
Bank Operating Subsidiaries: Free at Last or More of Same?

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BANK OPERATING SUBSIDIARIES: FREE AT LAST OR MORE OF SAME?

*James R. Smoot**

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INTRODUCTION

Late in 1994, the Office of the Controller of the Currency ("OCC") proposed certain seemingly modest changes to its mostly technical rules concerning the "corporate activities" of national banks, which are set forth in Part 5 of its regulations in the Code of Federal Regulations ("Proposed Part 5 Rules").¹ Among other things, these Proposed Part 5 Rules dealt with the activities of "operating subsidiaries," which under regulations then in force were corporations controlled by national banks that engaged in a variety of activities related to the business of banking.² Those regulations stated generally that all provisions of law and regulation applicable to national banks were "equally applicable" to their operating subsidiaries, unless a statute or regulation provided otherwise.³

One change in the Proposed Part 5 Rules was that OCC may, where appropriate, exempt an operating subsidiary from such a provision of law or regulation applicable to national banks, even in the absence of a formal statutory or regulatory exemption.⁴ OCC suggested that this action might be appropriate, for instance, where the provision in question imposes a specific restriction on the authority of a national bank to conduct a particular activity, but such restrictive provision does not necessarily apply to the bank's subsidiaries.⁵

1. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,034 (1994). The Office of the Controller of the Currency ("OCC") offered these proposals in compliance with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, 12 U.S.C. § 4803 (1994). Under this Act, OCC has implemented a broad Regulatory Review Program designed "to update and streamline OCC regulations and to reduce unnecessary regulatory costs and other burdens." Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,034.

2. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,056 (Proposed Part 5 Rules § 5.34).

3. 12 C.F.R. § 5.34(d)(2)(i). These previously effective regulations, 12 C.F.R. pt. 5 (1996), are hereinafter referred to as the "Old Part 5 Rules."

4. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,056 (Proposed Part 5 Rules § 5.34(d)(3)).

5. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,039 (Proposed Part 5 Rules § 5.34(d)(2)).

This seemingly modest change, however, attracted an enormous amount of attention in the financial services industry⁶ and incurred the wrath of influential members of Congress.⁷ House Banking Committee Chairman James Leach, who had been trying to shepherd financial services statutory reform through a reluctant Congress, strongly objected that this proposed change by OCC of its own regulations was utterly without statutory basis and dangerous to boot.⁸ Confronted with such ferocious hostility, OCC abandoned its schedule for finalizing the proposed rules⁹ and moved them to the back burner.¹⁰ When financial institution reform failed again in Congress, however, the proposed rules returned to the front burner and, with certain minor changes made by OCC in response to comments on the proposed rules, were finalized, effective December 31, 1996 ("New Part 5 Rules").¹¹ Promptly thereafter, opponents vigorously renewed their objections and in due course the New Part 5 Rules will no doubt land

6. See *infra* notes 92-93 and accompanying text.

7. See *infra* notes 103-06 and accompanying text.

8. See Pamela Atkins, *Leach Objects to OCC's Move To Allow Bank Subs Broader Powers*, 64 Banking Rep. (BNA) 729 (Apr. 10, 1995), available in LEXIS, BNA Library, BNABus File (engaging in nonbanking activities jeopardizes the federal deposit insurance system).

9. OCC's announcement of the Proposed Part 5 Rules requested that comments on them be delivered not later than January 30, 1995, Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,034, based upon which it would proceed to completion and adoption of final rules. According to a published report, the rules were to be finalized by the end of May of 1995. See Leslie R. Bullock, *Regulators Publish Agendas; OCC's Part 5 Proposal Set for Final Action During May*, 64 Banking Rep. (BNA) 950 (May 15, 1995), available in LEXIS, BNA Library, BNABus File.

10. Formal action on the rules ceased after they drew heavy criticism, and Congress and the Administration began pursuing serious efforts at statutory reform. Under the circumstances, discretion seemed to dictate that OCC stay its regulatory hand until the prospects for legislative reform became clearer. See Olaf de Senerpont Domis, *OCC May Get Upper Hand in Bid To Expand Activities Allowed in Bank Subsidiaries*, AM. BANKER, Feb. 12, 1996, at 4 (OCC Chief Counsel Julie L. Williams said OCC in "holding pattern" on Proposed Part 5 Rules and "monitoring what Congress [wa]s doing"); Justin Fox, *Hopes for Wider Powers Now Pinned on Courts, Regulators—Not Congress*, AM. BANKER, Jan. 2, 1996, at 1.

11. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341 (1996) (to be codified at 12 C.F.R. pt. 5).

Participants in the ongoing legislative and administrative efforts to reform financial institution regulation had predicted that OCC would proceed with the Proposed Part 5 Rules if Congress was unable to enact significant reform legislation, the Supreme Court held in favor of the banking industry in the *Barnett Bank* insurance sales case, *Barnett Bank v. Nelson*, 116 S. Ct. 1103 (1996), and Congress did not act to protect insurance agents against bank competition. See de Senerpont Domis, *supra* note 10, at 4; Fox, *supra* note 10, at 1. Banks won a major victory in the insurance arena with *Barnett Bank*, 116 S. Ct. at 1111 (holding that federal statute permitting national banks located in small communities to sell insurance preempts Florida statute prohibiting such sales; anti-preemption rule of McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (1994), does not apply). Further, Congress abandoned its effort at significant statutory reform. See *infra* note 47 and accompanying text. Thus, the stage was thus set for finalization of the proposed rules.

in the courts.¹² Thus, their validity and wisdom are again timely and important topics.

This Article will explore OCC's operating subsidiary reforms set forth in the New Part 5 Rules and the objections to them. The reforms appear to be both entirely permissible under the existing statutory regime and a desirable administrative contribution¹³ to the broader ongoing effort to enable banks to adapt to and prosper in a rapidly changing financial services environment. It is to that broader effort, however, that this Article first briefly turns in Part I, both to give historical context to the new rules and to explain why they have aroused so much attention and opposition. Thereafter, Part II will summarize the key elements of the New Proposed Part 5 Rules. Part III will consider the very fundamental, but still contested, question of whether national banks are permitted to have operating subsidiaries. The balance of this Article will examine the most important objections to specific parts of the new rules, including whether the bank ownership requirement may be reduced from eighty percent to a bare majority (or even less) of the operating subsidiary's stock (Part IV) and, most importantly of all, whether and under what circumstances an operating subsidiary might be permitted to engage in activities that its parent national bank may not (Part V).

I. BACKGROUND

The statutory regime that governs national banks is a none-too-tidy accumulation of legislation beginning with the National Bank Act of 1864,¹⁴ with important modifying and supplementing enactments consisting of, among others, the Glass-Steagall Act in 1933¹⁵ and the Bank Holding Company Act in 1956,¹⁶ plus a number of lesser acts.¹⁷

12. See Niles S. Campbell, *OCC Rule Expands Bank Business Lines; Operating Subsidiary Section Draws Fire*, 67 Banking Rep. (BNA) 873 (Nov. 25, 1996), available in LEXIS, BNA Library, BNABus File (American Council for Life Insurance and Securities Industry Association threaten both legal and legislative action to block new rules).

13. The New Part 5 Rules are thus an example of "incremental regulatory change" that I have previously suggested is, under current political circumstances, a useful prelude to a broader legislative overhaul of financial services laws. That broader overhaul is plainly inevitable but nonetheless slow in coming. James R. Smoot, *Financial Institutions Reform in the Wake of VALIC*, 29 CREIGHTON L. REV. 691, 692 (1996); see *infra* notes 46-51 and accompanying text.

14. Act of June 3, 1864, ch. 106, 13 Stat. 99 (codified as amended at 12 U.S.C. § 38 (1994)).

15. Glass-Steagall was a part of the Banking Act of 1933. Ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

16. Pub. L. No. 84-511, ch. 240, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841-50 (1994)).

17. E.g., Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified as amended in scattered sections of 12 U.S.C.); Garn-St. Germain

While the original 1864 legislation, when enacted, was intended to give national banks relatively broad powers,¹⁸ many of the subsequent acts circumscribed those powers in a manner that confines American banks to relatively narrow parts of the financial services business. Thus, while banks in many parts of the world are permitted and expected to offer a broad range of financial services, including securities and insurance services,¹⁹ in this country the Glass-Steagall Act has imposed significant limitations on the authority of banks to engage in securities activities,²⁰ and Congress also has restricted bank involvement in insurance underwriting and sales.²¹

Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.).

18. At the time, Congress wanted to encourage formation of national, rather than state, banks and to encourage owners of banks organized under state charters to convert to national bank charters. See Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676, 699 (1983).

19. See EDWARD L. SYMONS, JR. & JAMES J. WHITE, *BANKING LAW: TEACHING MATERIALS* 349-51 (3d ed. 1991) (insurance); *Firewall Restrictions Atypical Worldwide, Reports Survey of Laws in EU, 49 Nations*, 67 Banking Rep. (BNA) 722 (Oct. 28, 1996), available in LEXIS, BNA Library, BNA Bus File (securities and insurance); Robert M. Garsson, *Most Major Nations Are Said To Permit Securities Underwriting Within a Bank*, AM. BANKER, Oct. 6, 1995, at 2 (securities); William M. Isaac & Melanie L. Fein, *Facing the Future—Life Without Glass-Steagall*, 37 CATH. U. L. REV. 281, 296 (1988) (securities); Jonathan R. Macey, *The Inevitability of Universal Banking*, 19 BROOK. J. INT'L L. 203, 203-04 (1993) (insurance); Edward L. Symons, Jr., *The United States Banking System*, 19 BROOK. J. INT'L L. 1, 22 (1993) (insurance); Julie L. Williams & Mark P. Jacobsen, *The Business of Banking: Looking to the Future*, 50 BUS. LAW. 783, 785 (1995) (securities); Ron Chernow, *Saving the Banks: Bank Reform? What Bank Reform?*, WALL ST. J., Apr. 19, 1991, at A14 (insurance); Peter J. Wallison, *Saving the Banks: Banking and Commerce Belong Together*, WALL ST. J., Mar. 27, 1991, at A14 (insurance).

