related, but would require a careful factual examination before the exemption would become available. Oddly enough, the committee seemed to suggest that the scope of banking operations *as then carried on* would have some bearing on the determination of whether a nonbanking activity was closely related to the business of banking. Existing bank practices should have had no bearing on such determinations since these practices were the targets, not the standards, for the remedial legislation. Despite this inconsistency in the legislative history, the Board undertook the responsibility of administering the Bank Holding Company Act of 1956, beginning with the promulgation of Regulation Y.

C. *The Administrative Aftermath*

1. REGULATION Y

The Board issued the original Regulation Y,[46] pursuant to the BHCA, in 1956.[47] Section 5 of the regulation dealt with BHC interests in nonbanking organizations. It provided in pertinent part as follows:

> (b) **Shares of financial, fiduciary, or insurance companies.** Any bank holding company which is of the opinion that a com-

45. *Id.* at 13, [1956] U.S. CODE CONG. & AD. NEWS at 2494 (emphasis added).
46. 12 C.F.R. § 222 (1956) (current version at 12 C.F.R. § 225 (1977)).
47. 42 Fed. Res. Bull. 834-40 (1956).

> pany all the activities of which are of a financial, fiduciary, or insurance nature is so closely related to the business of banking or of managing or controlling banks, *as conducted by such bank holding company or its banking subsidiaries*, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act, may request the Board for such a determination pursuant to section 4(c)(6) of the Act.[48]

The emphasized language in the regulation clearly contemplated that the Board would construe the BHCA on the basis of how various banks conducted their business in a geographic market. This approach permitted Board approval of an application to engage in a proposed nonbanking activity in one part of the country and disapproval of an identical application in another part of the country.[49]

2. BOARD ORDERS: 1956-1970

In the fourteen years from the enactment of the BHCA of 1956 to the 1970 amendments[50] to that Act, the Board approved approximately ninety-two percent of all applications by BHCs to engage in insurance activities, whether as agency or underwriter.[51] In making a determination of whether the statutory exemption was applicable, the Board developed a three-step analysis. First, the Board examined the nature of the activity to determine whether it was of a financial, fiduciary, or insurance nature. Second, the Board questioned whether the proposed activity had a sufficiently close relationship to the business of banking as conducted by such bank

48. 12 C.F.R. § 222.5(b) (1956), *reprinted in* 42 Fed. Res. Bull. 838 (1956) (emphasis added).

49. *See* notes 77-80 *infra* and accompanying text.

50. Act of Dec. 31, 1970, Pub. L. No. 91-607, 84 Stat. 1760.

51. The Board issued orders in approximately 25 applications, denying only two. The authors were able to locate and examine the following Board orders: Citizens & Southern Holding Co., 55 Fed. Res. Bull. 673 (1969); Otto Bremer Co., 55 Fed. Res. Bull. 388 (1969); Denver U.S. Bancorporation, Inc., 54 Fed. Res. Bull. 233 (1968); Otto Bremer Co., 53 Fed. Res. Bull. 1555 (1967); First Virginia Corp., 53 Fed. Res. Bull. 373 (1967); First Oklahoma Bancorporation, Inc., 51 Fed. Res. Bull. 676 (1965); Otto Bremer Co., 49 Fed. Res. Bull. 1389 (1963); Virginia Commonwealth Corp., 49 Fed. Res. Bull. 934 (1963); Otto Bremer Co., 47 Fed. Res. Bull. 1039 (1961); Montana Shares, Inc., 47 Fed. Res. Bull. 767 (1961); St. Joseph Agency, Inc., 47 Fed. Res. Bull. 290 (1961); Otto Bremer Co., 46 Fed. Res. Bull. 621 (1960); Union Bond & Mortg. Co., 46 Fed. Res. Bull. 152 (1960); Wisconsin Bankshares Corp., 45 Fed. Res. Bull. 1136 (1959); First Virginia Corp., 45 Fed. Res. Bull. 1247 (1959); Northwest Bancorporation, 45 Fed. Res. Bull. 963 (1959); Bank Shares, Inc., 45 Fed. Res. Bull. 954 (1959); First Bank Stock Corp., 45 Fed. Res. Bull. 932 (1959); Otto Bremer Co., 45 Fed. Res. Bull. 892 (1959); General Contract Corp., 44 Fed. Res. Bull. 260 (1958); Transamerica Corp., 43 Fed. Res. Bull. 1014 (1957).

holding company or its banking subsidiaries. Finally, the Board had to decide whether surrounding circumstances were such that the proposed activity was a "proper incident" to the business of banking (i.e. whether ownership of the nonbanking interests would be consistent with the purposes of the Act). Each of these requirements will be examined separately below.

a. *Nature of the Activity*

By definition, applications to engage in insurance agency activities satisfy the requirement that all the activities of the existing or proposed nonbank BHC subsidiary were of a financial, fiduciary, or insurance nature.[52] On one occasion an applicant sought approval to engage in other activities in addition to that of an insurance agent. The Board granted the application on a conditional basis, requiring termination of the applicant's other activities.[53] Therefore, in regard to applications to engage in insurance agency activities, Board orders turned on the other two steps in the analysis: close relationship and proper incident.

b. *Close Relationship*

The requisite nexus between the business of banking and financial, fiduciary, and insurance activities generally took three forms: historical affiliation, qualitative integration, and quantitative integration.

Historically, many banks had been offering insurance agency services through an unincorporated department of the bank.[54] Where the Board found that the practice of operating insurance agencies in connection with banks had occurred in a particular geographic area without objection from local bank supervisory authorities, the Board accorded cumulative, but not conclusive, weight to such area practice as supporting a finding that the requisite nexus was present.[55] The closeness of the relationship could be confirmed by such long-settled area practice where banks and supervisory authorities had come to view insurance services as part of a well-rounded financial service[56] and a legitimate competitive device.[57]

52. *See, e.g.*, Transamerica Corp., 43 Fed. Res. Bull. 1014 (1957).

53. *See, e.g.*, Otto Bremer Co., 45 Fed. Res. Bull. 892 (1959) (requiring termination of lending and real estate activities).

54. *See, e.g.*, Otto Bremer Co., 49 Fed. Res. Bull. 1389, 1390 (1963); Otto Bremer Co., 47 Fed. Res. Bull. 1039, 1041 (1961); First Bank Stock Corp., 45 Fed. Res. Bull. 917, 929 (1959).

55. *E.g.*, Otto Bremer Co., 45 Fed. Res. Bull. 892, 895 (1959).

56. *Id.* at 899.

57. *Id.*

Moreover, many bank customers had come to expect insurance as part of bank services.[58] The Board specifically found that enactment of the BHCA did not diminish the weight to be afforded such area practice.[59]

Apart from area practice, the Board often found the requisite close relationship where there was a high degree of physical, organizational, and operational integration.[60] The common indicia of such integration were sharing of physical office space, employees and operating procedures. This qualitative integration also was accorded cumulative weight in supporting a finding that the requisite nexus was present.[61] Furthermore, the Board suggested that "such physical and personnel relationships may be regarded as giving rise to a presumption that the activities of the insurance agencies are 'related' or incidental to the business of the subsidiary banks."[62]

Quantitative integration was the final factor examined in ascertaining whether the relationship to banking was sufficient. In this regard, the Board was concerned with that portion of the insurance agency activities that were directly related to bank transactions and the extent to which the bank's business was dependent upon the activities of the insurance agency. Analysis centered on the amount of insurance written for: (a) borrowers on loan collateral; (b) borrowers on something other than loan collateral; (c) bank customers other than borrowers (e.g. depositors, safety deposit box holders, trust department clients, etc.); and (d) nonbank customers (i.e. the public at large).[63] The Board did *not* require that a majority or substantial part of the insurance written be on collateral of borrowers.[64] Rather, the Board merely required that there must have been "some direct and significant connection between [an insurance subsidiary's] activities and the business conducted by the related subsidiary banks in order to justify a conclusion that the requisite close relationship exists."[65] As with historical affiliation and qualitative integration, quantitative integration was accorded cumulative weight.[66]

58. Northwest Bancorporation, 45 Fed. Res. Bull. 963, 968 (1959).
59. *Id.* at 969. *But see* notes 45-46 *supra* and accompanying text.
60. Otto Bremer Co., 45 Fed. Res. Bull. 892, 895 (1959).
61. *Id.*
62. First Bank Stock Corp., 45 Fed. Res. Bull. 917, 930 (1959).
63. *See generally* Otto Bremer Co., 55 Fed. Res. Bull. 388 (1969).
64. Bank Shares, Inc., 45 Fed. Res. Bull. 954, 957 (1959).
65. *Id. See also* Otto Bremer Co., 55 Fed. Res. Bull. 388, 393-95 (1969) (Board rejected hearing examiner's recommendation that, since *all* of the insurance activities were not related to bank transactions, application be denied).
66. First Bank Stock Corp., 45 Fed. Res. Bull. 917, 931 (1959).

c. *Proper Incident*

If an activity was of a financial, fiduciary, or insurance nature and had a sufficient nexus to the business of banking through one of these three factors, the Board's inquiry then focused on whether an activity was a "proper incident." Since the overwhelming number of applications easily satisfied the "nature of the activity" and "close relationship" requirements, the real issue posed in applications by BHCs to perform insurance agency activities through nonbanking subsidiaries was whether these activities were a proper incident to the business of banking or of managing or controlling banks.[67]

With regard to a working definition of "proper incident," the Board suggested that "[s]ection 4(c)(6) [was] intended to exempt only those nonbanking businesses that 'usually' or 'naturally' 'depend upon' or 'appertain to' the business of banking or of managing or controlling banks."[68] In light of the broad language of this working definition, the Board went on to qualify its remarks by stating that:

> If a nonbanking business is a "proper incident" to banking or to managing or controlling banks, that is if it properly and "naturally appertains" thereto, it is less likely to cause a bank to be influenced by the "unnatural" or extraneous considerations or temptations that are "potential sources of evil." Hence, it is more likely to accord with the "purposes of the Act."
>
> In other words, when Section 4(c)(6) refers to "proper incident" and to the "purposes of this Act" it uses the terms jointly to limit the exemption in the section to situations which substantially escape the "potential sources of evil" against which the general prohibition was directed.[69]

The potential evils alluded to included, *inter alia*, the fear "that a holding company, in extending credit, might exert pressure on borrowers to do business with the lending bank's affiliated corporations rather than with their competitors, thus denying those borrowers an appropriate freedom of choice."[70] One hearing examiner found that this potential source of evil existed where an insurance agency was operated in conjunction with bank lending activities.[71]

67. General Contract Corp., 44 Fed. Res. Bull. 260, 295 (1958) (hearing examiner's recommendation).

68. Transamerica Corp., 43 Fed. Res. Bull. 1014, 1015 (1957). Note that section 4(c)(6) was redesignated section 4(c)(8). Act of July 1, 1966, Pub. L. No. 89-485, § 8(b), 80 Stat. 239.

69. Transamerica Corp., 43 Fed. Res. Bull. 1014, 1016-17 (1957).

70. *Id.* at 1016. *See generally* notes 21-27 *supra* as well as accompanying text.

71. General Contract Corp., 44 Fed. Res. Bull. 260, 295 (1958).

The Board, however, did not pass upon this conclusion since the applicant did not file the appropriate exceptions for Board review and, therefore, was deemed to have abandoned any objections to the hearing examiner's recommended decision.[72] Additionally, the Board broadened the section 4(c)(6) exemption by holding that only evils "peculiar to" the operation of a bank holding company, as distinguished from those evils occasioned by all banks whether or not affiliated with a holding company, were the targets of the BHCA.[73] This posture virtually assured the approval of every bank application to become a BHC through affiliation with a nonbank insurance subsidiary, where such bank had offered insurance agency services in a geographic area through an unincorporated department. In other words, area practice presumably negated the existence of potential evils peculiar to BHCs, thereby rendering the proposed activity a proper incident.[74]

Giving such weight to area practice might have led to exemptions in one part of the country and to denials elsewhere.[75] Although such results would have been consistent with Regulation Y,[76] there was some question as to whether such a result was consistent with the purposes of the BHCA.[77] The Board felt that it was.[78]

d. *Factors & General Rules*

The foregoing indicates that the Board asked the following

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72. *Id.* at 262.

73. In particular, the Board said:

> Section 4 was clearly not intended to remove *all* potential sources of evil in the banking field; it was directed at those that may be said to arise from, or be accentuated by, the operation of *bank holding companies*. Accordingly, it is important to determine whether a particular type of relationship is peculiar to banks in holding company groups, or, on the other hand, is prevalent among both holding company and nonholding company banks. If the latter circumstance prevails, it suggests that any 'potential evils' that may be inherent in the relationship are not of the kind against which Section 4 of the Holding Company Act was directed.

First Bank Stock Corp., 45 Fed. Res. Bull. 917, 932 (1959).

74. *Id.*

75. Bank Shares, Inc., 45 Fed. Res. Bull. 954, 959 (1959).

76. *Id.*

77. General Contract Corp., 44 Fed. Reg. Res. Bull. 260, 295-96 (1958). The applicant in *General Contract* had argued that federal law should be applied uniformly in each state so as not to require divestment in one state while allowing retention in another. The test offered by the applicant was "whether a particular activity is a 'proper incident' to the business of banking generally, and this should be based upon a uniform Federal policy, with the application of State law left as a matter of State concern." *Id.* The hearing examiner's response, which the Board never discussed, was that the proper standard to be applied was that furnished by the statute, namely, whether the proposed activity might tend to influence banks to pressure borrowers into doing business with affiliates. *Id.* at 296.

78. Bank Shares, Inc., 45 Fed. Res. Bull. 954, 959 (1959).

questions in determining whether an activity was to be permitted despite the prohibitions of section 4 of the BHCA: (1) Was there a general practice in the area for banks to have a related insurance agency? (2) Was this practice long-settled and without opposition from local supervisory bank authorities? (3) Was the physical relationship of the agency to the bank such that the former would operate from the latter's quarters? (4) Were bank employees engaged in the operation of the agency? (5) Were the operations of the agency intimately related to the operation of the bank? (6) Was a substantial part of the agency business done with bank customers? (7) Was the relationship between insurance agencies and banks prevalent in nonholding company banks as well as holding company banks?[79]

When the responses to all of these questions were affirmative, applications were approved without exception.[80] Nevertheless, it should be emphasized that the Board's analysis rarely consisted of an independent examination of whether public benefits to be derived from the proposed activity would outweigh adverse effects.[81] Although such a balancing test was not required by the BHCA, as originally enacted, some hearing examiners did make recommendations based on such a test. For example, in *First Virginia Corp.*,[82] the Board approved an application for the expansion of insurance activity to include the issuing and underwriting of credit life, health and accident insurance to borrowers of the applicant's banking affiliates. The Board adopted the hearing examiner's findings of fact, conclusions of law, and recommendations in approving the application.[83] This order is of unique importance in that it involved the first "public benefits" analysis by a hearing examiner.[84] Perhaps this

79. *See* Union Bond & Mortg. Co., 46 Fed. Res. Bull. 152, 156 (1960). *See also* Otto Bremer Co., 47 Fed. Res. Bull. 1039, 1042 (1961). In *Otto Bremer* the hearing examiner stated the general rule as follows:

> Where there are close historical, physical, and personnel relationships between the operations of a bank and of a connected insurance agency, and these relationships are sanctioned or not disapproved by local governmental authority, and where the arrangements have a wide acceptance in area practice, the insurance activity may be a proper incident of banking, and ownership of the insurance company's shares by a bank holding company appropriately exempted from the prohibition requirement of Section 4.

Id.

80. *See* note 51 *supra*.

81. *See, e.g.*, Virginia Commonwealth Corp., 49 Fed. Res. Bull. 934, 937 (1963) (writing of insurance coverage would improve competitive position and facilitate operations); Otto Bremer Co., 47 Fed. Res. Bull. 1039, 1041 (1961) (insulate bank from any liability arising out of operation of agencies by reason of their close association with bank).

82. 53 Fed. Res. Bull. 373 (1967).

83. *Id.* at 374.

84. The conclusion reached by the hearing examiner, which demonstrates an appreciation of a "public benefits" test, read as follows:

Board order, and subsequent orders[85] issued prior to the 1970 amendments to the BHCA, reflects a sensitivity to the growing Congressional concern which ultimately led to the 1970 amendments to the Bank Holding Company Act.[86]

IV. 1970 BHCA AMENDMENTS

A. *The Statute*

The 1970 amendments to the BHCA were designed in large part to expand the Act's coverage.[87] This objective was accomplished through definitional modifications. The definition of a BHC[88] was enlarged so as to include those companies owning or controlling only one bank.[89] Additionally, partnerships were included within the definition of "company,"[90] thereby subjecting them to the prohibitions and restrictions of the BHCA for the first time. The definition of "control" over a bank was expanded,[91] further broadening the definition of a BHC. Under the BHCA of 1956, "control" was defined as ownership or control of twenty-five percent of any class of a company's voting securities[92] or control over the election of a majority of directors.[93] The amendments provided that control also existed if "the Board determines . . . that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company."[94]

> [W]here as here, an applicant demonstrates that its nonbanking subsidiary will have the experience and resources adequate to maintain a successful credit insurance program and that it will be conducted in a manner consistent with the fiduciary role of its affiliated banks, while, at the same time, providing a needed service not otherwise available to the borrowing public, it is clear that the exemption should be allowed as in harmony with the purposes of the Act.

Id. at 379.

85. *See* Denver U.S. Bancorporation, Inc., 54 Fed. Res. Bull. 233, 240 (1968).

86. Act of Dec. 31, 1970, Pub. L. No. 91-607, 84 Stat. 1760.

87. Comment, *Implementation of the Bank Holding Company Act Amendments of 1970: The Scope of Banking Activities*, 71 MICH. L. REV. 1170, 1176 (1973).

88. *See* note 28 *supra* and accompanying text.

89. Pub. L. No. 91-607, § 101, 84 Stat. 1760 (1970).

90. *Id.*

91. *Id.*

92. Bank Holding Company Act of 1956, ch. 240, § 2(a)(1), 70 Stat. 133, *as amended*, 12 U.S.C. § 1841(a)(2)(A) (1970).

93. Bank Holding Company Act of 1956, ch. 240, § 2(a)(2), 70 Stat. 133, *as amended*, 12 U.S.C. § 1841(a)(2)(B) (1970).

94. Pub. L. No. 91-607, § 101(a), 84 Stat. 1760 (1970), *codified at* 12 U.S.C. § 1841 (a)(2)(C) (1970). However, Congress also fashioned an irrebutable presumption that any company holding power to vote less than five percent of any class of voting securities does not have control of the bank. Pub. L. No. 91-607, § 101(a), 84 Stat. 1761 (1970), *codified at* 12 U.S.C. § 1841(a)(3) (1970).

Congress also saw fit to carve out certain exemptions from the Act's coverage. Certain one-bank holding companies were excluded[95] while others found exemptions under a "grandfather" clause.[96]

Perhaps the two most significant amendments involved permissible nonbanking activities[97] and prohibitions of tie-ins.[98]

1. PERMISSIBLE NONBANKING ACTIVITIES

The original BHCA allowed BHCs to engage in activities "of a financial, fiduciary, or insurance nature" deemed so "closely related to the business of banking" as to be a "proper incident" thereto.[99] The 1970 amendments changed the language of this exemption and the activities permissible thereunder. The amended language reads as follows:

> (c) The prohibitions in this section shall not apply to
>
> . . . .
>
> (8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities

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95. Bank Holding Company Act of 1956, § 4(d), Pub. L. No. 91-607, § 103(7), 84 Stat. 1766 (1970), *codified at* 12 U.S.C. § 1843(d) (1970). For a discussion of the reasons underlying these exemptions see S. REP. No. 91-1084, 91st Cong., 2d Sess. 1 (1970), *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5527-30; CONFERENCE REPORT No. 91-1747, 91st Cong., 2d Sess. 1 (1970), *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 3573-76.

96. Bank Holding Company Act of 1956, § 4(a)(2), Pub. L. No. 91-607, § 103(1), 84 Stat. 1763 (1970), *codified at* 12 U.S.C. § 1843(a)(2) (1970). For a discussion of the reasons underlying the grandfather privileges see S. REP. No. 91-1084, 91st Cong., 2d Sess. 1 (1970), *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5522-24; CONFERENCE REPORT No. 91-1747, 91st Cong., 2d Sess. 1 (1970), *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5577-79.

97. Bank Holding Company Act of 1956, § 4(c)(8), Pub. L. No. 91-607, § 103(4), 84 Stat. 1764-65 (1970), *codified at* 12 U.S.C. § 1843(c)(8) (1970).

98. Pub. L. No. 91-607, § 106, 84 Stat. 1766 (1970), *codified at* 12 U.S.C. §§ 1971-78 (1970).

99. Bank Holding Company Act of 1956, ch. 240, § 4(c)(6), 70 Stat. 137 (1956). *See also* text accompanying notes 34-37 *supra*.

> commenced by the acquisition, in whole or in part, of a going concern . . . .[100]

2. ANTI-TYING PROVISIONS

Another major amendment of the BHCA dealt with tying arrangements involving banks. The anti-tying provisions read as follows:

> A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement —
>
> (1) that the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service;
>
> (2) that the customer shall obtain some additional credit, property, or service from a bank holding company of such bank, or from any other subsidiary of such bank holding company;
>
> (3) that the customer provide some additional credit, property, or service to such bank, other than those related to and usually provided in connection with a loan, discount, deposit, or trust service;
>
> (4) that the customer provide some additional credit, property, or service to a bank holding company of such bank, or to any other subsidiary of such bank holding company; or
>
> (5) that the customer shall not obtain some other credit, property, or service from a competitor of such bank, a bank holding company of such bank, or any subsidiary of such bank holding company, other than a condition or requirement that such bank shall reasonably impose in a credit transaction to assure the soundness of the credit.
>
> The Board may by regulation or order permit such exceptions to the foregoing prohibitions as it considers will not be contrary to the purposes of this chapter.[101]

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100. Pub. L. No. 91-607, § 103(4), 84 Stat. 1764-65 (1970), *codified at* 12 U.S.C. § 1843 (c)(8) (1970).

101. Pub. L. No. 91-607, § 106(b), 84 Stat. 1766-67 (1970), *codified at* 12 U.S.C. § 1972 (1970).

B. *The Legislative History*

1. INCLUSION OF ONE-BANK HOLDING COMPANIES

As indicated previously,[102] Congress had consciously chosen to exclude from the original Act's coverage holding companies which owned or controlled only one bank.[103] "Beginning in late 1967, however, a great number of the banks with assets in excess of $1 billion [became] affiliated with nonregulated one-bank holding companies."[104] This growth was perceived as a tendency toward cartelization of the economy and as a threat to the longstanding policy of separating banking from commerce.[105] Consequently, it was deemed necessary to bring these one-bank holding companies within the BHCA to guard against possible future abuses.[106]

2. CONTROL PROVISION

The expanded definition of control reflected a Congressional awareness that the affairs of a company may be controlled without owning twenty-five percent or more of its outstanding voting stock.[107] On the other hand, Congress also perceived that ownership of less than five percent could never constitute a controlling position.[108]

3. ANTI-TYING PROVISION

Many, if not all, of the provisions of the BHCA are addressed to the problem of misuse of economic power. In particular, banks possess economic power capable of being employed in undesirable ways: the use of economic power could lead to a lessening of competition or unfair competitive practices.[109] The anti-tying provisions of the BHCA were intended to prevent such abuses of economic power.[110] The Senate Committee on Banking and Currency reported

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102. *See* notes 28-30 *supra* and accompanying text.

103. Congress made this decision twice, in 1966 as well as 1956. *See* S. REP. No. 91-1084, 91st Cong., 2d Sess. 1 (1970), *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5520-21 (hereinafter referred to as S. REP. No. 91-1084).

104. *Id.* at 3, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS at 5521.

105. *Id.* at 3, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS at 5522.

106. *Id.*

107. *Id.* at 6, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS at 5524.

108. *Id.* at 6, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS at 5525. *See also* notes 91-94 *supra* and accompanying text.

109. *Id.* at 16, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS at 5535.

110. *Id.* Congress was also aware that such misuse of power was possible regardless of whether the bank is affiliated with a holding company or not. *Id.* This is contrary to some positions taken by the Board in passing on applications to engage in nonbanking activities. *See* note 73 *supra.*

that "[t]he purpose of this provision is to prohibit anti-competitive practices which require bank customers to accept or provide some other service or product or refrain from dealing with other parties in order to obtain the bank product or service they desire."[111]

It should be emphasized, however, that the anti-tying provisions of the BHCA are only effective in dealing with overt, coercive tying efforts by BHCs. As will be discussed at length below,[112] there is another more subtle form of tying which this provision is unable to combat and which may exist uniquely in credit transactions.

4. PERMISSIBLE NONBANKING ACTIVITIES

The underlying purpose and effect of the 1970 amendments to 12 U.S.C. § 1843(c)(8) have been the subject of much debate. One group maintains that the amendments were designed to retain the traditional separation of banking and commerce through more restrictive legislation.[113] The other group claims that the legislation was designed to broaden the range of activities in which BHCs could engage.[114] The opponents differ as to the purpose and effect of the two statutory tests[115] contained in the current version of the BHCA. The particular views of the opposing parties are presented below.

a. *Restrictive View*

The restrictive forces were led by Wright Patman, Chairman of the House Committee on Banking and Currency. Chairman Patman maintained that the House-Senate conferees' decision to accept the "closely related" test and reject the "functionally related"[116] test, advanced by advocates of an expansive approach, supports the insurance industry position that Congress did not intend to expand or liberalize the Act. The insertion of the "public benefits" test was viewed as establishing a more stringent standard than the 1956 Act.[117] Finally, Chairman Patman contended that the amendments required a "direct connection" between a proposed activity and an

111. *Id.*

112. *See* text accompanying notes 306-26 *infra*.

113. *See* Chase, *supra* note 12, at 1238.

114. *Id.*

115. Those tests, the "closely related" test and "public benefits" test are discussed hereafter. *See* Part VI *infra*.

116. Both the House and Senate had initially adopted versions of a bill to amend the BHCA which would have provided an exemption for activities "functionally related" to banking, such that their performance by a bank holding company affiliate reasonably could be expected to produce benefits to the public that would outweigh possible adverse effects. *See* S. REP. No. 91-1084, 91st Cong., 2d Sess. 12 (1970).

117. *See* 116 CONG. REC. 41,950-51 (1970).

activity banks were already authorized to perform.[118] Inclusion of insurance activities on the "laundry list" in the House bill[119] was additional evidence of the intent of the majority of the House conferees to limit permissible nonbanking activities.

b. *Expansive View*

The Senate conferees and a minority of the House conferees interpreted the language of the amendments as broadening the range of activities in which a BHC could engage. The following remarks by senatorial participants in the enactment of the BHCA amendments are indicative of the positions taken by the expansive forces.

> [The bill] frees the Board of the restrictive precedents established under the present act. . . . Furthermore, it defines "a proper incident" to banking in very broad terms of various benefits to the public as opposed to possible adverse effects.[120]
>
> The House managers' statement regarding the meaning of section 4(c)(8) is in my opinion a misconstruction of fact. It is hard for me to conceive of any way that an objective person present at the conference could interpret section 4(c)(8) as was done in that statement.[121]
>
> [Section 4(c)(8) as amended] retains [from the original Senate bill] maximum flexibility for the Federal Reserve Board to determine the activities in which a bank holding company and its subsidiaries may engage. . . .[122]

In sum, the proponents of a liberal and expansive application of the BHCA felt that:

> the Amendments would free the Board of the restrictions of the 1956 Act and would allow activities to be related to the business of banking generally, rather than perpetuate the concept that such activities must be related to the specific business carried on by the subsidiary banks of the particular holding company involved.[123]

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118. H. R. REP. No. 1747, 91st Cong., 2d Sess. 21 (1970).

119. The "laundry list" contained those activities in which BHCs were prohibited from engaging. In addition to insurance agency activities, BHCs and their subsidiaries would have been prohibited from engaging in the business of maintaining travel agencies; providing auditing or other professional services in the field of accounting; providing data processing services, except as incident to banking services; leasing property; and selling mutual funds. *See* 115 CONG. REC. 33,133-34 (1969). This "laundry list" was rejected in conference and did not appear in the final version of the amendments enacted into law.

120. 116 CONG. REC. 42,422-24 (1970).

121. 116 CONG. REC. 42,432 (1970) (remarks of Senator Bennett).

122. *Id.*

123. Chase, *supra* note 12, at 1238-39 & n.67. *See* 116 CONG. REC. 42,953-54 (1970)

V. THE INSURANCE INDUSTRY—BHC CONTROVERSY

A. *The Insurance Regulation*

Immediately following the 1970 amendments the Board, in January 1971, proposed a new Regulation Y[124] for the purpose of designating certain activities as "closely related" to banking.[125] The regulation lists as an activity closely related to banking:

> (9) acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following type of insurance:
>
> (i) Any insurance for the holding company and its subsidiaries;
>
> (ii) Any insurance that (a) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (b) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (c) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(c) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);
>
> (iii) Any insurance sold in a community that (a) has a population not exceeding 5,000, or (b) the holding company demonstrates that it has inadequate insurance agency facilities. . . .[126]

B. *Intervention by Insurance Forces*

1. GENERAL DEARTH OF INTERVENORS

As noted above,[127] the Board received approximately twenty-five applications to engage in insurance activities in the period between 1956 and 1970. In contrast, between January 1971 and December 1976, the Board permitted 625 notifications to engage de novo in insurance agency activities.[128] Between June 1972 and De-

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(remarks of Congressman Widnall); 116 CONG. REC. 42,424 (1970) (remarks of Senator Sparkman).

124. 12 C.F.R. § 225.4 (1977).

125. 36 Fed. Reg. 1430 (1971). On May 12, 1971, hearings were held on 12 C.F.R. § 225.4(a)(9) (1977), the insurance agency regulation, and on August 10, 1971, the Board announced its adoption.

126. 12 C.F.R. § 225.4(a)(9) (1977).

127. *See* notes 50-51 *supra* and accompanying text.

128. Carter H. Golembe Associates, Inc., Bank Holding Company *De Novo* Insurance Agency Expansion (Feb. 24, 1977) (unpublished memorandum on reserve at the office of the University of Miami Law Review).

cember 1976, the Board approved 119 applications to acquire ongoing insurance agencies.[129] Although the BHCA affords an opportunity for anyone who would become a competitor of the BHC if its application were approved to object to the approval of each of these applications,[130] most applications have been approved without challenge.

One reason for the dearth of intervenors is that many applications sought approval to sell only credit life, health and accident insurance and mortgage redemption insurance. As noted by the Board in *Worcester Bancorp, Inc.*,[131] in which life underwriting associations participated as intervenors, the legislative history of the BHCA indicates that Congress clearly intended that these kinds of insurance be considered closely related to banking.[132] In addition, these types of insurance generally involve small commissions which often do not justify the transaction costs in terms of the agent's time. Consequently, few, if any, agents are interested in selling these types of insurance.[133] The limited chance of obtaining a favorable Board ruling, particularly after *Worcester Bancorp, Inc.*, combined with the small commissions involved, have resulted in approval of these applications generally without objection by intervenors.