20. 12 U.S.C. § 24 (Seventh) (1994) (securities dealing by national banks limited to nonrecourse purchase and sale of securities for and at the request of customers; no underwriting); *id.* § 78 (no joint service by individuals as officers, directors, partners, or employees of both investment banks and Federal Reserve System member banks); *id.* § 377 (no affiliation by Federal Reserve System bank with any organization that is "engaged principally" in issuing, underwriting, or distributing securities); *id.* § 378(a)(1) (prohibiting anyone "engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds, debentures, notes, or other securities" from also "receiving deposits"). The limitations on national bank securities activities set forth in section 24 (Seventh) apply equally to state banks that are members of the Federal Reserve System. *Id.* § 335.

21. The Garn-St. Germain Depository Institutions Act of 1982 provided that "it is not closely related to banking" for a bank holding company to "provide insurance as a principal, agent or broker," except as specifically permitted in seven exemptive provisions that are limited to credit life insurance, certain grandfathered activities, insurance for the holding company and its employees, insurance activities in places with fewer than 5,000 inhabitants, or where there is a showing of inadequate insurance availability. 12 U.S.C. § 1843(c)(8)(A)-(G) (1994). This 1982 legislation restricted language in the original Bank Holding Company Act of 1956 that permitted a holding company to own shares of a company that was engaged exclusively in "financial, fiduciary, or insurance" activities that the Board of Governors of the Federal Reserve System determined were "so closely related to the business of banking" as to be a "proper incident thereto." Bank Holding Company Act of 1956, Pub. L. No. 84-511, § 4(c)(6), 70 Stat. 133, 137. When the Board broadly interpreted this language to permit holding company subsidiaries to sell a wide

For several decades, these restrictions were not serious impediments to profitable operations by banks. While their markets were indeed largely confined to such traditional activities as taking deposits, making loans, and clearing payments,²² those markets were also for the most part protected, low-risk, and generally profitable.²³ Beginning about thirty years ago, however, certain of those markets became attractive to other participants in the broader financial services industry. Thus, banks began losing loan business to pension funds, insurance companies, and even investment banking firms,²⁴ which

range of insurance products, see Symons, *supra* note 19, at 25, an alarmed insurance industry convinced Congress to enact a provision in the 1982 legislation to reduce the scope of bank holding company insurance activities, see Joyce Palomar, *Bank Control of Title Insurance Companies: Perils to the Public That Regulators Have Ignored*, 44 Sw. L.J. 905, 914 (1990).

Similarly, as to national banks themselves, section 92 of the National Bank Act provides that banks "located and doing business in any place the population of which does not exceed five thousand inhabitants" have authority to act as agents in the sale of fire, life, and other insurance. 12 U.S.C. § 92 (1994). Insurance interests have asserted that this language precludes, by negative implication, authority for national banks located in larger places to sell insurance, an assertion that has found some judicial support. *Variable Annuity Life Ins. Co. v. Clarke*, 998 F.2d 1295, 1298 (5th Cir. 1993), *rev. sub nom. NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995). However, the point remains open. 115 S. Ct. at 814-15 (not reaching the issue because the annuities at issue were held not to be insurance).

The Board of Governors of the Federal Reserve System is also frequently referred to (including in this Article) by a number of shorthand terms, such as the "Federal Reserve Board," the "Board" and the "Fed." This Article also from time to time refers to bank holding companies, which are dealt with in the Bank Holding Company Act and defined at 12 U.S.C. § 1841(a)(1), as "holding companies."

22. The federal definition of "bank" is:

[a]n institution . . . which both—

(i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and

(ii) is engaged in the business of making commercial loans.

12 U.S.C. § 1841(c)(1)(B). National banks are more specifically given authority to exercise: all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; [and] by loaning money on personal security; and by obtaining, issuing, and circulating notes . . .

Id. § 24 (Seventh).

23. See Emeric Fischer, *Banking and Insurance—Should Ever the Twain Meet?*, 71 NEB. L. REV. 726, 771-75 (1992); Helen A. Garten, *Subtle Hazards, Financial Risks, and Diversified Banks: An Essay on the Perils of Regulatory Reform*, 49 MD. L. REV. 314, 323-24 (1990).

24. Investment banking firms, or "investment banks," are financial organizations that engage in "activities associated with securities underwriting, making a market in securities, and arranging mergers, acquisitions and restructuring. . . . Investment banking also includes the services of brokers or dealers in secondary market transactions" ENCYCLOPEDIA OF BANKING AND FINANCE 661 (Charles J. Woelfel ed., 10th ed. 1994). Investment banks have historically been contrasted with "commercial banks," which are banks engaged in the activities described previously in note 22. This contrast was especially important in the legislative history and subsequent implementation of the Glass-Steagall Act, which was intended to separate commercial and investment banking activities. See, e.g., *Board of Governors of Fed. Reserve Sys. v. Investment*

could offer very competitive interest rates to business borrowers.²⁵ Businesses also discovered that offshore lenders²⁶ and the commercial paper markets²⁷ were quite satisfactory alternatives to borrowing from domestic banks. Similarly, in the consumer lending markets, banks have lost considerable market share in, for example, such important lines as credit card lending²⁸ and automobile and other consumer installment loans.²⁹

During the same recent period, moreover, banks began losing deposits, their primary source of funding for loans, to a variety of non-bank businesses that could offer deposit, safe keeping, investment, and payment services that were quite competitive to banks. Thus, de-

Co. Inst., 450 U.S. 46, 62 (1981); *Investment Co. Inst. v. Camp*, 401 U.S. 617, 629 (1971); S. REP. NO. 73-77, at 10 (1933); 77 CONG. REC. 4179, 4179 (1933) (remarks of Sen. Glass) (stating that the legislation would "confine to their proper business activities these large private concerns [investment banks] whose principal business is that of dealing in investment securities . . . and deny them the right to conduct the deposit bank business at the same time"); 77 CONG. REC. 3835, 3835-36 (1933) (remarks of Rep. Steagall).

I have argued elsewhere that the degree of separation between commercial and investment banks that was actually achieved by Glass-Steagall or even intended by the Congress that enacted it is subject to debate. See James R. Smoot, *Striking Camp and Moving to Higher Ground: The Hazardous Subtleties of "Subtle Hazards" in Bank Regulation*, 4 GEO. MASON L. REV. 21 (1995).

25. See Donald C. Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672, 679 (1987); G. Bruce Knecht, *Merrill Intends To Originate Major Loans—Securities Firm To Compete with Commercial Banks in Lending to Businesses*, WALL ST. J., June 20, 1994, at A2.

26. See Isaac & Fein, *supra* note 19, at 296 (foreign financial institutions compete successfully with domestic banks because, *inter alia*, they are not "encumbered by Glass-Steagall-type restraints"); Williams & Jacobsen, *supra* note 19, at 785.

27. Commercial paper consists of short-term, unsecured, and typically discounted (though it may be interest-bearing) obligations of a corporation. DICTIONARY OF FINANCE AND INVESTMENT TERMS 96 (John Downes & Jordon E. Goodman eds., 4th ed. 1995). The issuing corporation ordinarily pays a slightly lower effective interest rate than on a comparable bank loan. *Id.* In this credit market, the corporation sells its short-term obligations (with terms of up to 270 days) to investors, either directly or through a broker, which will place the paper and keep necessary records. See U.S. TREASURY DEP'T, MODERNIZING THE FINANCIAL SYSTEM, U.S. TREASURY DEPARTMENT RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS 23 (1991) [hereinafter MODERNIZING THE SYSTEM]. The commercial paper market has grown enormously in recent decades, *Role of Financial Institutions: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 100th Cong. 6 (1987) (statement of Alan Greenspan, Chairman, Board of Governors, Federal Reserve System). Further, that market has more or less equalled commercial bank lending in size. See MODERNIZING THE SYSTEM, *supra*, at 126, fig. 10 (ratio of outstanding commercial bank loans to commercial paper reduced from approximately 10:1 in 1960 to 1.2:1 in 1989); Fischer, *supra* note 23, at 771-75.

28. See Lisa Fickenscher, *Banks Lose More Ground as Credit Card Issuers*, AM. BANKER, Sept. 11, 1995, at 32 (banks held only 51.2% of the market for credit card receivables on March 31, 1995, down from 53.6% in 1993).

29. Automobile and storefront finance companies have made significant inroads into banks' market shares. See Fischer, *supra* note 23, at 771-75.

positors' funds that in prior decades flowed into bank accounts were siphoned off into brokerage firm asset-management accounts³⁰ and especially into money market funds.³¹ More recently still, bank customers have found satisfactory alternative providers for such traditional bank services as trust management³² and even currency dispensing.³³

The cumulative effect of these and related developments was that traditional commercial banking ceased being the safe, comfortable, and predictably profitable business it formerly had been, particularly as bankers sought business in riskier lending markets after their former, higher quality customers found other credit relationships.³⁴ Banks responded to these incursions into their markets in kind by proposing and offering new services and products in financial services markets then exclusively occupied by other players in the financial services industry. These new services and products were related to commercial banking and lent themselves well to commercial bank exploitation by virtue of the existing expertise and assets of the banks,³⁵ but they were not part (or at least an important part) of the traditional commercial bank catalog.

While banks have had considerable success in expanding into these new areas, that expansion has not been smooth or effortless. For one thing, the statutory limitations Congress imposed to confine banks and their holding company affiliates to traditional commercial banking activities³⁶ posed significant impediments. The incentives for banks to overcome those impediments and expand, however, were powerful. Glass-Steagall may have been intended, at least in part, to prevent a recurrence of the rash of bank failures that occurred during the Depression,³⁷ which was commonly attributed at the time to ex-

30. See Vanessa O'Connell, *Tired of Banks? Try Checking Out an Alternative*, WALL ST. J., Sept. 8, 1995, at C1 (noting that asset-management accounts combine stock and bond trading with access to money funds, pay market related interest rates, and are as easy to use as checking accounts).

31. See S. REP. NO. 96-378, at 4-6 (1979); JOSEPH AUERBACK & SAMUEL L. HAYES, *INVESTMENT BANKING AND DILIGENCE: WHAT PRICE DEREGULATION?* 92-93 (1986).

32. See Ellen E. Schultz, *Banks Get New Competition for Trusts*, WALL ST. J., Nov. 24, 1995, at C1 (noting that more people are placing their trust accounts in brokerage firms and mutual fund companies).