Another explanation for the low rate of intervention is found in the unique structure of the insurance industry.[134] The industry can be broken down into two groups: underwriters, who are in a sense the wholesalers; and agents, who are the retailers. The underwriters originate the policies, receive all premiums except the agent's commission, and pay claims. The underwriters are classified into two distinct groups: those who operate through the American agency system, and the "direct writers." Agents are the retail sales force that market the insurance policies to the public.

The American agency companies market their policies through "independent agents." These agents are not employed by any one

129. Carter H. Golembe Associates, Inc., Bank Holding Company Acquisitions of On-Going Insurance Agencies (Feb. 24, 1977) (unpublished memorandum on reserve at the office of the University of Miami Law Review).

130. 12 U.S.C. § 1850 (1970).

131. 60 Fed. Res. Bull. 393 (1974).

132. *Id.* at 395.

133. *Id.*

134. *See generally* Carter H. Golembe Associates, Inc., Lenders Acting as Insurance Agents: Public Policy Considerations (June 1975) (unpublished manuscript on reserve at office of the University of Miami Law Review) (hereinafter referred to as Golembe); Independent Insurance Agents of America, Bank Holding Company Property and Casualty Insurance Agencies: Is the Public Likely to Benefit? (undated, unpublished manuscript on reserve at the office of the University of Miami Law Review) (hereinafter referred to as IIAA).

underwriter. Generally, they represent more than one company, are compensated by commissions and theoretically place the customer's insurance with the underwriter who offers the policy most suited to that customer's particular needs. There are an estimated 75,000 agencies in the nation,[135] employing upwards of 300,000 agents,[136] with the vast majority employing four or fewer agents.[137] The direct writers, on the other hand, market their policies either by mail, through salaried representatives, or through exclusive or "captive agents" who represent only one underwriter.

A significant difference between independent agents and captive agents is that independent agents own their renewals, which means that the agent is free to decide to place the insurance with a different underwriter when the policy expires. This difference begets other differences. It results in somewhat lower premiums for direct written insurance since the direct writers pay little or no commission on renewals. Furthermore, salaried and captive agents must concentrate on generating new business, while independent agents have an incentive to focus a significant amount of their time on servicing existing accounts. The independent agents argue that in return for the higher cost of the policies they sell, the consumer receives the benefit of having an agent who will seek out the most appropriate policy at the best price, who will provide continuing expert service and counselling, and who will act as the consumer's representative in dealings with the underwriter, particularly where claims are involved.

Most BHC activity in the insurance area has concentrated on acting as agents, not underwriters, because Regulation Y only permits very limited underwriting activity.[138] When a BHC subsidiary acts as an insurance agency it markets the underwriters' policies just like agencies who are not BHC subsidiaries. Thus, BHC insurance subsidiaries do not generally compete with the underwriters, rather they become new outlets for the underwriters' policies. This may explain why underwriters have shown no interest in joining the independent agents in their efforts to contain BHC agency activity.[139]

Consequently, independent agents are the group most seriously

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135. IIAA, *supra* note 134, at 6.

136. Golembe, *supra* note 134, at 26.

137. *Id.*

138. 12 C.F.R. § 225.4(a)(10) (1977) only approves underwriting of credit life, health and accident insurance.

139. Underwriters have participated, however, in some applications by BHCs requesting approval to underwrite insurance under 12 C.F.R. § 225.4(a)(10) (1977). *See, e.g.*, Worcester Bancorp, Inc., 60 Fed. Res. Bull. 393 (1974).

affected by sale of insurance by BHC subsidiaries. As noted above,[140] however, these agencies are generally small operations employing one to four agents. Another explanation, then, for the lack of challenge to BHC insurance applications has been that the individual agencies affected by any particular BHC application are too small to afford the costs (primarily legal fees) involved in challenging the BHC application in a Board proceeding. In litigation where a monetary award is possible, the litigant bringing the action often decides whether or not he can "afford" the litigation expenses by treating the expenses as a gamble and weighing the likelihood of loss against the likelihood of recovery. Where a recovery is likely enough and in amount large enough to justify the gamble, the litigant proceeds. Often this allows a litigant to justify bringing an action which, if he loses, will cause financial strain. However, if a small insurance agency opposes Board approval of a BHC application to sell insurance, there is no possible monetary recovery to justify the expenses. The only possible benefit the agency can hope to gain is that it will retain the business which it might have lost to the BHC subsidiary. That loss, of course, is largely speculative. Furthermore, if the agency is unsuccessful, it will lose not only whatever business the BHC subsidiary takes away, but also the costs of participating in the hearings. Thus, it is not difficult to understand why none of the small agencies have been willing to fight singlehandedly BHC entry into the market.

2. IIAA PARTICIPATION

The fragmented structure of the industry has not totally foreclosed representation of the independent agents. What the independent agents could not afford to do individually they have done collectively through their state organizations and, more significantly, their national organization, known today as the Independent Insurance Agents of America ("IIAA").[141] The IIAA is composed of fifty state associations representing more than 33,000 agencies which employ approximately 150,000 agents.[142]

The activity of the IIAA began in 1970 when the Board ruled that the IIAA could participate as an intervenor.[143] Following that

140. *See* note 137 *supra* and accompanying text.

141. Prior to January 1976, the IIAA was known as the National Association of Insurance Agents (NAIA). It will be referred to herein as IIAA even when references are to pre-1976 activities.

142. *Competition in Banking Act of 1976: Hearings on S. 2721 Before the Committee on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 23 (1976) (statement of Edward J. Kremer).

143. First Nat'l Bancorporation, Inc., 56 Fed. Res. Bull. 544 (1970). The Board could

decision, the IIAA participated in a number of ways. In one early application after the 1970 amendments, the IIAA intervened. The holding company responded by withdrawing its application insofar as it related to insurance.[144] Later, when the Board proposed "simplified procedures" for de novo entry,[145] the IIAA sued for review and the Board suspended the proposed procedures.[146] Again, the IIAA sought review when the Board issued an interpretive ruling[147] to resolve questions that had arisen concerning the scope and terms of a previously issued regulation. The District of Columbia Court of Appeals, however, found that review at that time was premature.[148] In addition, the IIAA has sought more restrictive legislation to further limit BHC sale of insurance.[149] Finally, the two IIAA efforts which have dwarfed all of its other activities are its interventions before the Board in *Alabama Financial Group, Inc. (Southern)*[150] and *First National Holding Corp. (First National)*.[151] This intervention has led to what the Court of Appeals for the Fifth Circuit has referred to as the "huge commercial tug-of-war between the bank holding company industry on one hand and independent insurance agents and other insurance industry groups on the other."[152]

The arguments voiced by the protagonists during the various stages of this controversy appear throughout the remainder of this comment. A brief chronology of the controversy hopefully will provide a perspective helpful in understanding the discussion of those arguments.

In February 1972, Southern Bancorporation ("Southern") and First National Holding Corporation ("First National") filed separate applications to engage in selling a broad range of insurance

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have forced the IIAA to litigate the standing question, possibly causing considerable delay before the IIAA could participate. Since the IIAA possessed both the expertise and resources to help the Board identify weaknesses in the bank's presentation, the Board clearly acted in the best interests of the public by permitting the affected insurance agencies to be represented through their national association.

144. Colorado Nat'l Bankshares, Inc., 58 Fed. Res. Bull. 422 (1972).

145. 36 Fed. Reg. 17,328 (1971).

146. 36 Fed. Reg. 25,048 (1971).

147. 58 Fed. Res. Bull. 800 (1972), *now appearing at* 12 C.F.R. § 225.128 (1977).

148. National Ass'n of Ins. Agents, Inc. v. Board of Governors of the Fed. Reserve Sys., 489 F.2d 1268 (D.C. Cir. 1974).

149. *See* Revised Draft Bill (January 1974) and Revised Draft Bill (August 1974) *reprinted in* Golembe, *supra* note 134, apps. A & B, at 71.

150. *See* 39 Fed. Reg. 25,548 (1974) (Alabama Financial Group, Inc. is now Southern Bancorp., Inc.).

151. *See* 39 Fed. Reg. 33,411 (1974).

152. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 231 (5th Cir. 1976).

services. The types of insurance that either one or both sought to sell included: (1) credit life, health and accident insurance; (2) insurance for the BHC and its subsidiaries; (3) property damage insurance on assets being financed by the BHC or any of its subsidiaries; (4) liability insurance for borrowers; (5) insurance otherwise sold as convenience to the customer; and (6) general insurance in communities under 5,000 in population.

Notice of the applications was published and the IIAA and other insurance factions filed objections and requested a hearing. On March 6, 1973, the Board ordered a formal hearing, and in June of 1973 the hearing was held before Administrative Law Judge Paul N. Pfeiffer. His decision, rendered in early 1974, denied substantial portions of the applications. For the most part, the decision could be characterized as a victory for the insurance interests. However, the victory was short-lived. In July and September of 1974, the Board rendered its decisions on the Southern and First National applications. The Board accepted the administrative law judge's findings of fact, but drew opposite conclusions which heavily favored the BHC interests.

After the unfavorable Board orders, IIAA sought judicial review in the Fifth Circuit pursuant to 12 U.S.C. § 1848 (1969). On June 10, 1976, the court rendered its decision in *Alabama Association of Insurance Agents v. Board of Governors of the Federal Reserve System (Alabama)*.[153] The insurance interests regained part of the territory lost in the Board decision, but in the area of the most heated controversy, property and liability insurance, the court affirmed the Board's decision. IIAA filed for rehearing. The Board also petitioned for rehearing, but on different grounds. On January 10, 1977, the Fifth Circuit modified its opinion to forbid certain property and casualty insurance.[154] The January opinion granted the Board time to make further findings regarding sale of general insurance in communities under 5,000 in population, which the June decision had held not closely related to banking. Southern and First National requested further rehearing on January 21, 1977, and February 3, 1977, respectively, as did the Board on February 4, 1977. In the interim, the IIAA had requested the court to stay the issuance of the mandate so that it could apply to the Supreme Court for a writ of certiorari.[155] The Fifth Circuit responded by withdrawing the Janu-

153. 533 F.2d 224 (5th Cir. 1976), *modified*, 544 F.2d 1245 (5th Cir.), *petition for rehearing and rehearing en banc denied*, 558 F.2d 729 (5th Cir. 1977).

154. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 544 F.2d 1245 (5th Cir. 1977).

155. Petitioner's Motion to Stay the Issuance of the Mandate at 2.

ary opinion,[156] denying the petition for rehearing, and holding that the property and liability insurance forbidden in the January decision was permissible. The court further held that before the Board could implement the small community provision, it had to make further factual determinations.

The remainder of this comment will be devoted to a discussion and analysis of the substantive issues presented by the controversy. The "closely related" test will be examined by attempting to define it and its application to the various kinds of insurance. Thereafter, the analysis will be completed by examining in depth each factor of the "public benefits" test that Congress requires the Board to weigh in determining if an activity's benefits exceed its possible adverse effects.

VI. Statutory Test Analysis

A. *Closely Related*

1. Introduction

Prior to the 1970 amendments, the only guideline the Board had received from Congress was that BHCs could engage in activities that were "closely related." Although the pre-1970 BHCA indicated that activities of a "banking, fiduciary or insurance nature" were contemplated,[157] nothing in the statute helped the Board decide whether any particular insurance activity was indeed closely related. Essentially, Congress had told the Board that it felt that a certain nexus to the "business of banking" was required in order for a BHC to engage in the activity. *Closely* related suggested some fairly substantial degree of nexus. Beyond that, the determination was left to Board discretion.

Despite the Congressional debate surrounding the 1970 amendments,[158] the amended Act left the "closely related" language intact with no further explanation or guidelines as to how the Board should determine what constitutes a sufficient nexus to satisfy the test. The Board's own remark that "no precise guidelines were given"[159] might be made more accurate by deletion of the adjective "precise."

The imprecise "closely related" term leaves the Board with virtually unfettered discretion. Since the entire impact of the statute depends upon the definition of what is "closely related to banking," by relinquishing definition of this critical term to Board dis-

156. 544 F.2d at xxv.

157. *See* Part III *supra*.

158. *See* notes 113-23 *supra* and accompanying text.

159. The Alabama Financial Group, 39 Fed. Reg. 25,548, 25,550 (1974).

cretion, Congress has surrendered its legislative role to the Board.[160] In terms of drawing a line between what does and does not have a sufficient nexus to banking, the "closely related" language is meaningless without extensive interpretation. Such interpretation has been delegated to the Board due to Congress' failure to provide sufficient guidelines. The effect on the applicant is that the statute itself offers little basis for predicting whether a given activity is permissible. Furthermore, the nebulous "closely related" language creates a tremendous burden should the applicant seek judicial review of a Board decision. Since the Board's regulations defining what is "closely related" do not involve the findings typically required by statute to be made on the record after an opportunity for an agency hearing, the standard that has been employed is whether the findings are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.[161] Proving an abuse of discretion is a difficult burden even when the statutory limits of discretion are clear. With the legislative history a patchwork of conflicting intentions and no statutory explanation of the "closely related" term provided, attempting to prove that the Board abused its discretion in determining that an activity is closely related will force appellate courts to assume the legislative function that Congress surrendered to the Board.

The Board has attempted to remedy the problem of unpredictability by outlining, in regulations and interpretations, activities that qualify as closely related to banking. The bulk of this effort is contained in Regulation Y, which lists activities deemed closely related to banking, including certain insurance agency activities[162] and limited insurance underwriting activities.[163] After promulgation of Regulation Y, questions arose concerning the insurance agency provisions. On September 6, 1972, approximately one year after the insurance regulation took effect, the Board issued 12 C.F.R. § 225.128 interpreting 12 C.F.R. § 225.4(a)(9).[164] In addition, the Board has

160. Under the non-delegation doctrine, Congress cannot delegate any part of its legislative duties except under the limitation of a prescribed standard. *See* United States v. Chicago, M., St. P. & P.R.R., 282 U.S. 311, 324 (1931). Nonetheless, relatively vague standards have withstood judicial scrutiny. *See, e.g.*, Tagg Bros. & Moorhead v. United States, 280 U.S. 420 (1930) ("just and reasonable" is a sufficient standard). *See also* K. DAVIS, ADMINISTRATIVE LAW, CASES-TEXT-PROBLEMS 28 (1973).

161. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 240 (5th Cir. 1976).

162. 12 C.F.R. § 225.4(a)(9) (1977).

163. 12 C.F.R. § 225.4(a)(10) (1977).

164. IIAA unsuccessfully challenged this interpretive rule in federal court. The court found that the challenge was "premature" since the same issues raised in the proceeding could be raised before the Board in opposing particular applications. National Ass'n of Ins. Agents, Inc. v. Board of Governors of the Fed. Reserve Sys., 489 F.2d 1268 (D.C. Cir. 1974).

promulgated 12 C.F.R. § 225.126 (1977), which lists activities deemed *not* closely related to banking.

According to former Federal Reserve Board Chairman Burns, the "public benefits" test was added as a separate and distinct test;[165] however, the public benefits test has entered the Board's analysis in determining whether an activity should be listed in Regulation Y as an activity closely related to banking. The Board now engages in a two-stage closely related analysis. First, as it did before 1970, the Board decides whether an activity has a sufficient nexus to banking to be closely related.[166] Second, the Board applies what might be called a "generalized public benefits test." The Board has stated that, in adopting the Insurance Regulation, it "found that the performance by bank holding companies of those activities authorized by such Regulation satisfied, in general, this public benefits test."[167]

The use of such a generalized public benefits test is appropriate in determining if an activity is closely related to banking. Under the BHCA as amended in 1970, an applicant must establish that a proposed activity is both closely related to banking and can generate public benefits that exceed the adverse effects. It would serve no purpose for the Board to include activities in Regulation Y which, while having a sufficient nexus to banking, could never yield benefits that would exceed adverse effects, no matter what specific facts were presented in the application.

The Board, therefore, applies a "generalized public benefits test," listing in Regulation Y only those activities which have a reasonable chance of passing the public benefits test outlined in the statute as the second requirement for approval. As the IIAA correctly points out,[168] however, this should not create a presumption that the listed activity automatically passes the statutory public benefits test. That test should be applied vigorously to the facts of each case to ensure that the applicant meets his burden of proving that his particular application will provide a net benefit to the public.

Thus, Congress has left the definition of "closely related" to the Board. The Board has defined the term by delineating in Regulation

165. 116 CONG. REC. 20,650 (1970) (reference by Senator Sparkman to letter from Chairman Burns to House and Senate Conferees).

166. *See, e.g.*, Union Bond & Mortg. Co., 61 Fed. Res. Bull. 112, 113 (1975) (Board denied approval, specifically using the term lack of "nexus").

167. First Nat'l Holding Corp., 39 Fed. Reg. 33,411, 33,413 (1974).

168. Brief for Petitioner at 52-54, Georgia Ass'n of Independent Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224 (5th Cir. 1976) (hereinafter IIAA Brief).

Y those activities which have a sufficient nexus to banking and pass a generalized public benefits test. The discussion which follows examines the closely related test as it has been applied to insurance activities.

2. INSURANCE GENERALLY

In its brief in *Alabama*, the Board articulated its basis for finding insurance activities as a whole closely related to banking. It argued that traditionally there has been a close alliance between commercial banking and insurance, that adequate insurance coverage is an integral part of the bank customer's overall financial planning, and that bankers are knowledgeable in the insurance area and thus competent to give the necessary advice.[169] The Board further demonstrated the relationship between insurance and banking by noting that the insurance companies typically engage in lending and other financial services, and that savings and loan associations are permitted to sell certain kinds of insurance.[170]

Aside from assertions that bankers are competent to sell insurance, which IIAA suggests is not the case,[171] these statements are generally undisputed and do demonstrate certain "relationships" between the two industries. These general relationships provide a background upon which the Board overlays the circumstances surrounding the sale of each different kind of insurance to determine whether sale of a particular type of insurance is closely related to banking. The following discussion provides an analysis of whether particular kinds of insurance are closely related to banking.

3. CREDIT LIFE, HEALTH AND ACCIDENT INSURANCE

As discussed above,[172] there is little disagreement that credit life, health and accident insurance is closely related to banking. It should be noted, however, that this consensus of opinion refers only to decreasing term insurance, where the policy face amount is reduced as the loan is repaid. Level term insurance has been found by the Board to be not closely related to banking.[173]

In 1973, in *Worcester Bancorp, Inc. (Worcester)*, an application to engage in sales of credit life, health and accident insurance was

169. Brief for Respondent at 31-32, Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224 (5th Cir. 1976) (hereinafter referred to as Board Brief).

170. *Id.* at 32-33.

171. IIAA Brief, *supra* note 168, at 51.

172. *See* notes 131-33 *supra* and accompanying text.

173. Fidelity Corp., 59 Fed. Res. Bull. 472 (1973).

challenged by three insurance industry organizations.[174] The administrative law judge found such insurance closely related to banking when the loan was made by a bank, but suggested restricting sale of such insurance in connection with extensions by nonbank subsidiaries of the BHC.[175] The Board rejected this suggestion. It found that unrestricted sales by nonbank subsidiaries were also closely related to banking.[176] In so deciding, the Board relied on the following statement from the Senate Report on the Bank Holding Company Act of 1956:

> [T]he operation of a credit life-insurance program in connection with bank loans is clearly within the scope of banking operations as presently conducted. So is the operation of an insurance program under which insurance proceeds retire the outstanding balances of the mortgage upon the death of the mortgagor in cases where the bank holds the mortgage.[177]

The Board also relied on the legislative history of the 1970 amendments[178] and specifically pointed out that even the "negative laundry list" in the House version did not include the sale of credit life, health and accident insurance.[179]

In subsequent applications, the Board's closely related to banking analysis has often consisted of nothing more than the simple statement that credit life, health and accident insurance has "been determined by the Board to be closely related to banking (12 C.F.R. § 225.4(a)(1) and (9))."[180] In *Southern,*[181] the Board cited and reaffirmed its own conclusion in *Worcester* that credit life, health and accident insurance is closely related to banking.[182] As further rationale for that conclusion, the Board noted that banks require the customer to obtain credit life, health and accident insurance with the loan.[183]

Even the IIAA has conceded that credit life, health and accident insurance is closely related to banking.[184] The IIAA argues that this insurance is distinguishable from other, allegedly not closely

174. 60 Fed. Res. Bull. 393 (1974). IIAA was not one of the organizations.

175. *Id.* at 396.

176. *Id.*

177. *Id.* at 395.

178. Worcester Bancorp, Inc., 60 Fed. Res. Bull. 393, 395 (1974).

179. *Id.* at 395 n.4.

180. *See, e.g.*, United Carolina Bancshares Corp., 39 Fed. Reg. 32,796 (1974); First Tennessee Nat'l Corp., 39 Fed. Reg. 26,318 (1974).

181. 39 Fed. Reg. 25,548 (1974).

182. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550 (1974).

183. *Id.*

184. IIAA Brief, *supra* note 168, at 46-48.

related insurance, because: (1) credit life, health and accident insurance only exists as a result of a credit transaction; (2) it is sold on a group basis at low rates without reference to the borrower's health or personal condition; (3) it involves no real insurance decision requiring the advice of an agent; and (4) it has traditionally been sold by lending institutions and has not been available from ordinary insurance agents.[185] Since IIAA concedes that this insurance is closely related to banking, the issue was not raised before the Court of Appeals for the Fifth Circuit in *Alabama*.[186]

The most compelling reason for finding credit life, health and accident insurance to be closely related to banking is the legislative history cited by the Board in *Worcester*. While the history is of little assistance in determining whether Congress intended to include other types of insurance, and in fact it appears that those voting for the bill had intentions that were far from uniform, it is reasonable to conclude that the majority of those legislators involved intended that credit life, health and accident insurance should be considered closely related.[187] To the extent that it authorizes such insurance, 12 C.F.R. § 225.4(a)(9)(ii)(a) should be upheld by the courts.

While the IIAA's reasons for distinguishing credit life, health and accident issurance from other types of insurance may or may not have proven that the other types of insurance are not closely related, the explanations certainly suggest that credit life, health and accident insurance is the most closely related to banking of the various types of insurance.

4. MORTGAGE REDEMPTION AND MORTGAGE GUARANTEE INSURANCE

Mortgage redemption insurance is generally categorized with credit life, health and accident insurance in applications and for purposes of Board analysis. Its function in a mortgage loan transaction is similar to that of credit life, health and accident insurance in non-mortgage loans. As with credit life, health and acccident insurance, the legislative history indicates that the legislators considered mortgage redemption insurance to be closely related to banking.[188] Thus, the Board properly concluded in *Worcester* that

185. *Id.* at 48-49.

186. The court stated in *Alabama* that credit life, health and accident insurance "are not in issue here." Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 233 (5th Cir. 1976).

187. There is, however, some evidence in the legislative history suggesting that while credit life and mortgage redemption insurance were viewed as closely related, credit accident insurance and, by omission, credit health insurance were not. *See* IIAA Brief, *supra* note 168, at 36-37.

188. *See* note 177 *supra* and accompanying text.

mortgage redemption insurance is closely related to banking.

Prior to the Board's *Southern* decision mortgage guarantee insurance, which serves to protect the lender against loss of a specified percentage of a loan in the event of a foreclosure and sale of collateral, had been equated with mortgage redemption insurance.[189] Subsequent to approving mortgage guarantee insurance in *Southern*, however, the Board has reversed its position.[190]

5. PROPERTY INSURANCE

"Property" insurance covers physical damage to property in which the bank has taken a security interest as collateral for an extension of credit. Unlike credit life, health and accident insurance, the premiums for property damage insurance can be fairly substantial. In addition, a significant percentage of purchases of real property and higher priced personal property, such as automobiles, are financed by BHC subsidiaries. Therefore, should the courts determine that sale of property insurance is a permissible activity, a major reallocation annually of millions of premium dollars may follow, depending upon whether BHCs are able to compete successfully for that business.

The administrative law judge who conducted the hearings in *Southern* did not address property insurance separately. After a fairly extensive review of the BHCA's legislative history, he found that "[a] fair summary of the legislative history . . . indicates that the Congress clearly had credit-related insurance agency sales in mind as an enterprise closely related to banking."[191] In particular, he relied on remarks by former Federal Reserve Board Chairman Martin, cited by Senator Bennett, to the effect that "[p]ermissible acquisitions might include . . . acting as insurance agent . . . in connection with extensions of credit by other subsidiaries of the holding company."[192]

The Board agreed with the administrative law judge, finding that property insurance fell within subsection (ii)(a) of the insurance provision in Regulation Y and was in accord with the Board's previous interpretations of that provision.[193] In relying upon its own regulation and interpretation, the Board was essentially stating that

189. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550 (1974).

190. *See* Board Brief, *supra* note 169, at 20 n.15, *citing* 39 Fed. Reg. 39,502 (1974).

191. Recommended Decision of Law Judge in FRB Docket No. IA-8 (First Nat'l Holding Corp.), *reprinted in* IIAA Brief, *supra* note 168, app. 4, at 52a.

192. *Id.* at 49a.

193. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550 (1974).

property insurance is closely related because the Board says it is; however, the Board added the following rationale:

> [Property] insurance is essential from the lender's standpoint to assure that the value of the collateral will not be impaired by physical damage. The financial nature of the insurance transaction forms an integral function for the borrower as well, since the presence or lack of insurance protecting loan collateral is an essential element of credit evaluation.[194]

As indicated previously,[195] in the *Southern* order the Board reasoned that BHCs should be able to sell credit life, health and accident insurance because the borrower is required by the bank to have it. This argument is valid only because that insurance is generally unavailable elsewhere. Most agents do not carry it. However, where the insurance is readily available from agents, the need for the insurance might justify the BHCs requiring that the borrower obtain it, but it in no way supports the contention that the BHC should be able to market it. Similarly, where the bank does not require the insurance, but does consider the presence or lack of it in evaluating credit, there is no basis for concluding that the bank should sell the insurance.[196]

The opposing parties in *Alabama*[197] have each attempted to establish that the BHCA's legislative history supports their respective positions. The Board argues that it had approved property insurance before 1970, and that Congressional approval of the 1970 amendments without criticism of the pre-amendment Board decisions implied approval of those decisions.[198] In addition, the Board argued that the 1970 amendments were designed to give the Board greater flexibility.[199]

The IIAA has responded, claiming that Congress viewed the previous Board decisions as limited, narrow authorizations of property insurance sales based primarily on local practice, that continued approval of only limited activities was intended, and that sale of property insurance generally is not such a limited activity.[200]

The Fifth Circuit noted in *Alabama* that it must give "great respect" to pre-1970 decisions, since "Congress gave *no indication*

194. *Id.*

195. *See* notes 182-83 *supra* and accompanying text.

196. IIAA Brief, *supra* note 168, at 49 n.28.

197. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224 (5th Cir. 1976).

198. Board Brief, *supra* note 169, at 44-49.

199. *Id.* at 49-58.

200. Reply Brief of the Petitioner at 4-9, Georgia Ass'n of Independent Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224 (5th Cir. 1976).

of its dissatisfaction of the agency's interpretation of the scope of its . . . jurisdiction when it amended the Act."[201] This is not entirely accurate. If all of the legislators had been completely satisfied with the Board's interpretation of the closely related test, there would have been no heated debate on the issues of changing the language to "functionally related" and adding a negative laundry list. Furthermore, the IIAA points out that the pre-1970 applications were unchallenged, so neither the Board nor Congress was aware of the arguments to be made in opposition.[202] The IIAA also convincingly argues that these decisions rested heavily on the fact that there was long-established area practice for banks to sell the insurance.[203]

As discussed above,[204] the only conclusion that can be drawn from the record with certainty is that the legislators who created and voted for the 1970 amendments had conflicting views on what the amendments were intended to accomplish. Thus, the court's reliance upon inferred Congressional approval of pre-1970 decisions seems unjustified.

The court in *Alabama* rejected the IIAA argument that property damage insurance is not closely related because it is neither "functionally equivalent to an extension of credit" nor "operationally integrated into the lending transaction."[205] The court stated that the Board should be upheld when it articulates "any type connection between banking and the non-banking activity in question which makes it rational to consider the proposed activity an 'incident' to banking."[206] One might ask whether the "closely related" test has now become a "rational incident" test.

The court then concluded that property insurance was closely related because the banks need it to protect the collateral, and the borrowers need it to obtain credit. The court stated that since property insurance is "regularly desired" by both, it is closely related.[207] One might conclude, therefore, that "closely related" is a "regular mutual need" test. The IIAA has suggested, somewhat sarcastically, that such a test would justify banks selling automobiles, since the bank needs the automobile to give rise to automobile loans, and the

201. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 239 (5th Cir. 1976) (emphasis added).

202. IIAA Brief, *supra* note 168, at 38.

203. *Id.* at 38-39.

204. *See* notes 113-23 *supra* and accompanying text.

205. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 244 (5th Cir. 1976).

206. *Id.* at 244.

207. *Id.*

customer cannot obtain the loan without an automobile.[208]

In July of 1976, IIAA requested a rehearing by the Fifth Circuit. One argument raised was that the June 10, 1976 decision did not make clear whether only *bank* subsidiaries of the BHC could sell property insurance, or whether the *nonbank* subsidiaries could market it as well. IIAA argued that since the court had drawn a distinction between the kinds of subsidiaries when it invalidated 12 C.F.R. § 225.4(a)(9)(i) to the extent that the regulation allowed the BHC to broker insurance for its *nonbank* subsidiaries, consistency required that the distinction be made in the property insurance area as well. On January 10, 1977, the court modified the June 10 decision to invalidate 12 C.F.R. § 225.4(a)(9)(i)(a) and (b) to the extent that these regulations permitted property insurance sales by nonbank subsidiaries.[209] This decision was later withdrawn on August 3, 1977,[210] when the court held that sale of property insurance by nonbank subsidiaries was permissible.

On January 21, 1977, Southern petitioned for further rehearing, and, in February, both First National and the Board similarly petitioned. They argued that sale of property insurance was permitted before 1970 and, therefore, was implicitly approved by Congress in 1970;[211] that the ruling would result in unhealthy manipulation of loans in that loans normally made by nonbank subsidiaries would be made by bank subsidiaries to avoid the restriction on nonbank subsidiary sale of insurance;[212] that an activity performed by banks becomes "banking" by virtue of the fact that banks do it, and is still "banking" even when performed by a nonbank entity;[213] that the decision would have a severe national impact;[214] and that the decision created a severe "inconsistency," since nonbank subsidiaries are allowed to sell credit life, health and accident insurance without distinction.[215] All the petitions for rehearing were denied by the Fifth Circuit in the August opinion.

Thus, the dispute over property insurance has spawned language by the interested parties and the courts which, rather than

208. Petitioner's Petition for Rehearing and Suggestion For Rehearing In Banc (sic) at 13.

209. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 544 F.2d 1245 (5th Cir. 1977) (withdrawn at request of court 544 F.2d at xxv).

210. 544 F.2d at xxv.

211. Intervenors' Petition for Rehearing and Suggestions for Rehearing En Banc at 5-9; Petition for Rehearing of the Respondent Board of Governors at 8-9.

212. Petition for Rehearing of the Respondent Board of Governors at 9.

213. *Id.* at 9-10; Intervenors' Petition for Further Rehearing at 4.

214. Petition for Rehearing of the Respondent Board of Governors at 10; Intervenors' Petition for Rehearing and Suggestion for Rehearing En Banc at 4-5.