33. See Beth Piskora, *EDS Poised To Wrest Top Spot in ATMs from BankAmerica*, AM. BANKER, Aug. 28, 1995, at 1.

34. See Isaac & Fein, *supra* note 19, at 296; Macey, *supra* note 19, at 207-10; Williams & Jacobsen, *supra* note 19, at 785-86.

35. See Thomas G. Fischer et al., *The Securities Activities of Commercial Banks: A Legal and Economic Analysis*, 51 TENN. L. REV. 467, 571 (1984).

36. See *supra* notes 20-21 and accompanying text.

37. Approximately 5,000 banks failed during the first four years of the Depression, prior to enactment of Glass-Steagall in 1933. *Modernization of the Glass-Steagall Act: Hearing Before*

cessive bank involvement in speculative securities activities.³⁸ However, in the current era of increased competition from nonbanks, limitations on the ability of banks to diversify their business activities perversely serve to add to the riskiness of the banking enterprise.³⁹

Accordingly, larger commercial banks set about the task of convincing their regulators to permit them and their affiliates to engage in a broader range of securities⁴⁰ and, more recently, insurance-related⁴¹

the Senate Comm. on Banking, Housing, and Urban Affairs, 100th Cong. 33 (1987) (statement of Donald A. Ritchie, Associate Historian, Senate Historical Office).

38. See, e.g., Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61 (1981) (stating that the Glass-Steagall Act was enacted to protect against "any repetition of the widespread bank closings that occurred during the Great Depression" and at the time Congress believed that "the connection between commercial banking and investment banking, had contributed" to such closings).

39. See Langevoort, *supra* note 25, at 682-83; Robert E. Litan, *Evaluating and Controlling the Risks of Financial Product Deregulation*, 3 YALE J. ON REG. 1, 10, 18-19 (1985) (30% reduction in volatility of bank earnings when product line limitations were removed); Jonathan R. Macey, *Special Interest Groups Legislation and the Judicial Function: The Dilemma of Glass-Steagall*, 33 EMORY L.J. 1, 12 (1984); Note, *Restrictions on Bank Underwriting of Corporate Securities: A Proposal for More Permissive Regulation*, 97 HARV. L. REV. 720, 729 (1984) (analysis drawing upon portfolio theory suggested that combining bank and securities activities may reduce enterprise riskiness).

Moreover, the idea that the widespread bank failures during the Depression were the result of bank involvement in securities activities is highly questionable. See *Legislative Proposals To Restructure Our Financial System: Hearings on S. 1886, S. 1891 and S. 1905 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong. 92 (1987) (statement of Alan Greenspan, Chairman, Board of Governors, Federal Reserve System) [hereinafter *Hearings on S. 1886*] (banks with securities operations "did not fail in proportionately greater numbers" than other banks); Isaac & Fein, *supra* note 19, at 285-87.

Indeed, there is growing recognition of the likelihood that, on balance, traditional bank lending is a riskier activity than underwriting and dealing. See Isaac & Fein, *supra* note 19, at 299-300; Macey, *supra* note 19, at 206; *Bankers Support Leach Bill, with Caveats; Baker Looks at Insurance, Systemic Risks*, 64 Banking Rep. (BNA) 730 (Apr. 10, 1995), available in LEXIS, BNA Library, BNABus File [hereinafter *Bankers Support Leach Bill*] (statement by Michael E. Patterson, Chief Administrative Officer, J.P. Morgan & Co., Inc.); Charles S. Sanford, Jr., *Should the Glass-Steagall Act Be Repealed: Two Views*, AM. BANKER, Mar. 8, 1984, at 4 (position of President of Bankers Trust Co., New York).

40. Thus, holding company affiliates of banks obtained regulatory approval to act as discount brokers, 12 C.F.R. § 225.125 (1996); see *Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys.*, 468 U.S. 207 (1984), and as underwriters and dealers in (i) mortgage-backed securities, *Citicorp*, 73 Fed. Res. Bull. 473 (1987), *aff'd sub nom. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 839 F.2d 47 (2d Cir. 1988), (ii) corporate debt and equity issues, *J.P. Morgan & Co., Inc.*, 75 Fed. Res. Bull. 192, 213 (1989), and (iii) municipal revenue bonds, *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 839 F.2d 47 (2d Cir. 1988).

41. *Variable Annuity Life Ins. Co. v. Clarke*, 998 F.2d 1295, 1297 (5th Cir. 1993) (quoting Comptroller's Letter of March 21, 1990, approving sale of annuity contracts by a national bank subsidiary acting as agent for life insurance companies), *rev'd sub nom. NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 814-15 n.4 (1995) (approving sale of annuity contracts by a national bank subsidiary acting as agent for life insurance companies); R. Christian Bruce, *Judge Rules Against Retirement CD; Blackfeet National Sues Treasury*, 64 Bank-

activities. They have had considerable success in this campaign with OCC and the Federal Reserve Board,⁴² but their efforts to implement proposals for expanded services and products after approval by the regulators were met with vigorous challenge in the courts by other participants in the financial services industry whose turf these proposals seemingly invaded, including, most especially, investment banking⁴³ and insurance⁴⁴ interests.

While banks and their affiliates have ultimately won many of these battles, they have also suffered significant setbacks,⁴⁵ with the result that the legal landscape is even more scrambled than before. It is surely apparent that the statutory scheme for regulating the financial

ing Rep. (BNA) 1097 (June 5, 1995), available in LEXIS, BNA Library, BNABus File (describing OCC approval of "retirement certificate of deposit," which has some of the tax-deferred elements of an annuity contract).

42. See *supra* notes 40-41.

43. Investment banking and related trade organizations have challenged commercial bank or bank affiliate involvement in a number of securities activities approved by bank regulatory bodies:

(i) bank holding company or a nonbank subsidiary offering advice to closed-end investment company, Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46 (1981);

(ii) bank holding company ownership of a company involved in the retail sales of securities, Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207 (1984);

(iii) bank assisting corporate customers in placing their commercial paper, Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 137 (1984); Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 807 F.2d 1052 (D.C. Cir. 1986);

(iv) bank offering automatic stock purchasing services for its customers, New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091 (D.D.C. 1975), *vacated sub nom.* New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977);

(v) nonbank affiliate of a bank holding company underwriting and dealing (within certain limits) in government-issued or -guaranteed securities, Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 839 F.2d 47 (2d Cir. 1988);

(vi) nonbank affiliate of a bank holding company underwriting and dealing (within certain limits) in commercial paper, Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 847 F.2d 890 (D.C. Cir. 1988);

(vii) bank selling mortgage pass-through certificates, Securities Indus. Ass'n v. Clarke, 885 F.2d 1034 (2d Cir. 1989);

(viii) affiliate of a bank holding company underwriting and dealing (within certain limits) in corporate securities, Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 900 F.2d 360 (D.C. Cir. 1990); and

(ix) federal savings and loan associations jointly investing in a brokerage and investment advisory company, Securities Indus. Ass'n v. Federal Home Loan Bank Bd., 588 F. Supp. 749 (D.D.C. 1984).

44. See, e.g., *Variable Annuity Life Ins. Co.*, 998 F.2d 1295, *rev'd sub nom.* NationsBank of North Carolina v. Variable Annuity Life Ins. Co., 115 S. Ct. 810 (1995) (annuities); *American Land Title Ass'n v. Clarke*, 968 F.2d 150, 157 (2d Cir. 1992) (title insurance); *Saxon v. Georgia Ass'n of Indep. Ins. Agents*, 399 F.2d 1010, 1016 (5th Cir. 1968) (automobile, home, casualty, and liability insurance).

45. See, e.g., *Investment Co. Inst. v. Camp*, 401 U.S. 617 (1971) (organizing, sponsoring, managing, and underwriting mutual funds); *American Deposit Corp. v. Schacht*, 84 F.3d 834 (7th Cir. 1996) (retirement CD).

services industry is ripe for broad rethinking. Many of the existing statutes address the problems of a different era and, as they have accumulated over the decades, they have failed to make reasonable accommodations to the changing needs and problems of today. Thus, it is not surprising that Congress has tried three times in the last ten years to come to grips with the task of reformulating policy and law in this area.

The first two efforts, in 1988 and 1991, failed due to a combination of (i) the inability of the major players (commercial banks, investment banks, and insurance interests) to come to a compromise of their positions and (ii) a lack of political will on the part of Congress, faced with this disarray among the interested players, to impose significant statutory reform.⁴⁶ The third effort, undertaken by the last Congress, failed as well, for much the same reason.⁴⁷ In any event, the kinds of compromises given consideration late in the last session would, if enacted, entail implementation of some significant undesirable elements and would, for a number of reasons, plainly be worse than continuing to muddle through under the status quo.⁴⁸ Legislative paralysis is thus a kind of blessing.

46. See Smoot, *supra* note 13, at 752-55.

47. See *id.* at 755-59; Pamela Atkins, *Leach Seeks Roundtable Support in Effort To Move Bill to House Floor*, 66 Banking Rep. (BNA) 852 (May 20, 1996), available in LEXIS, BNA Library, BNABus File (Rep. Leach's bill was strongly opposed by banking interests, as well as Clinton Administration, and in any event the Senate was unable to act that session); Niles S. Campbell, *Fed Raises Section 20 Revenue Limit, Urges Congress To Act on Glass-Steagall*, 68 Banking Rep. (BNA) 3 (June 6, 1997), available in LEXIS, BNA Library, BNABus File (during prior session, Congress unable to come to consensus over form that modern financial industry should take); Niles S. Campbell, *Leach Abandons Broad Bank Reform, Settles for "Stripped-Down" Approach*, 66 Banking Rep. (BNA) 1065 (June 17, 1996), available in LEXIS, BNA Library, BNABus File (Rep. Leach acknowledged that "comprehensive bank industry modernization cannot move forward this year" and proposed stripped-down version of piecemeal reform); Geraldine Fabrikant, *Pataki Proposes Allowing Sale of Insurance by Banks*, N.Y. TIMES, June 17, 1996, at D4 (legislation has "little chance of passage this year"); Bill McConnell, *Whitewater Move to Bank Panel Seen Stalling Legislation*, AM. BANKER, Apr. 4, 1996, at 2 (Senate Banking Committee Chair D'Amato's preoccupation with ongoing Whitewater inquiry left little time for other legislative matters and Banking Committee members were in no mood to move difficult legislation).

48. See Smoot, *supra* note 13, at 759-67. I argued in this Article that, all things considered, but especially in light of (i) the expansive view recently taken by the Supreme Court in *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995), of the statutory concept of "the business of banking," 12 U.S.C. § 24 (Seventh) (1994), and the very broad discretion the Court gave OCC in determining what constitutes "the business of banking," 115 S. Ct. at 813-14 & n.2, and (ii) OCC's clear intent to explore the limits of national bank powers under section 24 (Seventh), the best course is for Congress to stay its hand and permit OCC to continue its piecemeal consideration of the subject.

The various legislative compromises under serious consideration at the end of the last session entailed a trade-off of consolidation and some augmentation of bank securities powers against, among other things, limits on and even diminution of insurance powers, potentially drawing a

Undaunted by prior failures, legislators have introduced several financial services industry reform bills in the current session of Congress.⁴⁹ While hope springs eternal that Congress can finally reach agreement on broad reform,⁵⁰ it appears doubtful that Congress will be able to do so any time soon.⁵¹ Under the circumstances, then, it appears that any change in the nature or mix of products and services to be offered by banks and their affiliates in the foreseeable future will

line of demarcation, which would no doubt prove difficult to erase or move in the future, between banking and insurance similar to the one drawn in the Thirties between banking and securities. This would be costly to banks and to consumers of banking, securities, and insurance services, and would defy policy and economic sense. Smoot, *supra* note 13, at 759-67.

49. See D'Amato, *Baker Introduce Modernization Bill Permitting Merger of Banking, Commerce*, 68 Banking Rep. (BNA) 297 (Feb. 17, 1997), available in LEXIS, BNA Library, BNABus File. Senator Alfonse D'Amato and Representative Richard Baker introduced identical bills, S. 298 and H.R. 669, substantially the same as the bills they introduced in the last Congress, that would broadly remove most barriers between banking and nonbanking (that is, commercial) firms. *Id.* Representative James Leach had previously introduced his own, much more modest reform bill, H.R. 10, that would not permit affiliation of banking and commercial enterprises. *Id.* Somewhere between these two bills is a proposal by Representatives Marge Roukema and Bruce Vento, H.R. 268, that has considerable support among interested industry groups. See Pamela Atkins, *Industry Groups in Accord on Need for Reform, But Differ on Key Details*, 68 Banking Rep. (BNA) 299 (Feb. 17, 1997), available in LEXIS, BNA Library, BNABus File.

50. See, e.g., Bill McConnell, *GOP Congressional Victories Seen as Boost for Glass-Steagall Repeal*, AM. BANKER, Nov. 7, 1996, at 1 (Representative Leach sees hope "for a less partisan atmosphere"); Pamela Atkins, *House Members Introduce Blueprint for Financial Services Reform Next Year*, 67 Banking Rep. (BNA) 479 (Sept. 30, 1996), available in LEXIS, BNA Library, BNABus File (Representative Roukema hopeful that efforts at reform in current Congress "can avoid the deadlock over banks' insurance activities that have doomed efforts in prior years").

51. See, e.g., Pamela Atkins, *Holding Company Association Says Bills Would Move System Backward*, 68 Banking Rep. (BNA) 203 (Feb. 3, 1997), available in LEXIS, BNA Library, BNABus File (reform legislation "contentious" among leading members of Congress); Campbell, *supra* note 12, (lawmakers and representatives of securities and insurance industries say New Part 5 Rules "may have derailed any chance" to arrive at consensus for reform legislation); Jeffrey Goldfarb, *No Reform Likely in 105th Congress, Staff Member, Former Staff Aide, Predict*, 67 Banking Rep. (BNA) 957 (Dec. 9, 1996), available in LEXIS, BNA Library, BNABus File (Representative Leach pessimistic on chances for reform and Representative Frank predicts "very little" will happen in new Congress); Bill McConnell, *Chances Seen Slim for Modernization*, AM. BANKER, Jan. 31, 1997, at 3 (reform unlikely because of (i) inability of House, which typically initiates legislation in this area, to reach agreement and (ii) significant differences among industry groups, according to Sen. Robert Bennett and Rep. Michael Oxley).

As has been the case in prior sessions of Congress, the interested industry groups began the new session in serious disarray on significant issues that have foiled Congressional action before. See, e.g., Atkins, *supra* note 49 (detailing differing views and priorities of large banks, community banks, diversified financial companies, securities firms and insurance companies); Bill McConnell, *Tepid Reception Is Expected for Financial Reform Bills*, AM. BANKER, Feb. 11, 1997, at 2 (discussing differing positions of key bank and thrift industry organizations).

This general tone of pessimism about the possibility of any reform emerging during the next two years from the new Congress is shared by current and former members of the House and Senate Banking Committee staffs, who cite growing polarization among House committee members and upcoming reelection battles for many of the Senate Banking Committee members, including Chairman D'Amato. See Goldfarb, *supra*.

come from further regulatory action, within the confines of what current law permits, by the bank regulators, chiefly OCC and the Board of Governors of the Federal Reserve Board,⁵² which brings us back to OCC's New Part 5 Rules and changes in the operating subsidiary concept found in them.

II. NEW PART 5 RULES

OCC has historically specified certain rules, policies, and procedures concerning the "corporate activities" of national banks in Part 5 of its regulations in the Code of Federal Regulations.⁵³ Part 5 deals with, among other things, the steps necessary for the formation of a national bank, which is a federally chartered entity, and with such nuts-and-bolts corporate matters as dividends, capital, and acquisitions.⁵⁴ In November 1994, OCC published a proposal to amend Part 5.⁵⁵ While some of the proposed changes related to routine house-keeping matters, the most important had to do with "operating subsidiaries."

Under the Old Part 5 Rules, a national bank could conduct activities that were "part of or incidental to the business of banking by means of an operating subsidiary corporation,"⁵⁶ which had to be a corporation at least 80% of the voting stock of which is owned by the bank.⁵⁷ Such entities are commonplace.⁵⁸ For a banking business

52. National banks fall under the jurisdiction of OCC. 12 U.S.C. §§ 221, 248 (1994). The Federal Reserve Board regulates, among other things, the parent corporations, that is, bank holding companies, of banks under the Bank Holding Company Act of 1956. *Id.* §§ 1841-50.

53. Rules, Policies, and Procedures for Corporate Activities, 12 C.F.R. pt. 5 (1996).

54. The major topics addressed in the Old Part 5 Rules were: organizing the bank, *id.* § 5.20; conversion by a state bank to a federal charter, *id.* § 5.24; fiduciary powers, *id.* § 5.26; establishing, acquiring, and relocating branches, *id.* §§ 5.30, 5.40; business combinations, *id.* § 5.33; operating subsidiaries, *id.* § 5.34; investments, *id.* § 5.36; capital, *id.* §§ 5.46, 5.47; changes in management or control, *id.* §§ 5.50, 5.51, dividends, *id.* §§ 5.61, 5.62, and applications; comments, hearings, and decisions in connection with the foregoing, *id.* §§ 5.2 - 5.14. The New Part 5 Rules deal with the same topics but contain numerous changes. See Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341-57 (1996) (to be codified at 12 C.F.R. pt. 5) (summarizing the changes); *id.* at 60,357-62 (tabulating changed provisions in New Part 5 Rules); *id.* at 61,362-87 (text of New Part 5 Rules).

55. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,033 (1994).

56. 12 C.F.R. § 5.34(c) (1996).

57. *Id.* OCC distinguishes operating subsidiaries from two other types of corporations whose shares a national bank may own. Operating subsidiaries are owned by banks under their incidental powers authority of 12 U.S.C. § 24 (Seventh) (1994) and regulated by OCC under 12 C.F.R. § 5.34. A "statutory subsidiary," on the other hand, is a corporation a national bank may own by virtue of some express statutory provision, see, e.g., 12 U.S.C. § 24 (agricultural credit corporations), *id.* §§ 601, 618 (foreign branching and banking corporations), *id.* § 1861 (bank service corporations); 15 U.S.C. § 682(d) (1994) (small business investment companies). Finally, a "DPC" subsidiary is a corporation whose shares the bank acquired through foreclosure or similar procedure in connection with a "debt previously contracted" by a customer of a bank.

based upon a holding company, the "operating subsidiary" is thus an organizational alternative to a direct subsidiary of a bank's holding company parent. An "operating subsidiary," of course, is more directly controlled by bank management than would be a direct subsidiary of the holding company. OCC policy provided that it was "primarily a business decision"⁵⁹ of the bank to determine whether to create or acquire an operating subsidiary or to conduct an activity through it, but that business decision was subject to OCC's prior determination that the operating subsidiary and its activities were legally permissible and prudent.⁶⁰ Giving some content to the concept of what was legally permissible, the Old Part 5 Rules provided that "[u]nless otherwise provided by statute or regulation, all provisions of Federal banking laws and regulations applicable to the operations of the parent bank shall be *equally applicable* to the operations of its operating subsidiaries."⁶¹

The Proposed Part 5 Rules embodied two significant changes. The first was that the voting stock ownership requirement was reduced to "more than 50 percent" of the subsidiary's voting stock⁶² from at least 80 percent, a change that OCC suggested could add useful "flexibility

DPC subsidiaries are not part of the bank's continuing operations and their shares must be disposed of in due course pursuant to 12 U.S.C. § 29 (1994). See Letter from OCC in Response to Representative Dingell's Letter Dated Dec. 27, 1994, at 8 (on file with the *DePaul Law Review*) [hereinafter OCC Response to Dingell].

58. For example, operating subsidiaries have, with OCC approval, engaged in the (i) brokering of annuities, see *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 812 (1995); (ii) dealing in financial futures and options for the subsidiary's own account, clearing transactions involving financial futures and options for its customers, and execution, clearing, and advisory services for its customers in transactions involving agricultural, petroleum, and metals futures and options, OCC Interpretive Letter No. 494, [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083 (Dec. 20, 1989); and (iii) brokering agricultural and metals futures for customers in connection with bank loans to the customers, OCC Interpretive Letter No. 356, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,526 (Jan. 7, 1986).

59. 12 C.F.R. § 5.34(d).