215. Petition for Rehearing of the Respondent Board of Governors at 6.

clarifying the definition of closely related, has created even more ambiguity and uncertainty.

6. LIABILITY INSURANCE

"The liability insurance at issue would protect borrowers from liability resulting from injury or damage to the person or property of others in connection with property financed by holding company banks."[216] Generally, this insurance is marketed in a "package" with property insurance.

In an interpretive ruling,[217] the Board decreed that liability insurance is credit related if it "supports the lending transaction." The Board has also indicated that where the liability insurance is customarily sold in a "package," such as with automobile or homeowner's liability insurance, the sale supports the extension of credit.[218]

The Board argues that, like property insurance, liability insurance is needed by the bank to guarantee that the borrower will be able to repay the loan. However, this argument would apply to *any* insurance, since insurance is always purchased in order to avoid a potential financial loss, and any such loss could affect the borrower's ability to repay. The argument is more directly relevant vis-a-vis property damage insurance, since that insurance safeguards the specific collateral which has been put up as security for the loan. Without secured collateral, the bank would be left standing in line with other creditors. But if the borrower is unable to repay the loan due to some added liability he incurs, the bank would still be protected because it has a security interest in the collateral ahead of other creditors. The Fifth Circuit pointed out that the bank is better off if there is liability insurance than if it were to foreclose, because "repayment rather than repossession is the bank's primary objective."[219] While this may be true, clearly the bank's need for property damage insurance is significantly more related to the loan than its need for liability insurance. The difference is underscored by the fact that banks generally *require* property insurance, while liability insurance is optional.[220]

In its order in *Southern*, the Board simply stated that since the

216. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 244 (5th Cir. 1976).

217. 12 C.F.R. § 225.128(c)(1) (1977).

218. 12 C.F.R. § 225.128(c)(1)(iii) (1977).

219. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 245 (5th Cir. 1976).

220. *Id.* at 249.

insurance is generally sold as part of a "package," it "fulfills a legitimate need of the lender and borrower alike."[221] The IIAA objects that such reasoning is tantamount to saying that liability insurance is "closely related to an activity which is closely related to banking, thus itself becoming closely related to banking."[222] This phrasing suggests that perhaps the Board has stretched the argument too far. The Fifth Circuit, however, approved the logic but restated the Board's language more subtly, concluding that while the case for liability insurance is "significantly weaker"[223] than that for property insurance, liability insurance is 'incidental' to the sale of property damage insurance and necessary for effectuation of the Congressional purpose with respect to [that] . . . activity."[224] Apparently then, if an activity is "incidental" to a closely related activity, the incidental activity is itself closely related.

The court added, almost as an afterthought to bolster its conclusion, that there had been two pre-1970 approvals of liability insurance sales. As with property insurance, this argument pales when one considers that the "functionally related" and "negative laundry list" debates suggest some Congressional disapproval of pre-1970 Board orders, and that these pre-1970 decisions were unchallenged and based heavily on long-standing area practice.

While liability insurance alone has not been held closely related to banking, its fate throughout the Fifth Circuit decision and subsequent modifications has been directly linked to that of property insurance. As of the August decision, liability insurance is considered closely related to banking when purchased with property insurance and sold by any BHC subsidiary, bank or nonbank.

7. CONVENIENCE INSURANCE

12 C.F.R. § 225.4(a)(9)(ii)(c) authorizes BHCs to act as agents with respect to insurance that:

> is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(c) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii) . . . .

By interpretive ruling[225] the Board has limited premiums from

221. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550 (1974).
222. IIAA Brief, *supra* note 168, at 59.
223. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 244 (5th Cir. 1976).
224. *Id.* at 250.
225. 12 C.F.R. § 225.128(e) (1977).

such sales to less than five percent of the aggregate premium income of the BHC agency. In its order in *Southern*, the Board simply stated that such insurance has been expressly permitted under the Insurance Regulation.[226] In its brief to the Court of Appeals, the Board argued that convenience insurance is a "*necessary* activity to the operation of an affiliated insurance agency."[227] The Board suggested, for instance, that such insurance allows the BHC to renew the insurance of an elderly driver who has repaid his loan and cannot purchase insurance elsewhere without difficulty, and also allows a borrower to insure his second car on the same policy. Therefore, it is the Board's argument that the five percent limit, the caveat that the convenience provision may not be used to engage in general insurance business, and the need to sell such insurance to meet the particular needs of a few customers, conjoin to make the activity closely related.

The IIAA argued in their brief to the Fifth Circuit that the current language of the regulation is too broad.[228] IIAA concedes that certain convenience insurance (a renewal, for instance) is closely related to banking. IIAA objects, however, to the broad language that apparently allows sales of insurance totally unrelated to banking. IIAA also suggests that the five percent limit be reduced to one or two percent.[229]

The Fifth Circuit agreed with IIAA on the issue of broadness. It accepted the idea that an incidental activity necessary to carrying on permissible ones is closely related, but found it difficult to see how serving the particular needs of a few customers was necessary.[230] The court held the regulation invalid and suggested that the Board redraft it.

8. GENERAL INSURANCE IN COMMUNITIES UNDER 5,000 POPULATION

12 C.F.R. § 225.4(a)(9)(iii) permits the BHC agency to sell "any insurance . . . in a community that (a) has a population not exceeding 5,000, or (b) the holding company demonstrates it has inadequate insurance agency facilities."

This provision is apparently derived from 12 U.S.C. § 92 (1970) under which national *banks* have been permitted to engage in such insurance sales since 1916.[231] In approving such applications, the

226. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550-51 (1974).
227. Board Brief, *supra* note 169, at 63.
228. IIAA Brief, *supra* note 168, at 69.
229. *Id.*
230. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 242 (5th Cir. 1976).
231. *Id.* at 248.

Board has usually stated that such activities have been "previously determined by regulation to be closely related to banking (12 C.F.R. § 225.4(a)(9))."[232]

In its June 10, 1976 decision, the Fifth Circuit found this regulation invalid.[233] It noted that 12 U.S.C. § 92 was intended to provide necessary additional income to small banks to improve stability and profitability,[234] and should not be interpreted to mean that such activities were "banking."

On its face, the decision seems insignificant. After all, if the BHC is not allowed to form a nonbank subsidiary to sell such insurance, it can simply have the bank subsidiary sell it under 12 U.S.C. § 92. However, there is a significant tax consequence that may have a severe impact upon the transferability of small independent banks.[235] Often small BHCs were sold to long term employees who finance the purchase and rely on insurance revenues to repay these large loans.[236] Only about forty percent of bank profits may be paid to the BHC as dividends. Thus, if only the bank rather than nonbank subsidiaries may sell the insurance, the amount of money available to the BHC to repay the loans is severely reduced. It has been suggested that if the Fifth Circuit decision of June 10th stands, the smaller banks will be taken over by large BHCs, since without insurance revenues small purchasers will be unable to meet their debt obligations.[237]

The Board was apparently surprised by the June decision and requested rehearing. In the January 10, 1977 decision, the court modified its stance and granted the Board time to make additional findings to establish the close relationship between banking and sale of general insurance in small communities, and to determine whether the current language might permit activities which were not intended, such as general insurance sales in small communities by BHCs that are not located in those communities.[238] The August decision instructed the Board not to implement the small community regulation until it supported with further findings the conclusion that such insurance is closely related to banking.[239] Conse-

232. *See, e.g.*, Cody Agency, Inc., 58 Fed. Res. Bull. 736 (1972).

233. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 243 (5th Cir. 1976).

234. *Id.* at 248.

235. *See* THE INDEPENDENT BANKER 12, 14 (Mar. 1977).

236. *Id.* at 14.

237. *Id.* at 15.

238. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 544 F.2d 1245, 1247 (5th Cir. 1977) (case withdrawn by request of court).

239. 558 F.2d 729, 730-31 (5th Cir. 1977).

quently, this regulation is not in force pending further Board action.

9. MISCELLANEOUS INSURANCE SALES

The kinds of insurance discussed above have been those upon which the controversy has focused. Several other types of insurance have been mentioned and will be discussed briefly.

12 C.F.R. § 225.4(a)(9)(i) permits sale of "any insurance for the holding company and its subsidiaries." The court invalidated this provision insofar as it allowed the sale of insurance to nonbank subsidiaries but found the sale of insurance to bank subsidiaries of the BHC permissible.[240] The court found that the bank subsidiaries *needed* certain kinds of insurance; but, how this justifies BHC *sale* of the insurance is far from clear. The bank subsidiaries need many goods and services, but that does not authorize the BHC to sell those goods and services to them. The court noted that even sales to bank subsidiaries have a relationship to banking that is "in many cases quite indirect; in many cases the bank's need for it is no different than the need of any business enterprise."[241] While the court seemed less than pleased with this relationship, it noted its limited role in reviewing the Board's decision and refused to overturn it. The court went only so far as to find that sales to nonbank subsidiaries of the BHC were not closely related to banking because "[s]uch insurance simply does not contribute to the operations of those subsidiaries actually engaged in the banking business."[242] This language suggests still another closely related test: a "contribution to operations" test.

BHCs have also sought to sell use and occupancy insurance, business interruption insurance, fidelity insurance, and surety bonds.[243] The Board declined to find the first three of these closely related on the ground that insufficient evidence was presented by the applicants. The Board found that surety bonds traditionally had been part of the mortgage transaction and were directly related to an extension of credit. The Fifth Circuit discussed surety bonds vis-a-vis public benefits, but affirmed without discussion the Board's closely related decision.

Conclusions regarding the application of the closely related and public benefits tests will be made after reviewing the public benefits test. For the present, it is sufficient to note that an adminis-

240. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 240-41 (5th Cir. 1976).

241. *Id.* at 241.

242. *Id.*

243. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550 (1974).

trative law judge, a federal agency, and a federal circuit court have each applied the term "closely related" to these facts, but no two have been able to agree on the results. Attempts to clarify the term have merely added more conflicting and meaningless verbiage to a term whose very drafters could probably not reach any consensus as to definition.

B. *Public Benefits*

1. INTRODUCTION

In 1970 Congress added the following language to 12 U.S.C. § 1843(c)(8):

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as *greater convenience, increased competition*, or *gains in efficiency*, that outweigh possible adverse effects, such as *undue concentration of resources, decreased or unfair competition, conflicts of interests*, or *unsound banking practice*.[244]

It is interesting to note that there is one significant difference between this test, which determines whether a BHC may engage in a particular activity, and the test in section 1842(c)(2), which determines whether an applicant may become a BHC. Under the section 1842(c)(2) test, the Board is not to approve an application to become a BHC "unless it finds that the anti-competitive effects of the proposed transactions are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served."[245] The section 1843(c)(8) test does not require that the benefits "clearly" outweigh the adverse effects. It merely requires that they "reasonably be expected" to outweigh "possible" adverse effects.

The significance of this difference is most apparent in cases where it is determined that there are no adverse effects. The "clearly outweigh" language of section 1842 suggests that even when there are no adverse effects, a minimum threshold amount of benefit must be reached before an applicant may become a BHC. Under the section 1843(c)(8) test, however, even a de minimis benefit will apparently be sufficient to warrant approval where there are no adverse effects.

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244. 12 U.S.C. § 1843(c)(8) (1970) (emphasis added).
245. 12 U.S.C. § 1842(c)(2) (1970).

A second significant difference between the two tests is found in the "*possible* adverse effects" language of the section 1843(c)(8) test. The adjective "possible" suggests that the Board may have more freedom to speculate in finding adverse effects to balance under the section 1843(c)(8) test, making this test harder to pass.

These two tests, of course, are designed to handle two different situations. In some cases, however, the difference may be one more of form than substance. For instance, if an insurance agency seeks to acquire a bank, it must, under section 1842, obtain permission to become a BHC. To do so, it must demonstrate that the association of the bank and the insurance agency will yield public benefits that clearly outweigh the adverse effects. If a BHC seeks to acquire an insurance agency, it must apply for permission under section 1843(c)(8), and demonstrate that the public benefits are reasonably expected to outweigh possible adverse effects. In both cases, the result sought is the same — sale of insurance through a BHC subsidiary. The controlling factor in determining which test applies is simply which entity is making the application. To the extent that the applications which seek to achieve almost identical results are subjected to the two arguably different tests, there appears to be an inherent inconsistency.

The language of the section 1843(c)(8) test, particularly the presentation of the factors to be considered in the analysis, may suggest at first glance that there are three benefits to be balanced against four possible adverse effects. A more careful analysis reveals that there is an alternative conceptualization of the test that leads to a more thorough understanding. Note that "increased competition" is one of the listed benefits, while "decreased or unfair competition" is one of the listed possible adverse effects. This is certainly appropriate. If increased competition is desirable, it is only logical that decreased competition is undesirable. However, it seems just as logical, although not explicitly stated, that if increased convenience and gains in efficiency are benefits to the public, then any resultant inconvenience or reduction in efficiency are adverse effects. For instance, bank-related agencies might drive out of business other more convenient insurance agencies, or reduce the revenues of all other agencies whose fixed costs might then make them less efficient and result in higher prices or reduced services. In addition, a bank-related agency might be more convenient, but less efficient. Should resulting inconvenience not then be balanced against possible increased convenience to see if the bank-agency affiliation does really generate a *net public benefit*? Similarly, if undue concentration of resources is adverse, diversification of resources should be a benefit. The public would also benefit if the bank-agency association *eliminates* some conflict of interest that might exist under the current system, such as banks recommending insurance agencies to those who purchase bank services, or if bank sale of insurance leads to sounder banking by enabling the bank to better determine if its collateral is properly insured. Thus, rather than three benefits and four adverse effects, section 1843(c)(8) really suggests six factors that the Board should weigh, each of which may be a net benefit or detriment to the community: convenience, competition, efficiency, concentration of resources, conflicts of interests, and banking soundness.

The following discussion of these six factors will include, as did the closely related discussion, a review of the Board's orders in the Southern and First National applications. Two points should be kept in mind during that discussion. The first is that one reason the discussion focuses on these cases is that the majority of the Board's decisions offer little insight into the reasoning behind the Board's conclusions. While cursory treatment of the closely related test may be appropriate in some cases, the nature of the public benefits test suggests that a more rigorous analysis generally would be appropriate. When an applicant seeks to engage in an activity which has been determined by regulation or previous decision to be closely related, there is little reason for the Board to do more than point out that the activity has been previously determined to be closely related to banking. However, the public benefits test was added to ensure that in addition to falling into a category that was closely related to banking, each individual application would result in a benefit to the public. To make such a determination the Board must consider the unique circumstances of each application, including an analysis of the banking and insurance industries in a particular market.

The Board's decisions, however, do not evidence a detailed examination of specific circumstances. For instance, in *United Carolina Bancshares Corp. (United Carolina),*[246] the Board made the following statement: "Based upon the *foregoing* and other considerations reflected in the record, the Board has determined, in accordance with the provisions of section 4(c)(8), that consummation of this proposal can reasonably be expected to produce benefits to the public that outweigh possible adverse effects."[247] Unfortunately for those interested in understanding the Board's reasoning, the "foregoing" was the simple statement that "[t]here is no evidence

246. 39 Fed. Reg. 32,796 (1974).
247. *Id.* at 32,796 (emphasis added).

in the record indicating that consummation of the proposed transaction would result in any undue concentration of resources, unfair competition, conflicts of interests, unsound banking practices or other adverse effects on the public interest."[248]

Other applications single out one adverse factor for specific mention, but even then do little more than make two conclusory statements instead of one. For instance, in *First Tennessee National Corp. (First Tennessee)*,[249] the Board offered the following analysis: "From the facts of record, and in view of the nature of Tower's insurance business, it does not appear that the continuation of these insurance activities upon approval of the application would have any adverse effect on existing or future competition."[250] In *United Carolina*, the Board's analysis again consisted of nothing more than a statement to the effect that the record revealed no adverse effects.