60. Before proceeding with a proposal to create or acquire an operating subsidiary or to give an existing operating subsidiary additional activities to perform, a bank had to notify OCC of its intention, *id.* § 5.34(d)(1)(i), (ii), but it did not do so where the operating subsidiary would be engaging in activities previously approved by OCC in connection with a prior notification, so long as the activities continued to be legally permissible and were conducted in accordance with any limitations imposed by OCC in its prior approval, *id.* § 5.34(d)(1)(iv). If OCC did not respond within thirty days of notification, then the bank could proceed with its proposal. This thirty-day abeyance period permitted OCC to consider whether the proposed activities "exceed those legally permissible" for an operating subsidiary and whether the bank's operating subsidiary proposal was "consistent with prudent banking principles" and OCC policy. *Id.* § 5.34(d)(1)(iii).

61. 12 C.F.R. § 5.34(d)(2)(i) (emphasis added).

62. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,033, 61,056 (1994) (Proposed Part 5 Rules § 5.34(d)(2)). In addition, no other party could "control" the operating subsidiary. *Id.*

for the operating subsidiary structure.”⁶³ The New Part 5 Rules add even more flexibility by permitting the bank to possess less than a majority voting interest in the operating subsidiary, so long as it holds effective control and no other person holds more than 50% of the voting interest, and by defining operating subsidiary to include “a corporation, limited liability company, or similar entity.”⁶⁴

The more controversial change deals with the applicability to operating subsidiaries of legal rules imposed generally on banks and, by implication, the activities in which operating subsidiaries may engage. The Proposed Part 5 Rules carried forward some of the approach to this issue found in the old rules,⁶⁵ but they dropped the categorical statement that laws and regulations applicable to the bank “shall be *equally applicable*” to the operating subsidiary.⁶⁶ Instead, the following appeared: “Unless otherwise provided by statute or regulation, or *determined by the OCC in writing*, all provisions of Federal banking laws and regulations applicable to the operations of the parent bank apply to the operations of the bank’s operating subsidiaries.”⁶⁷ This passage, of course, retained the idea from the old rules that an operating subsidiary could be involved in services or other activities prohibited to banks themselves, so long as an existing statute or regulation applicable to operating subsidiaries so permits.⁶⁸ However, the passage added the concept that OCC might also permit a particular operating subsidiary to pursue activities prohibited to banks, even in the absence of such a generally applicable exemptive statute or regulation, if OCC determined that to be appropriate in a specific circumstance. OCC would presumably have done so by means of issuance of

63. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,039 (Proposed Part 5 Rules § 5.34(d)(2)). OCC reemphasized the requirement for bank control of the subsidiary, notwithstanding participation in it by another entity. *Id.*

64. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(d)(2)).

65. The kinds of business activities in which an operating subsidiary could engage under the Proposed Part 5 Rules were dealt with, in part, under the headings “Standards and requirements” and “Qualifying subsidiaries,” in which the Old Rules were essentially reiterated. Thus, an operating subsidiary: (i) may “engage in activities that are a part of, or incidental to, the business of banking under 12 U.S.C. [§] 24 (Seventh) (1994), and other activities authorized for national banks or their subsidiaries under other statutes,” Rules, Policies, and Procedures for Corporate Activities, 12 C.F.R. § 5.34(d)(1) (1996), and (ii) “must engage only in activities that are a part of, or incidental to, the business of banking under 12 U.S.C. [§] 24 (Seventh), or in other activities authorized for national banks or their subsidiaries under other statutes,” *id.* § 5.34(d)(2).

66. *Id.* § 5.34(d)(2)(i); see *supra* note 61 and accompanying text.

67. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,033, 61,056 (1994) (emphasis added) (Proposed Part 5 Rules § 5.34(d)(3)).

68. See *supra* note 57 and accompanying text.

an interpretive letter or similar communication to a bank seeking permission for its operating subsidiary to pursue such activities.

The commentary accompanying the Proposed Part 5 Rules made clear that this revised wording was quite deliberate and purposeful:

This revised standard allows the OCC to determine on a case-by-case basis whether an activity deemed to be within the business of banking or incidental to banking may be conducted in an operating subsidiary to an extent or in a manner different from the way the activity is conducted at the parent bank level. This might include activities that the parent bank is not allowed to conduct because of a specific restriction that applies to the parent bank but not necessarily to its subsidiaries.⁶⁹

This change, however, elicited more comment from interested parties than any other⁷⁰ and, in response, OCC preserved the concept⁷¹ but added a new provision to the final rules specifying detailed procedures by which OCC may determine in writing that an operating subsidiary may engage in an activity that is part of or incidental to the business of banking but in a manner that is "different from that permissible for the parent national bank."⁷² OCC noted in its commentary accompanying the New Part 5 Rules:

69. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,039.

70. OCC received a total of seventy-one letters commenting on the Proposed Part 5 Rules, Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341 (1996) (to be codified at 12 C.F.R. pt. 5), of which forty-six commented upon this element of the rules, *id.* at 60,350. About 75% of these comments were supportive of the new approach, citing the organizational flexibility, improved efficiency and increased competition it would afford. *Id.* Nonetheless, a significant number of comments opposed it on the bases that OCC lacked authority to adopt it, that the new approach was inconsistent with other provisions of statutory law and prior OCC precedent, and that it would expose banks to significant risk. *Id.* at 60,350-51.

71. The concept is now embodied in three related provisions of the New Part 5 Rules. The first is section 5.34(d)(1):

Authorized activities. A national bank may establish or acquire an operating subsidiary to conduct, or may conduct in an existing operating subsidiary, activities that are part of or incidental to the business of banking, as determined by the Comptroller of the Currency, pursuant to 12 U.S.C. [§] 24 (Seventh), and other activities permissible for national banks or their subsidiaries under other statutory authority.

Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,374 (to be codified at 12 C.F.R. § 5.34(d)(1) (emphasis added)). The second is section 5.34(d)(3):

Examination and supervision. . . . In conducting activities authorized under this section, unless otherwise provided by statute or regulation (including paragraph (f) of this section), applicable provisions of Federal banking law and regulations pertaining to the operations of the parent bank shall apply to the operations of the bank's operating subsidiary.

Id. (to be codified at 12 C.F.R. § 5.34(d)(3) (emphasis added)); see *infra* note 72 (describing section 5.34(f)).

72. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,376 (to be codified at 12 C.F.R. § 5.34(f)). This new paragraph added significant procedural conditions and substantive requirements to a finding by OCC that an operating subsidiary may conduct an activity in a manner not permissible to its parent bank. Unless OCC has previously approved the

The final rule confirms . . . that [permissible activities for operating subsidiaries] may include activities different from what the parent national bank may conduct directly, *if*, in the circumstances presented, the reason or rationale for restricting the parent bank's ability to conduct the activity does not apply to the subsidiary, and if the ability of the subsidiary to conduct the activity would not frustrate a congressional purpose of preventing the activity from being undertaken by its parent bank.⁷³

The two passages quoted above from OCC's commentaries on the Proposed Part 5 Rules and the New Part 5 Rules can be and have been given several readings. A reasonably narrow reading, and one that is consistent with other elements of the Clinton Administration's program for financial services reform during the last session of Congress,⁷⁴ is that OCC merely intends to accommodate the possibility that, in an appropriate case, an operating subsidiary of a bank may

activity, it must publish notice in the Federal Register and thus provide an opportunity for public comment. *Id.* (to be codified at 12 C.F.R. § 5.34(f)(1)).

In addition, significant new "corporate requirements" will apply. *Id.* (to be codified at 12 C.F.R. § 5.34(f)(2)). Among other things, under this new provision the operating subsidiary conducting any such activity: (i) must be "physically separate and distinct" from the parent bank in its operations and employees (if bank and operating subsidiary share same facility, operating subsidiary's zone of business must be "distinguishable, to the extent practicable," from the area where bank customers conduct business with the bank); (ii) must be "held out" in its written materials and third-party relations as a "separate and distinct entity from the bank"; (iii) may not adopt the name of its parent bank and shall take "appropriate steps to minimize the risk of customer confusion" if its name is similar to the parent bank's; (iv) must be "adequately capitalized"; (v) must maintain "separate accounting and corporate records"; (vi) must conduct its activities under "independent policies and procedures" that reinforce customer perception that the subsidiary is separate from the bank; (vii) may enter into service contracts with bank only upon arm's length terms; (viii) must conduct separate board meetings and other corporate formalities; (ix) must have a board of directors at least one-third of the members of which shall not also be members of the bank's board; and (x) must implement internal controls "appropriate" to the "risks associated with the subsidiary." *Id.* at 60,376-77 (to be codified at 12 C.F.R. § 5.34(f)(2)).

Finally, under sections 5.34(f)(3)(i) and (ii) of the new provisions, a number of restrictive requirements are to be imposed for purposes of determining the capital adequacy of the bank where the operating subsidiary is engaged in an activity under paragraph (f) as principal. *Id.* at 60,377 (to be codified at 12 C.F.R. § 5.34(f)(3)(i), (ii)). These restrictions are designed to ensure that only financially strong and well-managed banks will undertake these activities through their subsidiaries. *Id.* at 60,354.

73. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,352 (citation omitted).

74. The Clinton Administration's approach to legislative reform in the last Congress envisioned that banking organizations could engage in certain activities either in a bank holding company subsidiary or in a bank operating subsidiary. Which vehicle the banking organization chose would be purely "a private business decision" of the organization. Pamela Atkins, *Rubin Testifies on Glass-Steagall Plan, Differs from Leach on Structuring Links*, 64 Banking Rep. (BNA) 458 (Mar. 6, 1995), available in LEXIS, BNA Library, BNABus File (statement of Treasury Secretary Rubin) (endorsing the idea that choice of structure in affiliates "should remain a private business decision").

engage in activities that are permissible for subsidiaries of bank holding companies.⁷⁵ This change, however, is potentially significant.

Holding company subsidiaries may now engage in a broader range of securities activities than banks may themselves, given the strictures and structure of Glass-Steagall. That Act, as case law and administrative practice have recognized,⁷⁶ makes an important distinction between the kinds of securities activities that are permissible for a bank and for a nonbank affiliate of a bank. The securities activities of nonbank affiliates are governed by Glass-Steagall section 20⁷⁷ rather than sections 16⁷⁸ and 21,⁷⁹ which govern bank securities activities. Whereas sections 16 and 21 flatly prohibit most kinds of bank underwriting of and dealing in securities, section 20 more loosely forbids bank affiliation with an organization "engaged *principally*" in such activities.⁸⁰

Thus, in a case involving a challenge to the Federal Reserve Board's action permitting a bank holding company's nonbank affiliates⁸¹ to underwrite and deal in commercial paper,⁸² the D.C. Circuit noted that, under the wording of the relevant provisions, a nonbank affiliate of a bank may engage in certain activities pursuant to section 20 that a bank may not engage in at all under sections 16 and 21, "provided those activities are not the 'principal' activities of the affiliate."⁸³ The

75. An even narrower reading is that the new provision would permit an operating subsidiary to engage in an activity that a bank could, in theory, engage in but that OCC determines to be, in a particular case, sufficiently fraught with risk that prudence dictates its being carried out instead by an operating subsidiary. See *infra* notes 204-16 and accompanying text.

76. See *infra* notes 77-86 and accompanying text.

77. 12 U.S.C. § 377 (1994).

78. *Id.* § 24 (Seventh).

79. *Id.* § 378(a)(1).

80. *Id.* §§ 24 (Seventh), 378(a)(1).

81. The affiliates were not subsidiaries of banks within the holding company structure.

82. The Board has authority to regulate bank holding companies and their subsidiaries (or at least some of them) under the Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841-50 (1994). A "bank holding company" is basically a company that "has control over any bank." *Id.* § 1841(a)(1). "Control" is defined as (i) direct or indirect ownership of, or power to vote, twenty-five percent or more of any class of voting stock of a bank, (ii) control of the election of a majority of the board of directors of a bank, or (iii) other controlling influence over the management or policies of a bank, as determined by the Board. *Id.* § 1841(a)(2).

83. *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 847 F.2d 890, 894 (D.C. Cir. 1988); see *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 839 F.2d 47, 58 (2d Cir. 1988).

The Supreme Court has also acknowledged that section 20 applies a looser standard to holding companies and their nonbank subsidiaries than sections 16 and 21 apply to banks themselves. *Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst.*, 450 U.S. 46, 60 n.26 (1981) (stating that a "less stringent standard" applies to decide if holding company has violated section 20 than applies to decide if bank has violated sections 16 and 21); *id.* at 64 (stating that "[i]n both

Board had approved the commercial paper programs⁸⁴ but with significant numerical limitations on the revenues that these activities generated, limitations that served to assure that the programs did not become the "principal" activities of the affiliates. The affiliates were thus able to engage in underwriting and dealing, to a degree, without violating Glass-Steagall section 20.⁸⁵

Since section 20's "less stringent standard" in separating commercial and investment banking⁸⁶ permits commercial banks to have at least some affiliates with a degree of underwriting and dealing activities, an important question is whether the affiliated entity could be a bank operating subsidiary instead of the traditional bank holding company affiliate. On their face, the Proposed Part 5 Rules seemed hospitable to that idea.⁸⁷ This impression is reinforced by OCC's

the Glass-Steagall Act itself and in the Bank Holding Company Act, Congress indicated that a bank affiliate may engage in activities that would be impermissible for the bank itself").

This difference in wording ("engaged" in section 21 versus "engaged principally" in section 20) was not inadvertent. Although section 21 as originally introduced read "engaged principally," a principle sponsor of Glass-Steagall, Senator Bulkley, deleted "principally" in a subsequent amendment, *see Securities Indus. Ass'n*, 839 F.2d at 58, because he feared that "principally engaged" might not encompass the activities of certain of the large investment bankers, which were at the time involved in a broad range of business activities, 77 CONG. REC. 4180 (1933) (statement of Sen. Bulkley). If those investment banking organizations could escape coverage under section 21 because of its looser language as originally proposed, then that provision would not serve to prevent them from engaging in banking by accepting deposits. For a more detailed discussion of the significance of this point, see *infra* Part V.B and accompanying text.

84. *See Chase Manhattan Corp.*, 73 Fed. Res. Bull. 367 (1987) (granting permission to the Chase Manhattan Corporation to underwrite and deal in commercial paper to a limited extent); *Bankers Trust New York Corp.*, 73 Fed. Res. Bull. 138 (1987) (granting permission to underwrite and deal in municipal revenue bonds and mortgage-related securities, as well as commercial paper).

85. The Board initially specified that underwriting and dealing must amount to less than 5% of the nonbank affiliate's gross revenues, a level of underwriting and dealing activities seen by the Board as not violating section 20's prohibition on bank affiliation with an organization "principally engaged" in dealing and underwriting. After deliberation, the Board concluded that "principally" entails a level of activity that is less than "chiefly" (which was the banks' position) but more than "regular" or "integral" (which was the Security Industry Association's position). The Board embraced a middle ground that "principally" really meant "substantially" and that less than 5% of the gross revenues of the affiliate would be insubstantial. 73 Fed. Res. Bull. at 140-46. *See Orders Issued Under Section 4 of the Bank Holding Company Act*, 73 Fed. Res. Bull. 473, 475-76 (1987); *Board of Governors of the Fed. Reserve Sys. v. Agnew*, 329 U.S. 441, 446-48 (1947) (discussing the meaning of "primary" or "primarily engaged").

The Board reconsidered this point two years later and decided that securities activities contributing up to 10% of the affiliate's gross revenues would not violate section 20. Modifications to Section 20 Orders, 75 Fed. Res. Bull. 751, 751 (1989).

The Board liberalized the revenue limits even further (to 25%) in 1996. *See infra* notes 231-37 and accompanying text.

86. *Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst.*, 450 U.S. 46, 60-61 n.26 (1981).

87. The banking industry believed that the Proposed Part 5 Rules went at least that far. *See OCC Counsel Offers Roadmap for Bankers Considering New National Bank Proposals*, 64 Bank-

accompanying commentary, wherein it said that, under the proposed rules, OCC would decide on a case-by-case basis whether a particular activity "may be conducted in an operating subsidiary to an extent or in a manner different from the way the activity is conducted at the parent bank level."⁸⁸ For example, OCC might use this proposed authority with respect to activities "that the parent bank is not allowed to conduct because of a specific restriction that applies to the parent bank *but not necessarily to its subsidiaries*."⁸⁹ One such restriction that comes to mind in this context is that set forth in Glass-Steagall section 16 or 21, which prevents the parent bank from engaging directly in most kinds of underwriting or dealing. The "not necessarily" language in the commentary suggests that, while there may be room to question the authority of operating subsidiaries to engage in such activities as permitted under section 20, OCC has preserved its option to make the argument in the affirmative if and when an appropriate proposal reached its office. The final version of the rules remains hospitable to this possibility, as confirmed by OCC's accompanying commentary,⁹⁰ which is quoted above.⁹¹

Thus, at the very least, it would appear that the New Part 5 Rules could be a means of enabling operating subsidiaries to engage in underwriting or dealing, at least for some part of their revenues. The new rules may also, however, be read more broadly. After the proposed rules appeared in the Federal Register, there was speculation in the financial press that OCC intended to take advantage of the proposed rules to authorize more direct bank involvement in revenue bond underwriting⁹² and in new kinds of real estate brokerage, data

ing Rep. (BNA) 597, 597 (Mar. 20, 1995), available in LEXIS, BNA Library, BNABus File [hereinafter *OCC Counsel Offers Roadmap*] ("[P]roposal appeals to bankers who say they could use it as a new home for existing companies that operate under revenue constraints.").

88. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,033, 61,039 (1994) (Proposed Part 5 Rules § 5.34(d)(2)).

89. *Id.* (emphasis added).

90. See Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,352 (1996) (to be codified at 12 C.F.R. pt. 5).

91. See *supra* note 73 and accompanying text. The commentary also notes that [u]nder the final rule . . . the OCC must evaluate an operating subsidiary application involving this type of activity [not permissible for parent bank] on a case-by-case basis. For each activity, the OCC will consider the particular activity at issue, and weigh: (1) the form and specificity of the restriction applicable to the parent bank; (2) *why* the restriction applies to the parent bank; and (3) whether it would frustrate the purpose underlying the restriction on the parent bank to permit a subsidiary of the bank to engage in the particular activity.

Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,352.

92. This had been seen as beyond a bank's authority under Glass-Steagall. See Robert M. Garsson, *OCC's Paperwork Rewrite Paves the Way for Banks To Expand Their Powers*, AM. BANKER, Jan. 20, 1995, at 3.

processing services, financial management counseling, and insurance underwriting.⁹³

Such speculation was no doubt encouraged by authoritative public pronouncements subsequent to issuance of the proposed rules, suggesting that OCC will be favorably disposed to bank proposals to expand the scope of their activities. For instance, at an industry gathering in March 1995, OCC's chief counsel outlined the agency's analytical framework for considering future bank requests for approval of new products or services.⁹⁴ If OCC determines, in the exercise of its broad discretion as contemplated by the Supreme Court in *NationsBank of North Carolina v. Variable Annuity Life Insurance Co.* ("VALIC"),⁹⁵ that a bank's proposal involves activity that is within "the business of banking," then the agency will be inclined to approve where the activity is a "contemporary functional equivalent (or outgrowth) of a recognized banking function,"⁹⁶ where the activity would either benefit customers or strengthen the bank and where the risks inherent in the activity are similar to risks banks have traditionally encountered.⁹⁷ The "broad aim" of this approach is "to allow banks to evolve in a changing industry without taking on too much risk,"⁹⁸ but the chief counsel pointedly noted that "an approach that focuses too much on limiting banks to traditional activities in a highly competitive environment may actually diminish safety and soundness in the long run."⁹⁹

93. See *OCC Seeks Comment on Easing Bank Rules, Opening Door for New Sub Power Requests*, 63 Banking Rep. (BNA) 815 (Dec. 5, 1994), available in LEXIS, BNA Library, BNABus File; Colleen Brennan & Lesia Bullock, *Bankers Hopeful a Republican Congress Will Mean Expanded Powers, More Relief*, 64 Banking Rep. (BNA) 133 (Jan. 16, 1995), available in LEXIS, BNA Library, BNABus File (according to Rich Whiting, General Counsel of the Bankers Roundtable, a bank industry trade organization, the Proposed Part 5 Rules have "the potential for not being as narrow as Glass-Steagall and securities activities"); Atkins, *supra* note 8. This speculation was renewed after the rules were finalized. See Olaf de Senerpont Domis, *Banks Rush To Embrace New Freedoms*, AM. BANKER, Nov. 25, 1996, at 1 (national banks' planning for taking advantage of New Part 5 Rules includes proposals for new or expanded activities involving insurance, equipment leasing, municipal revenue bond underwriting, real estate brokerage, and management and information processing).