The Board's treatment of benefits is often equally cursory. In *First Tennessee*, the only benefit mentioned was that "[c]onsummation of this proposal should enable Tower to become a more effective competitor."[251] In *United Carolina*, a loan company which sold insurance was to be acquired. The Board stated that consummation would increase financial resources of the BHC and provide pro-competitive management direction.[252] These remarks seem to apply only to the loan activities of the acquired company, not to its insurance agency activities. Although insurance premiums may make available some additional resources, every insurance application would have this result. The argument that an acquisition makes additional resources available is not mentioned in applications which involve the acquisition solely of an insurance agency. One could conclude, then, that no specific benefits of the sale of insurance were considered. An example of an even more blatant failure to consider specific benefits is the approval in *Citizens Investment Co.*,[253] in which the Board failed to mention the public benefits test at all. Many applications combine remarks on adverse effects similar to those noted above[254] with a remark like that in *Mountain Financial Services, Inc.*,[255] in which the Board stated as the only benefit that "[a]pproval of the application to engage in such [insurance] activities would insure a convenient source of

248. *Id.*
249. 39 Fed. Reg. 26,318 (1974).
250. *Id.* at 26,319.
251. *Id.*
252. United Carolina Bancshares Corp., 39 Fed. Reg. 32,796 (1974).
253. 58 Fed. Res. Bull. 143 (1972).
254. *See* notes 247-49 *supra* and accompanying text.
255. 42 Fed. Reg. 4,213 (1977).

credit related insurance services to Bank's customers."[256]

The Board's reliance upon the absence of evidence of adverse effects in the record raises a serious question about its role in applying the public benefits test, particularly when applications are unchallenged. When an administrative agency performs a quasi-judicial function in settling disputes between adversary parties, it may be appropriate to rely solely upon the "record." When the applicant has no adversary, however, the Board is charged with a role that in effect makes the Board both the judge and the counsel for the general public. The Board is to determine if the public will benefit. When the application is unchallenged, the Board is reviewing a "record" presented by the applicant alone. While the applicant is required to supply the Board with "facts," it is not uncommon that opposing parties may have radically different views of what the "facts" are, or of how they should be viewed. Even when there is an intervening party, the question remains whether this totally relieves the Board of its responsibility as the guardian of the public interest and transfers that responsibility to the shoulders of an intervenor who, while opposing the applicant, may be involved only to promote his own private interests, not to benefit the public. As will be discussed below,[257] it might not be unreasonable to expect the Board to make certain factual inquiries independently in order to insure that the public is properly protected.

When an appellate court reviews the Board's public benefits decisions, the court applies a different standard than it does in reviewing the "closely related to banking" determinations. Since a regulation defining what is closely related "does not involve findings 'required by statute to be made on the record after opportunity for an agency hearing,' "[258] the court determines only whether the Board's findings are " 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' "[259] However, the Board's public benefits findings are on a record generated by an agency hearing, and the standard of review is that there must be " 'substantial evidence' " to support the Board's conclusions.[260] Thus, the court has considerably more freedom to reexamine and possibly overrule Board findings on the public benefits question.

Against this background, the individual factors to be consid-

256. *Id.*

257. *See* Part VI.B.3. *infra*.

258. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 240 (5th Cir. 1976).

259. *Id.*

260. *Id.*

ered by the Board in determining if the public benefits exceed the possible adverse effects will now be examined.

2. CONVENIENCE

The main form of increased convenience that the BHCs suggest will occur is the "one-stop shopping" which may result if a bank sells insurance on the premises. Instead of having to make the trip to an insurance agent, the customer may purchase his credit-related insurance at the bank while finalizing the loan. In addition to the time saved by not making a special trip to an agent, it is argued further that the time devoted to the insurance transaction will be reduced because much of the information needed has already been given to the bank in the loan application, thus avoiding the duplication that would occur if the customer had to repeat that information to an agent. Applicants have suggested that one further convenience is that when insurance is purchased from a bank, premiums can be added to loan payments so the customer pays both with one check.

The Board has often found that the sale of insurance at the bank premises would result in added convenience. The Board's published decisions, however, generally provide no information as to how the Board reached this conclusion. The decisions often simply remark that "consideration relating to the convenience and needs of the communities to be served" are "consistent with approval."[261]

In his recommended decisions on the applications of Southern and First National, the administrative law judge found that the degree of increased convenience would be minimal.[262] In a third, similar case, the judge found that there were as many as twenty-five insurance agencies within four blocks of one bank office.[263] In the Southern and First National applications the BHC did not plan to have an agent at each bank office. The administrative law judge noted in the *Southern* decision that this would make personalized service relatively inconvenient.[264] The administrative law judge also noted that some types of insurance may be obtained from an agent

261. *See, e.g.*, Mountain Financial Services, Inc., 42 Fed. Reg. 4,213 (1977); Citizens Inv. Co., 58 Fed. Res. Bull. 843 (1972).

262. Recommended Decision of Law Judge in FRB Docket No. IA-10 (Alabama Case), *excerpts reprinted in* IIAA Brief, *supra* note 168, app. 3, at 34a; Recommended Decision of Law Judge in FRB Docket No. IA-8 (First National Holding Corp.), *excerpts reprinted in id.* at 54a.

263. Recommended Decision of Law Judge in FRB Docket Nos. IA-3, 6, 7, 12, 13 (Florida cases), *excerpts reprinted in* IIAA Brief, *supra* note 168, app. 2 at 10a.

264. Recommended Decision of Law Judge in FRB Docket No. IA-10 (Alabama Case), *excerpts reprinted in* IIAA Brief, *supra* note 168, app. 3, at 34a.

over the phone,[265] that in other types there is a substantial time lag before the policy has to be delivered,[266] and that where the bank buys dealer paper, the customer normally will not be able to consummate his borrowing and insurance purchase at the same time and place.[267] The above comments related to non-commercial insurance, but the administrative law judge found that bank sale of commercial insurance adds even less convenience, since sophisticated commercial buyers frequently have their own insurance agents.[268]

The Board disagreed, finding that the added convenience was a significant public benefit. In *Southern*, the Board found a "*considerable* savings in time."[269] The Board conceded that the lack of agents at each facility reduced the convenience, but that there was still this "considerable" savings since the loan officer would contact the agent at the main branch for the borrower.[270] In its decision on the First National application two months later, the Board found a "savings in time," but it was not described as "considerable."[271] The Board there also responded to the administrative law judge's conclusions regarding commercial insurance, noting that the information needed for commercial loans and commercial insurance overlapped, creating an added convenience.[272]

The administrative law judge based his findings upon what appears to be a thoughtful inquiry into the practical factors, such as the convenience and the location of other insurance agencies, and thorough consideration of the logical arguments presented. If the Board engaged in any analysis, its decision does not reflect it; however, in its brief in the *Alabama* case the Board expanded its reasoning somewhat. It conceded that the lack of agents at all bank outlets results in "substantially less" convenience,[273] but argued that the bank planned to add more agents as needed, and that the convenience factor was preserved as a benefit since the bank was arranging the insurance despite the absence of an agent.

The Court of Appeals for the Fifth Circuit, applying the

265. Recommended Decision of Law Judge in FRB Docket Nos. IA-3, 6, 7, 12, 13 (Florida cases), *excerpts reprinted in* IIAA Brief, *supra* note 168, app. 2, at 10a.

266. *Id.* at 11a.

267. *Id.*

268. *Id.*

269. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,551 (1974) (emphasis added).

270. *Id.*

271. First Nat'l Holding Corp., 39 Fed. Reg. 33,411, 33,413 (1974).

272. *Id.*

273. Board Brief, *supra* note 169, at 82.

"substantial evidence" test, overturned the Board's findings.[274] The court noted that without agents at bank branches the insurance transaction would lack the personal, face-to-face discussion which makes arranging insurance matters "much easier,"[275] that is, more convenient. The court also concluded that the same convenience that the Board argued was being offered could be achieved by the bank contacting an independent agent for the customer.[276]

One additional argument has been raised by the insurance participants outside the proceedings and not commented upon by either the Board or the Fifth Circuit. Although bank sale of insurance allows the customer to purchase insurance and to obtain a loan at one stop, it forces the customer to purchase insurance from two different sources, some from the bank and other kinds from his insurance agent. This may create other inconveniences. It is argued that the customer sacrifices one form of "one-stop shopping" in order to gain another.[277] Furthermore, the insurance agents argue that when the insurance transaction is complicated, the loan officer will not be able to handle it, so another individual will have to be called in.[278] Allegedly, this eliminates the proposed convenience of giving all the necessary information to one person.[279]

Since convenience is one element in the balancing test which calls for comparing it and other benefits to various adverse effects, even if the Board is correct and there is some net convenience, the amount or significance of that convenience is a relevant question. In some businesses, one-stop shopping may be a convenience each individual consumer will recognize. For instance, in food shopping, a consumer may truly appreciate a small savings of fifteen minutes to an hour a week. But, even assuming that the trip to an independent agent does take as much as an extra hour, which might not be

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274. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 244, 248 (5th Cir. 1976).

275. *Id.* at 252.

276. *Id.*

277. IIAA, *supra* note 134, at 29.

278. *Id.* at 28.

279. It might be logically counterargued that the consumer should be allowed to choose which inconvenience he finds easier to endure. However, it should be remembered that the burden here is on the BHC to prove that greater convenience will result if that is one of the benefits the BHC relies upon. Thus, the insurance company does not have to prove that the inconvenience is sufficient to justify denying a choice to the consumer. That inconvenience is argued to counter the BHC convenience argument in the hopes of showing that the BHC has failed to meet its burden of proving that increased convenience will result. Furthermore, the possibility of voluntary tying suggests that the public's choice may not be based on convenience, thus the mere fact that consumers may purchase bank insurance would not prove that bank insurance was more convenient. *See* text preceding and accompanying notes 306-13 *infra*.

the case with agents located a block away, how many times a year does the average person purchase credit insurance? True, one might buy a home, two cars and a boat as well as finance a business all in one year, but even that is only a savings of a maximum of five hours. Of course, this is speculation; but, it would be hard to imagine an average savings per person nationwide of more than an hour or two a year. The one exception may be in the credit life, health and accident area where the insurance is not readily available from independent agents. To the economist, a savings of an hour per year multiplied by millions of consumers may constitute an efficiency that will indirectly benefit the public. To the consumers themselves, however, a savings of an hour is one they are not likely to notice. Thus, even if the Board's conclusion that increased convenience would result from bank sale of insurance is correct, there is a legitimate question as to whether that benefit will be able to outweigh any adverse effects.[280] In this case, however, the Fifth Circuit has determined that based on the existing record, the convenience to be gained where the bank does not have agents at each facility is not significant enough to constitute a public benefit.

3. COMPETITION

The competitive effect of approval of an application by a BHC to sell insurance is the one factor that is listed in section 1843(c)(8) as both a benefit, "increased competition," and an adverse effect, "decreased or unfair competition." The emphasis is appropriate, since it is in this area that the battle between the banking and the insurance forces has become most heated.

The conflict in this area has focused on two separate arguments. BHCs have argued that BHC sale of insurance will have a pro-competitive effect by forcing independent agents to work harder to compete with the BHC subsidiaries. The agents dispute this, and in addition, charge that sale of insurance by BHC subsidiaries will result in "voluntary tying" of the insurance sale to the credit transaction, giving the BHC subsidiary an *unfair competitive edge*.

The initial BHC argument appears deceptively simple. An increase in entrants into a market is generally viewed as the opposite of monopolization and is naturally associated with increased competition. However, the insurance industry forces argue that the industry is already highly competitive. They note that the top four under-

280. The question of how much convenience results will be relevant to the following conclusions. *See* Part VII.B. *infra*.

writers control only twenty percent of total sales, and the top ten control only thirty-three percent. There are 4,700 underwriting companies,[281] and approximately 75,000 agencies[282] already established and competing.

The BHC response is that despite the number of direct writers and independent agents, the industry is inefficient and not competitive. The most complete explanation of the BHC position is found in *Lenders Acting as Insurance Agents: Public Policy Considerations*, by Carter H. Golembe Associates, Inc. (Golembe).[283]

Golembe notes that since insurance premium rates are set by regulating agencies responding to proposals by underwriters, the role agents may play in controlling prices is limited.[284] Golembe also presents statistics which demonstrate that the unique insurance agency business experiences reverse economies of scale.[285] In other words, as agency size increases, costs consume a larger percentage of each premium dollar instead of a smaller percentage. Thus, volume does not generate cost savings which could be passed on to the consumer. Nevertheless, Golembe argues that the agents do have some ability to influence prices, but that agents have used their influence to raise, not lower, prices.

Golembe proposes that since agents' commissions are one cost of underwriting insurance reflected in premium prices, agents could lower premiums by: (1) urging the underwriters to lower their commission rates; or (2) choosing companies which offer lower premiums due to lower commissions. Instead, Golembe maintains that agents avoid these lower priced, lower commission policies and that high volume agencies use their bargaining power to negotiate higher, not lower commissions.[286]

The agents respond that it is the BHCs, not the insurance agents, who have displayed an inclination to place their own financial gain ahead of the public interest. They point to the experience of BHC sale of credit life, health and accident insurance in Florida. BHC rates for such insurance became so high that the Insurance Commission intervened and imposed a price ceiling of seventy-five cents per $100 of coverage. Despite the fact that the insurance was available from insurance agencies in the state for as little as thirty-eight cents per $100, after the Commissioner's action almost all

281. IIAA, *supra* note 134, at 2-3.
282. *Id.* at 6.
283. Golembe, *supra* note 134.
284. *Id.* at 30.
285. *Id.* at 28-30.
286. *Id.* at 30.

banks were selling the insurance at the maximum.[287] In addition, some banks were allegedly avoiding the maximum by accepting interest free deposits by underwriters. Other abuses, not related to prices, have also been alleged.[288]

Golembe offers statistics demonstrating that the cost to underwriters of using the American agency system is higher than the cost of direct writing. The implication is that the agencies are inefficient.[289] In response to charges of inefficiency, agents argue that the consumer who purchases from an independent agent has chosen to pay slightly higher rates in return for personal services of the agent, which include advice on how much insurance to carry, which company to purchase it from, and assistance in handling claims.

Golembe suggests, however, that the agent's advice may be motivated by factors other than the customer's best interests. Golembe alleges that agents carry virtually identical policies at different prices, using the lower priced policy on price-conscious consumers and pushing similar but price-inflated policies when the consumer is less likely to be a "shopper."[290] Golembe also reveals that some underwriters offer higher commissions once a certain volume is reached.[291] The point is that while agents argue that their personal service involves choosing the best policy for the individual customer, the agent may in fact yield to the obvious conflict of interest and choose a policy which will result in the highest commission to the agent.

Golembe further maintains that since independent agents own their renewals, they "live off renewals" and do not actively seek new accounts.[292] Statistics are presented which indicate that direct writer agents spend more time selling and do sell more new policies.[293] Theoretically, BHC competition would force independent agents to be more aggressive. The independent agents logically answer that they spend more time servicing existing accounts, particularly in handling claims.