94. See *OCC Counsel Offers Roadmap*, *supra* note 87 (comments by Julie Williams, chief counsel for the OCC, to luncheon sponsored by American Conference Institute). The approach outlined in this presentation was not limited by its terms to new operating subsidiary proposals but would apply to all applications for approval received by OCC.

95. 115 S. Ct. 810, 814 n.2 (1995)

96. See *OCC Counsel Offers Roadmap*, *supra* note 87 (comments by Julie Williams, chief counsel for the OCC, to luncheon sponsored by American Conference Institute).

97. *Id.*

98. *Id.*

99. *Id.* If banks continue to be limited to their traditional activities, they may ultimately find themselves taking higher risks. "Safety and soundness can be enhanced by allowing banks to

In light of this expansionary framework for review of bank proposals and OCC's recently clarified and broadened power to define "the business of banking" in *VALIC*,¹⁰⁰ under the New Part 5 Rules, operating subsidiaries could become an important means for banks to expand the scope of their businesses,¹⁰¹ a point that is not lost on bank critics in Congress or on other participants in the financial services industry, who have served notice that they will vigorously continue to resist bank encroachment. This brings the Article, then, to the point: Is the reincarnation of the operating subsidiary under the New Part 5 Rules a legitimate and permissible exercise by OCC of its powers? Critics have taken exception both to the reduction in ownership element and to the idea of operating subsidiary exercise of powers denied to banks themselves.¹⁰²

III. MAY BANKS HAVE SUBSIDIARIES?

First, however, there is the question of whether national banks are empowered to have subsidiaries and, if so, under what limitations, if any. The foregoing discussion assumed that this was not in issue, and national banks have certainly operated, in recent years, at least, as if it were not. Nevertheless, OCC's Proposed Part 5 Rules rekindled interest in the issue of the authority of national banks to own the stock of operating subsidiaries. This issue is closely related to the more important one of whether operating subsidiaries may do things that national banks may not. The issue of whether banks can own an operating subsidiary, however, is logically a prior issue and, in the de-

innovate within prudential limits, and to be responsive to emerging customer needs." *Id.*; see *supra* note 39 and accompanying text.

100. 115 S. Ct. 810 at 814 n.2.

101. It has even been suggested that the rules will be midwife to the birth of European-style "universal banks," Garsson, *supra* note 91, at 3, with broad authority to conduct business in a manner heretofore unheard of in the United States, see de Senerpont Domis, *supra* note 10, at 4. According to Karen S. Petrou, President of ISD/Shaw Inc., the operating subsidiary proposal is "so significant because in full flower it recreates the national bank as a universal bank, which in its own right controls an array of both banking and nonbanking services, as opposed to doing that under a holding company." *Id.* This "universal bank" model was also endorsed by former Federal Reserve Board governor, John P. LaWare, is more efficient than and equally safe as current holding company approach. *Id.*

102. The New Part 5 Rules contain other elements pertaining to operating subsidiaries, such as procedures for after-the-fact notice concerning, or expedited review of, certain types of new bank activities, which are interesting innovations and were in the proposal stage magnets for critical comment. See Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(e)). These other elements of the operating subsidiary part of the new rules are beyond the scope of this Article, as are other interesting provisions of the new rules not pertaining to operating subsidiaries.

bate about changes to the Old Part 5 Rules, opponents made it a separate point.

Most vigorously asserted by Representative John Dingell in a letter to OCC questioning numerous elements of the proposed rules,¹⁰³ the argument is simply stated as follows: First, OCC lacks specific statutory authority to permit national banks to acquire or establish operating subsidiaries, whose stock they would own. This circumstance is to be contrasted with other contexts in which national banks are expressly authorized by statute, within specific limits, to purchase and own stock in special purpose corporations, such as bank service corporations, Edge Act companies, and safe-deposit corporations.¹⁰⁴ Second, a part of the Glass-Steagall Act expressly prohibits national banks from owning for their own account "any shares of stock of any corporation,"¹⁰⁵ with certain exceptions not here relevant. As Representative Dingell saw matters, this "stock purchase restriction" in Glass-Steagall on its face prevented a bank from owning shares in an operating subsidiary (except as otherwise specifically permitted). The restriction was thus a bar to OCC's efforts with respect to operating subsidiaries under the Proposed Part 5 Rules¹⁰⁶ and presumably remains so under the New Part 5 Rules.

It is true that national banks do not have the benefit of a specific statutory provision authorizing them to make use of subsidiaries in the conduct of their business, but their authority to do so as an incident to the conduct of the business of banking generally seems too well established to be successfully challenged now. A national bank has authority "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking."¹⁰⁷ As a general matter of statutory interpretation, for an incidental power to be "necessary" to the accomplishment of some purpose or achievement of some goal, it need

103. Letter from Rep. John D. Dingell, Chairman, Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, to OCC 1 (Dec. 27, 1994) (on file with the *DePaul Law Review*) [hereinafter 1994 Dingell Letter]. The Securities Industry Association made a broadly similar argument in its letter of comment on the proposed rules. Letter from Marc E. Lockritz, President, and Steve Judge, Senior Vice-President, The Securities Industry Association, to OCC 14 (Jan. 30, 1995) (on file with the *DePaul Law Review*) [hereinafter SIA Letter].

104. 1994 Dingell Letter, *supra* note 103, at 2.

105. 12 U.S.C. § 24 (Seventh) (1994).

106. 1994 Dingell Letter, *supra* note 103, at 2-3 (citing HARVEY PITT ET AL., *THE LAW OF FINANCIAL SERVICES* 135 (1993)). Indeed, Rep. Dingell asserts in his letter that OCC agreed with this interpretation until 1963, when it began taking an expansive view of the authority of national banks under their "incidental powers" authority contained in section 24 (Seventh). *Id.* at 3.

107. 12 U.S.C. § 24 (Seventh).

not be indispensable or a sine qua non for such accomplishment or achievement. It is sufficient that the power is "appropriate and helpful"¹⁰⁸ or "convenient or useful."¹⁰⁹ Numerous courts dealing with bank power cases have previously adopted such a broad construction of the word "necessary,"¹¹⁰ and the Supreme Court recently gave strong reinforcement to that approach in *VALIC*.¹¹¹

As OCC sees it, one such "incidental power" of national banks, a power that banks have in common with corporations in general, is the

108. See *Welch v. Helvering*, 290 U.S. 111, 113 (1933) (meaning of "necessary" in phrase "ordinary and necessary expense" for the conduct of a business).

109. See *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 413-15 (1819). Cf. *Legal Tender Case*, 110 U.S. 421, 440 (1884) (stating that article I, section 8, clause 18 of the Constitution, containing the "necessary and proper" powers clause, encompasses powers that are "not limited to such measures as are absolutely and indispensably necessary, without which the powers granted must fail of execution; but they include all appropriate means which are conducive or adapted to the end to be accomplished").

110. See *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 430 (1st Cir. 1972) ("*sine qua non* standard would be an inappropriate measure of a national bank's incidental powers under 12 U.S.C. § 24, Seventh"; word "necessary" does not "connote that which is indispensable").

Over the years, courts have found that a number of activities, services, and products that are not specifically enumerated as within the powers of national banks and that could not be described as indispensable to the conduct of the business of a bank are nonetheless permissible under the incidental powers grant of section 24 (Seventh). *Id.* at 430-34. Such activities, services, and products are sustained as incidental to the conduct of the business of banking on a number of other less restrictive bases:

(a) Some are seen as similar to an express power. See *Colorado Nat'l Bank v. Bedford*, 310 U.S. 41, 50 (1940) (safe-deposit business sustained as incidental power because similar to express power to accept deposits); *First Nat'l Bank v. City of Hartford*, 273 U.S. 548, 559-60 (1927) (sale of mortgages and similar debt instruments permitted as incidental power because closely related to power to discount or negotiate debt instruments or make loans); *Clement Nat'l Bank v. Vermont*, 231 U.S. 120, 139-40 (1913) (paying state taxes for customers similar to express power to receive deposits); *Merchants' Bank v. State Bank*, 77 U.S. (10 Wall.) 604, 648 (1870) (certification of checks similar to discounting and negotiating bills of exchange); *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382-83 (9th Cir. 1977) (leasing of personal property similar to loan secured by personal property).

(b) Others are found to be "useful" or "convenient and useful" to a bank in the conduct of its other business. See *First Nat'l Bank v. Taylor*, 907 F.2d 775, 778 (8th Cir. 1990) (incidental powers "not limited to activities that are deemed essential to the exercise of express powers"; offering debt cancellation contracts permissible incidental power because useful to bank in giving customers means of retiring bank loan upon death); *Securities Indus. Ass'n v. Clarke*, 885 F.2d 1034, 1049 (2d Cir. 1989) (sale of mortgage pass-through certificates in connection with sale of mortgage loans permitted because "convenient and useful").

111. *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 814, 817 (1995) (holding that the power of a national bank to broker annuities, while not listed as among the statutorily enumerated powers of national banks, is, nonetheless, "an 'incidental powe[r] . . . necessary to carry on the business of banking'" pursuant to 12 U.S.C. § 24 (Seventh) (1988 & Supp. V 1993)). The Court in this case reversed the Fifth Circuit, which had taken the miserly view that, even if brokering of annuities by banks could be seen as "incidental" to the business of banking, "by no stretch of the imagination can that power be deemed 'necessary.'" *Variable Annuity Life Ins. Co. v. Clarke*, 998 F.2d 1295, 1302 (5th Cir. 1993), *rev. sub nom.* *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

power to conduct business through a subsidiary.¹¹² The opposing view has it that this approach stretches the concept of incidental powers too far, especially in light of the fact Congress has on numerous occasions seen fit to give specific authorization for national bank ownership of particular types of subsidiaries.¹¹³ These contrary viewpoints basically reduce to the question of whether national banks have historically had, though they may not always have exercised, the power to make use of subsidiaries in the conduct of business and, if so, to the further question of whether Congress has restricted this power in a manner that bars the use of operating subsidiaries as contemplated by OCC rules (present and past). Put differently, this dispute is about whether new or additional congressional action is a prerequisite to any previously unspecified use by banks of subsidiaries or whether, instead, previous actions by Congress relating to bank ownership of subsidiaries have done no more than confirm preexisting power or restrict the ability of banks to own subsidiaries in particular fashions and in specific circumstances.