One final point made by Golembe is that the independent agents have been experiencing a loss of market share to the direct writers.[294] This, like their higher rates, suggests that the independent agents are inefficient and cannot compete successfully. The

287. IIAA, *supra* note 134, at 19-20.
288. *Id.* at 20-23.
289. *Id.* at 31.
290. Golembe, *supra* note 134, at 31.
291. *Id.* at 32.
292. *Id.* at 36.
293. *Id.* at 53.
294. *Id.* at 25, 47.

agents' answer is that the price competition of direct writers has resulted in a shift in the focus of sales by independent agents. In the uncomplicated personal lines, service is less a factor, and, therefore, direct writers have been able to capture a steadily increasing share of this market. The independent agents have responded by focusing on the more complicated areas of insurance where service is important to the consumer. Thus, the statistics represent not so much an across-the-board loss in market share as a division of the insurance market, with the independent agents taking the smaller, service-oriented kinds of insurance and the direct writers capturing the kinds more susceptible to less personal volume treatment.[295]

As might well be expected, the parties also disagree on the effect BHC sale of insurance will have on the small independent agents. The insurance industry insists that BHC insurance subsidiaries will drive small agents out of business. In their petition for rehearing the insurance groups cited the administrative law judge's conclusion that "it is possible, even probable, that the mom and pop agency will be driven into merger or out of business entirely" and "the independent commission agents would have difficulty surviving."[296] Golembe, on the other hand, argues that BHCs are unlikely to capture such a significant market share as to drive out substantial numbers of agents, and if the agents are driven out because they cannot compete with more efficient insurance distribution systems, the public will benefit nonetheless. Golembe's last point is well taken. It makes no economic sense to protect the agents if their downfall is a result of their inefficiency. However, this Darwinian approach to economics is only valid in the absence of the existence of unfair competitive factors, and as will be discussed hereafter,[297] there is a serious question as to whether unfair voluntary tying, rather than inefficiency, would be responsible for forcing the small agencies out of business.

In considering these various arguments it is easy to lose sight of the fact that whether there is a net public benefit is the real issue. It may be maintained that additional entrants into a market, even if they do add "competition," do not by virtue of that fact alone create a public benefit. The public only benefits if the added competition has one of the following effects: greater convenience, lower prices, or better service. Since convenience is considered as a factor separately, it should not be included here under competitive effect.

295. IIAA, *supra* note 134, at 11.

296. Petitioner's Petition for Rehearing and Suggestions for Rehearing In Banc (sic) at 10 n.8.

297. *See* notes 306-26 *infra* and immediately preceding and accompanying text.

The Board found in *Southern*[298] and *First National*[299] that no more than a "minimum amount" of price competition would result. The Fifth Circuit found that there would be "some pressure for lower prices."[300] Applicants indicated no intention to undercut the agents. Therefore, the belief apparently is that to offset the competitive advantage that the BHC has due to the convenience of its one-stop shopping service, the agents will have to employ what limited influence over prices that they have to lower prices. The suggestion that agencies could be operated profitably if commissions were lower has not been substantiated. Even if it is possible, the fact that in the face of undisguised price competition from direct writers the agents have failed to lower their rates hardly supports the notion that they would suddenly take that approach in response to similar competition from BHC subsidiaries. At best, it is speculation to predict lower prices. It is difficult to see how such speculation constitutes "substantial evidence" that there would be a reduction in prices as a result of BHC entry into the market.

Both the administrative law judge and the Board, as well as the *Alabama* court, agreed that increased competition on the basis of service would result. While on its face this seems perfectly logical, the question left unanswered is just what service the agents are now supposed to offer. If there are additional services to provide or a way to better provide existing services, the fact remains that the agents have not done so already to compete more effectively with the direct writers.

It may be argued that since a large portion of the market shares taken over by the direct writers has been in insurance lines requiring the least service, the agents have not had to give the best service to keep the service-oriented market share. However, the direct writers do offer the service-oriented insurance and have taken some of that market, suggesting that the agents have, in fact, kept that market by striving to give the best possible service. Thus, the question arises as to what "substantial evidence" leads to the conclusion that it can be "reasonably expected" that agents will be able and willing to increase service. It should be noted that the Board is authorized to speculate on adverse effects, since it may weigh "*possible* adverse effects,"[301] but benefits must be "reasonably *expected*."[302]

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298. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,551 (1974).

299. First Nat'l Holding Corp., 39 Fed. Reg. 33,411, 33,413 (1974).

300. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 249 (5th Cir. 1976).

301. 12 U.S.C. § 1843(c)(8) (1970) (emphasis added).

302. *Id.* (emphasis added).

The Board and the court also found that there would be added competition as a result of the financial expertise of the loan officers.[303] IIAA alleges that there was no evidence in the record to indicate how this expertise would be helpful in ensuring that the borrowers have the proper insurance coverage, and no evidence to suggest that borrowers were not currently getting the proper package.[304]

It must be remembered that the burden of presenting substantial evidence—showing that the public can reasonably be expected to benefit—is on the applicant BHC.[305] The BHC arguments here are speculative, and the counter-arguments of the insurance industry seem at least as plausible. The conclusion that BHC entry into the insurance agency business is likely to yield any price reduction or increased service appears highly questionable.

In addition to disputing the competitive effects of BHC sale of insurance, the insurance industry alleges that the BHCs will have an unfair competitive advantage as a result of "voluntary tying." IIAA distinguishes voluntary tying from coercive tying as follows:

> Coercive tying results from specific attempts of the lender to use its power over credit (the tying product) to coerce the borrower to purchase insurance (the tied product). Voluntary tying, on the other hand, results '. . . from a customer's realization that he stands a better chance of securing a scarce and important commodity (such as credit) by 'volunteering' to accept other products or services rather than seeking them in the competitive market.'[306]

IIAA further points out that the line of demarcation between the two is often blurred since subtle suggestions by the loan officer may not be an outright insistence upon purchase of insurance as a condition to credit approvals, but may create a pressure to purchase the insurance that induces a response that is not totally voluntary.

Coercive tying is prohibited by section 106 of the BHCA, as amended.[307] However, the statutory prohibition is impotent in preventing voluntary tying, which is a psychological phenomenon which can occur in the mind of the borrower without any suggestion by the loan officer at all. The mere knowledge that the bank also

303. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 249 (5th Cir. 1976); First Nat'l Holding Corp., 39 Fed. Reg. 33,411, 33,413 (1974); Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,551 (1974).

304. IIAA Brief, *supra* note 168, at 79-80.

305. Worcester Bancorp, Inc., 60 Fed. Res. Bull. 393, 394 (1974).

306. IIAA Brief, *supra* note 168, at 82-83.

307. *See* notes 109-12 *supra* and accompanying text.

sells insurance may be sufficient to generate the belief in a borrower's mind that purchase of insurance will enhance his chances of credit approval. The argument of the insurance agents is that the competition from the BHC subsidiaries will not be based on service or price. Essentially, they argue that inherent in BHC sale of insurance, even without any overt action by the bank employee, there exists a voluntary tying effect which gives a BHC insurance subsidiary an unfair competitive edge against which the insurance agencies cannot compete. The alleged result is that even if independent agents were to offer better services and/or lower prices, the consumers would succumb to the psychological pressure of voluntary tying. Potentially, the public could end up with more expensive insurance or less service, while thousands of independent agents, who may be more efficient, lose business.

It should be noted that voluntary tying is not a concept originated by the IIAA in *Alabama*. As the IIAA brief points out, concerns over voluntary tying have been voiced by Congress,[308] the Antitrust Division of the Department of Justice,[309] and even the Federal Reserve Board staff.[310]

It should further be noted that the belief of consumers that purchasing insurance from the lending institution will aid the chances of credit approval is not totally unfounded. In evaluating credit, the bank does a risk-reward analysis similar to that done in any well thought out investment. The bank weighs the potential earnings (interest) against the risk of loss (default). The additional insurance premium income may raise the reward side of the ratio high enough to justify a risk that the interest income alone may not justify.[311] IIAA points to testimony by one bank official in the hearings on First National's application suggesting that where the applicant purchased bank insurance, the bank might be "more receptive" to approving the loan.[312] Even clearer evidence of at least one bank's inclusion of insurance premium income in its credit evalua-

308. IIAA Brief, *supra* note 168, at 87, *citing* H.R. REP. No. 1747, 91st Cong., 2d Sess. 18 (1970).

309. IIAA Brief, *supra* note 168, at 87.

310. *Id.* at 88, *citing Hearings on Consumer Credit Insurance Act of 1969 Before the Subcommittee on Financial Institutions of the Senate Banking and Currency Committee*, 91st Cong., 1st Sess., 163 (1969).

311. Absent usury laws, this situation would not arise, since it would be simpler and more efficient for the bank to charge an interest rate sufficient to create a risk-reward ratio high enough to justify the loan. In effect, this use of a tie-in is a method of circumventing usury regulation, and in economic terms is only an evil to the extent that the usury laws are justifiable. For a discussion of use of tie-ins to evade price regulation, see Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19, 21-23 (1957).

312. IIAA Brief, *supra* note 168, at 84.

tion is found in the following letter read into the record at recent Senate hearings.

> I regret very much the incident concerning "Mr. X". I based my decision regarding this matter on what I thought to be the interest of "Mr. X" and the bank. As I indicated to "Mr. X", our bank could not accept the loan unless we were allowed to write the credit life insurance. As I discussed by phone, the primary reason for this request to write the insurance, was because this action increased the return of income on the loan by a good margin. Had our bank been denied this additional income, we could not have approved the loan. Because of the extremely tight credit situation, I feel "Mr. X" would not have obtained the loan elsewhere. Therefore, I believed our bank to be doing "Mr. X" a service by granting this type of loan under these circumstances, with credit as tight as it is at present.
>
> I can still appreciate and understand your reasoning and regret that "Mr. X" saw fit to cancel his policy with your company. I am hopeful this situation will not occur again in the future.[313]

Golembe suggests a number of answers to charges that tie-ins will occur. Some of the arguments raised are apparently directed at coercive tying and do not apply to voluntary tying. For instance, Golembe argues that even subtle pressure would offend bank customers and drive them to competitors; but voluntary tying may occur without any pressure whatsoever. Golembe further suggests that consumers are now "much more alert to credit alternatives and much more aggressive with respect to abusive business behavior."[314] It is argued that the disclosure requirements of Regulation Z[315] help the consumer to be aware of the price he is paying for insurance in order to make comparisons. If the comparisons are unfavorable, the consumer has other bank and nonbank credit alternatives.

The arguments based on consumer awareness and credit alternatives to a large extent ignore the nature of the credit transaction. In other consumer settings, the consumer's focus is on purchasing a specific product (goods or services) at the best available price. The price of that product is one of his primary concerns. In the credit transaction, the consumer's main focus is on obtaining the credit. His concentration on the relatively large figures involved in the loan itself, may severely diminish his sensitivity to the relatively small

313. *Competition in Banking Act of 1976: Hearings on S. 2721 Before the Committee on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 99 (1976) (letter offered by Mr. Schmuck, appearing on behalf of various insurance industry members).

314. Golembe, *supra* note 134, at 38.

315. 12 C.F.R. § 226 (1977).

differences between insurance rates. Furthermore, while most consumer purchases require only a decision by the consumer to buy, the "purchase" of credit also requires the decision by the lender to consent to the credit extension.[316] Depending upon the credit standing of the consumer, this approval may be a source of great concern to the consumer, further distracting his focus from the price of the insurance. Young borrowers without credit experience who are attempting to establish a credit standing may feel that approval of the loan is paramount. Even if the borrower is aware that there are alternative sources of insurance offering better service or lower cost, he may consciously decide that if the purchase of bank insurance may improve his chances of loan approval, the sacrifice is worthwhile.

Furthermore, the availability of alternative credit sources does not offer quite the same flexibility to the consumer as does competition in other industries. Often consumers seek credit from banks where they have savings and checking accounts and utilize other services. A consumer may logically feel that his best chance for credit approval is from a bank with whom he has an established relationship. He may succumb to the voluntary tying influence at his regular bank to help his chances of credit approval there, fearing that if that bank would not grant the credit, others with whom he has no relationship would be even less likely to extend credit. In addition, obtaining credit from a different source forces the consumer to choose between the inconvenience of dealing with two institutions and the inconvenience of switching all of his other banking services to the second bank. While these arguments are highly speculative, they are no more speculative than Golembe's suggestion that consumer awareness will prevent voluntary tying.

In addition, it has been argued that if insurance is not discussed until after the credit is approved then there can be no tying effect. The theory is that since the approval has been made, the customer knows that the insurance purchase is not needed to improve the chance of obtaining the loan. However, this may not totally eliminate tying. Most customers have continuing relationships with their banks. The customer may feel that by buying the insurance elsewhere he will create a less favorable atmosphere if there is a problem meeting loan payments and he has to negotiate for an extension. Also, he may feel that failure to purchase the insurance may make him a less desirable customer to the bank and affect a future loan,

316. The element of "seller approval" is a function of the usury laws which prevent the bank from charging an interest ratio high enough to justify credit approval.

particularly in a tight credit market where he may be competing for the same loan dollars with a bank customer whose past record indicates to the bank that a loan to that customer will also generate insurance premium income.

One final suggestion has been that voluntary tying may be eliminated by totally separating the credit and insurance transactions. Aside from the fact that this eliminates a substantial portion of the convenience and efficiency of bank sale of insurance, the consumer may still feel that there is communication between the bank departments and that the insurance purchase may still aid his loan approval.

In his findings in the *Southern* application, the administrative law judge concluded that voluntary tying was a possible adverse result of bank sale of insurance.[317] However, the Board found that no unfair competition would occur because: (1) there were no specific instances of tying in the record; (2) insurance was generally not discussed until after a loan had been closed; (3) penetration figures for a bank-related insurance agency in North Carolina indicated that a very low percentage of sales of insurance relative to total loans was obtained by that agency; and (4) there are nonbank credit sources available in the applicant's market area.[318] The Board further stated that "[i]t is clear from this evidence of record that Applicant does not possess that degree of market power sufficient to create the danger of voluntary tying. . . ."[319]

Although not in any way binding upon the Board, market power over the tying product (as in this case, the credit) has been held to be an essential element in proving the existence of a tying arrangement that violates the anti-trust laws.[320] The market power requirement is based on the reasoning that if the seller of a product does not possess market power over the tying product, the buyer will simply purchase the tying as well as the tied product elsewhere.[321] However, price regulation, such as usury laws, creates a form of market power that does permit a seller to benefit from a tying arrangement.[322] Furthermore, if voluntary tying were only the feeling that *not* purchasing insurance would *hurt* chances of credit approval, then borrowers might consciously avoid banks that sold insurance. Then market power would be a relevant factor because

317. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,551 (1974).
318. *Id.*
319. *Id.* at 25,552.
320. United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977).
321. Bowman, *supra* note 311, at 20.
322. *Id.* at 21-23.

alternatives might be limited. But voluntary tying is just as much a positive feeling that purchasing the insurance may help the chances of credit approval. Thus, borrowers may seek out banks which sell insurance in the hope that by purchasing the insurance the borrower may be able to offer the bank an added incentive to approve the credit request. Nevertheless, the Fifth Circuit confirmed the Board's conclusions.[323] Interestingly, the court described the Board's role as one of determining the "reasonable likelihood" of adverse effects,[324] whereas the statute calls for balancing "possible" adverse effects.[325]

The Board concluded that no voluntary tying existed due to the lack of market power. While there may be disputes among economists as to whether such voluntary tying should be considered anti-competitive, particularly if the banks prove to be more efficient producers, the Board, by examining whether or not it existed, arguably implies that it views voluntary tying to be an anti-competitive effect. The burden of proving that there would be no adverse effects is on the applicant. The only concrete evidence in the record was the penetration rates of two insurance agency subsidiaries. One dealt only with mortgage lending, and the other was apparently in a community of under 5,000 population, since the subsidiary sold general insurance.[326] Other than this scant empirical evidence, the conclusions of the administrative law judge, the Board, and the Fifth Circuit have been speculation.

Whether voluntary tying is a real danger does not seem to be a matter that would evade empirical evaluation. Testing consumer attitudes by survey has become a sophisticated art used frequently in the marketing of products. It should not be difficult to design a survey to determine whether a consumer would feel that purchase of the insurance sold by the BHC would enhance chances of loan approval. Such a survey might also demonstrate whether certain factors, such as not discussing insurance until after loan approval, would reduce the consumer's belief that the insurance sale was a factor in loan approval. The findings might well be that irrespective of the specific circumstances in a given application, a certain amount of voluntary tying could be expected as inherent in bank sale of insurance. This would not necessarily mean that all applica-

323. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 249-51 (5th Cir. 1976).

324. *Id.* at 250.

325. 12 U.S.C. § 1843(c)(8) (1970).

326. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 250 (5th Cir. 1976).

tions would fail the public benefits tests. What it would mean is that, in every BHC application to sell insurance, it would be assumed that there was inherent in such sales a certain level of adverse effects (due to voluntary tying) which would have to be outweighed by benefits. In other words, a threshold amount of public benefits would have to be demonstrated in order to gain approval to sell insurance. There would then be no more instances where the Board finds no adverse effects and therefore grants approval based on any, even de minimis, public benefits.

The question of the existence and degree of voluntary tying in these transactions goes to the heart of whether or not BHC sale of insurance complies with the Congressional goals under the BHCA. The outcome may result in the reallocation of millions of dollars of insurance premiums to less efficient providers of insurance. The result would be that substantial numbers of independent agents may be forced out of business, while consumers incur increased insurance costs. At the very least, it would seem that the Board should require the applicants to meet their burden of proving that voluntary tying would not occur. Ideally, however, one might suggest that the Board, as protector of the public interest, take upon itself to commission a study by competent experts to ensure an impartial gathering of data which would allow the Board to make an educated, empirical determination, instead of one based on speculation and guesswork by Board members who have no qualifications for evaluating psychological pressures which may influence decisions of the credit consumer.

4. EFFICIENCY

BHCs have argued, and the Board has agreed, that BHCs can market insurance more efficiently than can independent agents. Golembe argues that the agents live off renewals and have not taken advantage of direct billing services offered by the underwriters. He further points to the saving that results from not taking the same information from the borrower twice and from avoiding appraisal and inspection of collateral by both bank and insurance company. Additional efficiencies are allegedly to be found in use of the BHCs' data processing facilities and personnel and management resources.[327]

IIAA counters that: (1) when the insurance and credit transactions are separated to avoid tying, the efficiencies are lost as procedures are then duplicated; (2) that, as the Golembe publication

327. Golembe, *supra* note 129, at 52-55.

itself demonstrates,[328] agencies do not experience economies of scale; and (3) that accounting services, which BHC data processing could take over, account for only one percent of agency expenses.[329]

In *First National*, the administrative law judge found gains in efficiency "doubtful" since the BHC subsidiary did not plan to use direct billing.[330] The Board disagreed without mentioning the judge's reasoning, finding efficiencies in reduced advertising and solicitation expenses and in the combining of the insurance and credit operations.[331] While the Fifth Circuit agreed with the Board's findings, it criticized the Board for not considering possible sources of *inefficiency* to determine if there were net gains. For this reason, the court refused to uphold the Board's conclusion.[332] The most interesting of the court's comments, however, is found hidden in a footnote. The court states that increased efficiency is a public benefit even if no improved service or lower prices result, because "a public benefit in a broad sense is conferred whenever a service is performed in a new way which requires less of society's limited human and economic resources."[333] One might question, in light of the unemployment rates in recent years, whether conserving our "limited human resources" is really a public benefit. Essentially the court has held that if a bank can make more profit selling insurance than an agency can, the public benefits. While there may be support for such an argument in the capitalist economic theory, a question certainly may be raised as to whether this is what Congress envisioned when it required the Board to look for public benefits. If the BHC subsidiary can market insurance at lower cost, it seems inconsistent with the intent of the public benefits test not to require that the banks pass on those savings to demonstrate a public benefit. Indeed, in approving applications to *underwrite* credit life, health and accident insurance under 12 C.F.R. § 225.4(a)(10), the Board has specifically required projections of either lower rates or increased policy benefits.[334] A similar requirement for approval of BHC insurance agency activities would be proof of BHC efficiency claims and would end the speculation regarding efficiency as a benefit by showing a concrete savings to the public.

328. *Id.* at 27-30.

329. IIAA, *supra* note 134, at 29-32.

330. IIAA Brief, *supra* note 168, at 75.

331. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,551 (1974).

332. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 248-49 (5th Cir. 1976).

333. *Id.* at 248 n.21.

334. 12 C.F.R. § 225.4(a)(10)(n.8) (1977).

5. UNDUE CONCENTRATION OF RESOURCES, CONFLICTS OF INTEREST, AND UNSOUND BANKING PRACTICES

The remaining three factors will be dispensed with briefly because they have not been the subject of major controversy. As the Fifth Circuit has pointed out, undue concentration of resources blends into competitive effects, and the meaning of "undue" is unclear.[335] IIAA argued in *Alabama* that undue concentration would result from approval because, based on projected volume, the BHC agency would be a very large agency. Although the administrative law judge found that both applications would result in a concentration of resources that would pose a threat to independent agents,[336] both the Board and the court concluded that this adverse effect was not present.[337] Next to the income and assets of a large BHC, the income and assets of even a larger insurance agency is not an addition that makes a sizable increase in the BHC's resources. Agency size seems to go more to competitive effects than concentration of resources. A merger of a BHC and a large underwriter with investment assets might be more the kind of transaction contemplated under "undue concentration of resources."

A "conflict of interest" adverse effect was argued by the IIAA, which suggested that the bank and the borrower might have different "interests" in the collateral being insured.[338] How this would result in a real conflict is not clear. Both the independent agent and the bank would have an incentive to see that the borrower was at least adequately insured in order to generate the highest premiums, and both have the same incentive not to offend a customer by pushing insurance he does not need. The only real conflict of interest is the incentive to sell unneeded insurance, and both independent agents and BHC subsidiaries must deal with that equally.

Finally, the issue of unsound banking practices is not even argued by the IIAA. While insurance premiums might induce the bank to make a loan it would not otherwise make, presumably this is a result of a risk/reward analysis which would balance out over time, since theoretically the higher risk of default would be covered by the added income. The Board concluded that regulatory supervision of loans would prevent banks from making unsound loans to

335. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 251 (5th Cir. 1976).

336. IIAA Brief, *supra* note 168, at 93-94.

337. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 251 (5th Cir. 1976).

338. IIAA Brief, *supra* note 168, at 94-95.

earn insurance premiums.[339] The Fifth Circuit did not address the issue.

VII. Recommendations

A. *A Proposed Conceptual Modification*

Former Federal Reserve Board Chairman Burns has referred to the closely related and public benefits tests as two separate and distinct tests.[340] This conceptual dichotomy seems to have been generally accepted without question; however, both the statutory language and the above discussion of the closely related test suggest that scrutiny of this two-test concept might well be in order.

The statutory language calls for the Board to determine if activities are "so closely related to banking . . . as to be a proper incident thereto."[341] In deciding if an activity is a proper incident, the Board is to consider whether "benefits" which "outweigh possible adverse effects" "can reasonably be expected."[342] If an activity is closely related when it is a proper incident, and is a proper incident if it yields a net benefit, then it is closely related if it yields a net benefit. Rather than suggesting two tests, the language seems to define the kind and degree of relationship necessary to satisfy the "closely" component in "closely related." The relationship must be one that can reasonably be expected to yield a net benefit to the public.

In the general discussion above of the closely related to banking test, it became painfully obvious that if there is a closely related test per se, neither Congress, the administrative law judge, the Board, nor the Fifth Circuit appears to be able to agree on what it is. Various attempts to explain it include: "direct and significant connection,"[343] "functional equivalent to an extension of credit,"[344] "organizationally and physically integrated into the operations of the bank holding company,"[345] "credit related,"[346] "*directly* related to an extension of credit,"[347] "close functional relationship,"[348]

339. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,552 (1974).
340. *See* note 165 *supra* and accompanying text.
341. 12 U.S.C. § 1843(c)(8) (1970).
342. *Id.*
343. H.R. Rep. No. 91-1747, 91st Cong., 2d Sess. 21 (1970).
344. IIAA Brief, *supra* note 168, at 60.
345. Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,549 n.3 (1974).
346. Board Brief, *supra* note 179, at 25.
347. *Id.* at 38 (emphasis added).
348. Practicing Law Institute, Bank Counsel 1976, at 120 (1976) (Corporate Law and Practice Handbook Series No. 220, H. Mortimer, Chairman).

"operational integration . . . into the bank lending process,"[349] "naturally . . . depend upon" or "appertain to,"[350] "so integrally related . . . as to require . . . provision in a specialized form,"[351] "contribut[ing] to the operations of those subsidiaries actually engaged in the banking business."[352] An activity has been deemed closely related if the bank has a legitimate need for it, or it supports the credit transaction in a significant way.[353] An activity has also been deemed closely related to banking where it is "incidental to" and "necessary for the effectuation of" another closely related activity.[354] Furthermore, the above discussion noted language which seems to transform the closely related test into a "rational incident to banking" test,[355] or a "regular mutual need" test.[356]

After carefully reviewing all of these attempted definitions or paraphrasings, it is still virtually impossible to delineate guidelines that assist in predicting whether a given activity is or is not closely related to banking. One is left with the conclusion drawn early in the discussion of the closely related test that closely related is simply what the Board says it is, unless the appellate courts decide arbitrarily to substitute their definition for the Board's.

While the closely related language is nebulous, indefinable and unpredictable, the public benefits test is workable, allows reasonable predictability, and is thoroughly consistent with concepts of government regulation in a capitalist society. In a capitalist economy based upon free competition, business should be free of government regulation unless there is reason to believe that regulation is in the public interest. Because of the potential adverse results of permitting banks to engage in nonbank activities through holding company subsidiaries, regulation has been determined to be in order.[357] If the basic premise underlying regulation is that permitting these nonbank activities may in some cases result in harm to the public, the logical goal of the regulation should be to permit those activities that will yield a net benefit to the public, and forbid those activities which will yield a net injury to the public. In other

349. Salley, *What is Closely Related to Banking?*, 56 MONTHLY REVIEW, FEDERAL RESERVE BANK OF ATLANTA 98 (June 1971), *cited in* IIAA Brief, *supra* note 168, at 50.

350. Transamerica Corp., 43 Fed. Res. Bull. 1014, 1015 (1957).

351. National Courier Ass'n v. Board of Governors of the Fed. Reserve Sys., 516 F.2d 1229, 1237 (D.C. Cir. 1975).

352. Alabama Ass'n of Ins. Agent v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 241 (5th Cir. 1976).

353. *Id.* at 244.

354. *Id.* at 245.

355. *See* notes 205-07 *supra* and accompanying text.

356. *See* notes 207-08 *supra* and accompanying text.

357. *See* notes 18-26 *supra* and accompanying text.

words, a public benefits test alone is the purest, simplest way for the Board to make decisions that would be totally consistent with the reasoning behind the regulation.

Apparently an assumption was made by those drafting the original closely related language that if an activity had a close relationship to banking, then BHC participation in that activity is less likely to have adverse effects and more likely to yield benefits. This assumption is not without logical foundation. The more related to banking an activity is, the more likely bank management and employees will be able to use their expertise to perform the activity efficiently, and the less likely it would be to distract bank management from their banking responsibilities. If the bank can perform the service efficiently, the public is likely to benefit from quality service or lower prices. However, the fact that activities which are closely related are more likely to yield a net benefit does not mean that *only* closely related activities will yield a benefit. For instance, the Fifth Circuit found that certain convenience insurance authorized by Regulation Y was not closely related.[358] Yet some of these types of convenience insurance, as the Board has found, do yield a public benefit. If the purpose of regulation is to protect the public interest by allowing activities which will result in a net benefit, there appears to be something wrong with a test designed to implement that policy if activities that do yield a public benefit fail the test.

The legislative history, the administrative law judge's hearings, Board orders and appellate court decisions reveal that attempts to treat the closely related language as a test have deteriorated into a confusing and meaningless semantic legerdemain that is inconsistent with the most basic purpose underlying regulation.

The addition of the public benefits language in 1970 should be viewed not as the addition of a second test, but rather as a clarification of the meaningless closely related test. If there is a net benefit to be derived from allowing a BHC to engage in a certain activity, by definition that activity should be considered a "proper incident" to banking. Regulation Y can still stand, but not as a list of activities that the Board has arbitrarily, without statutory guidelines, defined as closely related to banking. Rather, Regulation Y should be, as it now partially is, simply a list of those activities which pass a "generalized public benefits" test, that is, are likely to pass the public benefits test. Regulation Y could then provide a useful guide-

358. Alabama Ass'n of Ins. Agents v. Board of Governors of the Fed. Reserve Sys., 533 F.2d 224, 242-43 (5th Cir. 1976).

line for applicants by defining activities involving circumstances which often result in net public benefits, but it would not preclude approval of activities not on the list if a net benefit could be demonstrated.

Adoption of this approach by the Board would end the wasteful semantic debate over the term "closely related" and would leave the Board with a test that is relatively clear and totally consistent with the theory behind regulation.

B. *Public Benefits: A More Intensive Analytical Approach*

Whether the Board adopts the suggestion to drop the dysfunctional "closely related" test as a separate test or not, there is room for major improvement in the Board's treatment of the public benefits test as applied to insurance applications.

First, voluntary tying either exists or does not exist. Voluntary tying is a psychological phenomenon that occurs, if at all, in the mind of the consumer. Whether or not it exists is not the kind of finding of fact that an administrative law judge, the Board, or the courts are competent to make without expert assistance. At the very least the applicants, in order to meet their burdens of showing a net public benefit, should be required to demonstrate with proper empirical evidence, such as a study conducted by persons with the proper psychology and consumer economics background, that voluntary tying does not occur. Ideally, however, the Board should commission its own study in order to ensure impartiality, since the lack of pure adversary proceedings makes it inappropriate to rely upon the intervening party to criticize such a study. If the study shows that voluntary tying is inherent in these credit related insurance transactions, the Board should attempt to evaluate the severity of this adverse effect. The resultant amount of adverse effect inherent in such transactions would create a threshold level of adverse effect which would have to be exceeded by benefits.

Furthemore, the Board should re-evaluate the allegations concerning the convenience factor in order to make some judgment as to how significant any increased convenience may be. The Board might view the convenience both in terms of the effect on an individual consumer and in terms of the aggregate national time savings. Only by making a judgment as to the degree of increased convenience that may be expected can the Board weigh this convenience against the adverse effects.

A third factor deserving reconsideration is increased efficiency. The position taken by both the Board and the Fifth Circuit is that increased efficiency is a public benefit regardless of whether the savings are passed on to the consumer. Even if there is theoretical economic support for such a position, it is questionable whether Congress had in mind such sophisticated economic footwork when it listed increased efficiency as a "public" benefit. It seems much more likely that Congress would have viewed the consumer as the "public," and would have intended that the efficiencies be passed on. If BHC subsidiaries can indeed operate more efficiently, it seems only logical to require them to meet their burden of proof and demonstrate their efficiency. They can do this by passing cost savings on to the consumer so as to yield a benefit that consumers can experience, instead of one that can only be read about in economics texts. The Board insists that permission to *underwrite* insurance depends heavily on demonstrating lower costs to the public.[359] There is no reason not to impose a similar requirement on permission to engage in agency activities.

VIII. CONCLUSION

An analysis of the controversy over sale of insurance by BHC subsidiaries suggests that two broad revisions are in order. First, the dysfunctional closely related test should be abandoned. Second, the Board should halt the guesswork and properly determine to what degree, if any, voluntary tying occurs; it should reconsider its conclusion that a meaningful increase in convenience is achieved by BHC subsidiary sale of insurance; and where increased efficiency is alleged, the BHC should be required to demonstrate such efficiency by proving that the consumer will receive either increased services or lower prices. If these suggestions are adopted the Board will be in a better position to perform its task of employing its regulatory authority to promote the public interest.

359. *See* note 334 *supra* and accompanying text.