In this, OCC surely has the better of the argument. As a general matter of the power of national banks to take advantage of the ordinary incidents of the corporate form, banks should be able to make use of operating subsidiaries, at least absent specific prohibition by Congress and so long as bank regulators approve.¹¹⁴ The language of the National Bank Act,¹¹⁵ which was originally adopted during the Civil War, is surely broad enough for this purpose. The current incarnation of the relevant portion of that Act, found in the first sentence of section 24 (Seventh), provides that a national bank is empowered

[t]o 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; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling ex-

112. See Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(a)); *id.* at 60,351-52; OCC Response to Dingell, *supra* note 57, at 1.

113. Letter from Rep. John D. Dingell, Ranking Minority Member, Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, to OCC 1-4 (Jan. 30, 1995) (on file with the author) [hereinafter 1995 Dingell Letter].

114. OCC's position on the point is as follows:

It is common corporate practice in the United States for companies to conduct some of their business through subsidiaries. Absent an express prohibition, there is no reason a national bank should be denied such corporate flexibility. Operating a subsidiary allows the bank to conduct the banking business in a manner convenient and useful to itself and to its customers, as permitted by 12 U.S.C. § 24 (Seventh).

OCC Response to Dingell, *supra* note 57, at 1.

115. Act of June 3, 1864, ch. 106, 13 Stat. 99.

change, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes.¹¹⁶

The order of the clauses in this provision (grant of incidental powers followed by listing five commonly accepted categories of banking powers introduced by the word “by”) might seem to suggest that the extent of banks’ “incidental powers” is limited to the matters referred to in the trailing list of categories, but that order reflects a reversal of the original 1863 ordering, in which “incidental powers” were listed at the end of the specific powers as, in effect, a separate category of powers.¹¹⁷ When the current order of clauses (“incidental powers” preceding listing of specific powers) appeared in an amendment adopted a year later in 1864, nothing in the legislative history suggested that Congress intended this reordering of clauses to effect a substantive change.¹¹⁸ Indeed, at the time, Congress intended to make a national banking charter more attractive than a state charter and thus is unlikely to have intended to narrow the range of national banking powers.¹¹⁹

Later amendments to the National Bank Act and a study of the antecedent statutory sources upon which that Act was based suggest strongly that “the business of banking” consists of more than simply the listed five categories of powers.¹²⁰ In any event, the Supreme Court clearly addressed this issue in *VALIC*,¹²¹ which considered an insurance company’s assertion that OCC’s authorization of national bank sales of variable annuities was invalid because, among other things, no such activity was listed in section 24 (Seventh). The Court expressly (and unanimously) held that the “‘business of banking’ is

116. 12 U.S.C. § 24 (Seventh).

117. Act of Feb. 25, 1863, ch. 58, §11, 12 Stat. 668. National banks were therein granted the power

to carry on the business of banking by obtaining and issuing circulating notes . . . by discounting bills, notes, and other evidences of debt; by receiving deposits; by buying and selling gold and silver bullion, foreign coins, and bills of exchange; by loaning money on real and personal security . . . and by exercising such incidental powers as shall be necessary to carry on such business

Id.

118. See Symons, *supra* note 18, at 700.

119. Congress was amending national banking statutes in the hope of encouraging the founding of more national banks, whether as new banks or through conversion of state charters. *Id.* at 699. It seems highly unlikely that Congress would set about that task by narrowing national bank powers, thereby making national banks relatively less attractive than state banks, particularly those in states, for example, New York, that granted very broad banking powers to state-chartered banking institutions. *Id.* at 700.

120. See Smoot, *supra* note 13, at 722-25.

121. *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.”¹²² So long as OCC’s exercise of its discretion in approving bank activities, whether as a part of “the business of banking” or as “incidental” thereto, is “kept within reasonable bounds,”¹²³ OCC’s exercise should pass muster.

When we then address the question of whether OCC “kept within reasonable bounds” when it approved the utilization of operating subsidiaries by national banks, we are faced with a timing question. In fact, OCC did not formally authorize this practice until 1966,¹²⁴ fully 103 years after enactment of the statutory basis for that action. Such an extended delay between enactment of the underlying legislation and administrative promulgation of implementing and interpretive regulation, however, is neither unique in the annals of banking law nor, as the Supreme Court made clear in another very recent banking law case, *Smiley v. Citibank (South Dakota)*,¹²⁵ any impediment to judicial approval of a recently promulgated rule.¹²⁶

OCC, which treated its action in 1966 as simply confirming and codifying existing national bank authority to create operating subsidiaries, found ample authority for that step under the “incidental powers” provision of section 24 (Seventh) and concluded that the “stock purchase restriction” in Glass-Steagall simply did not apply.¹²⁷ Significantly, in the years thereafter, challengers have often contested the activities of operating subsidiaries, but they have not questioned the underlying authority of national banks to own the subsidiaries as a general matter.¹²⁸

OCC’s actions in 1966 did not entirely escape critical notice in Congress.¹²⁹ Congress, however, did not then and it has not since acted to deprive OCC of its authority to permit national banks to create and

122. *Id.* at 814 n.2.

123. *Id.*

124. Acquisition of Controlling Stock Interest in Subsidiary Operations Corporation, 31 Fed. Reg. 11,459 (1966) (codified at 12 C.F.R. § 5.34(d)).

125. 116 S. Ct. 1730 (1996).

126. *Id.* at 1733.

127. Acquisition of Controlling Stock Interest in Subsidiary Operations Corporation, 31 Fed. Reg. at 11,459.

128. See, e.g., *NationsBank of North Carolina v. Variable Annuity Life Insurance Co.*, 115 S. Ct. 810 (1995) (brokerage subsidiary selling variable annuities); *Clarke v. Securities Indus. Ass’n*, 479 U.S. 388 (1987) (acquisition and creation of bank subsidiaries offering securities discount brokerage services); *American Ins. Ass’n v. Clarke*, 865 F.2d 278 (D.C. Cir. 1989) (acquisition by bank of company offering municipal bond insurance).

129. See *Federal Reserve Rulings Regarding Loan Production Offices and Purchases of Operating Subsidiaries: Hearings Before the House Comm. on Banking and Currency*, 90th Cong. (1968) [hereinafter *Federal Reserve Rulings*] (regulations challenged by several congressmen).

own operating subsidiaries.¹³⁰ Indeed, in the intervening years, Congress has enacted legislation acknowledging the existence of operating subsidiaries.¹³¹ Even more significantly, however, support for the idea that in 1966 OCC was merely confirming an incidental power that national banks had under existing law may also be found in the language and history of the 1927 McFadden Act,¹³² which is best remembered for specifying certain requirements for the establishment of branches by national banks but also limited banks' securities powers in certain respects.

In the course of consideration of this legislation, questions were raised about the conduct by national banks of safe-deposit businesses. The legislation permitted banks to continue to engage in such business, but it did so in a curiously backhanded fashion. It did not affirmatively provide that banks were empowered to conduct the safe-deposit business through a subsidiary. Rather, it merely specified by means of a proviso that, in carrying on such business, the bank may not invest more than 15% of its unimpaired capital and surplus in the capital stock of a corporation organized under state law to conduct that business.¹³³ This device of limiting a bank's investment in stock or other assets is a common one in banking law¹³⁴ and typically serves to protect banks against loss associated with a particular activity in which investment may be made. The safe-deposit business proviso

130. See *infra* notes 137-60 and accompanying text (discussing whether prior action by Congress in Glass-Steagall had this effect).

131. E.g., Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 102, 101 Stat. 552, 564 (added section 23B of Federal Reserve Act); Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 410, 96 Stat. 1469, 1515 (amended section 23A of Federal Reserve Act); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, § 105(a), 92 Stat. 3641, 3646 (added section 5(e) of Bank Holding Company Act).

132. Ch. 191, 44 Stat. 1224 (1927).

133. The relevant language in its entirety is as follows:

Provided, That in carrying on the business commonly known as the safe-deposit business the [bank] shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the [bank] actually paid in and unimpaired and 15 per centum of its unimpaired surplus.

12 U.S.C. § 24 (Seventh) (1994).

134. For instance, in addition to the provision of section 24 (Seventh) referred to in the next paragraph in text, further on in section 24 (Seventh) the following may be found:

Notwithstanding any other provision of this paragraph, the [bank] may purchase for its own account shares of stock issued by any State housing corporation incorporated in the State in which the [bank] is located and may make investments in loans and commitments for loans to any such corporation: *Provided*, That in no event shall the total amount of such stock held for its own account and such investments in loans and commitments made by the [bank] exceed at any time 5 per centum of its capital stock actually paid in and unimpaired plus 5 per centum of its unimpaired surplus fund.

Id.

necessarily assumes, because it does not itself provide, that the bank has authority to own the stock of the corporation in which the limited investment is made.

Note further that the 15% limitation cannot have been intended to restrict a bank to a minority investment in a safe-deposit business corporation, since the proviso speaks in terms of the bank's "carrying on" the safe-deposit business and, in any event, an investment of 15% of a bank's capital and surplus is surely more than enough to own a safe-deposit business outright. This must be contrasted to another part of section 24 (Seventh) that permits bank investment of up to 10% of capital and surplus in the stock of another bank or a bank holding company and that also expressly limits the bank's investment to not more than 5% of any class of voting stock of the other bank or holding company.¹³⁵ The absence of such an ownership percentage limitation in the safe-deposit proviso is telling.

Even more telling are the House and Senate reports accompanying the legislation, which "recognize[d]" and "affirm[ed]" the previous use of subsidiaries to conduct a safe-deposit business.¹³⁶ The conclusion is thus inescapable that Congress assumed, when it enacted the safe-deposit business proviso to section 24 (Seventh) in 1927, that banks had preexisting authority to own subsidiaries. It is more than a

135. This part of section 24 (Seventh) states:

Provided further, That notwithstanding any other provision of this paragraph, the [bank] may purchase for its own account shares of stock of a bank insured by the Federal Deposit Insurance Corporation or a holding company which owns or controls such an insured bank if the stock of such bank or company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions . . . [and their] officers, directors, and employees, but in no event shall the total amount of such stock held by the [bank] in any bank or holding company exceed at any time 10 per centum of the [bank's] capital stock and paid in and unimpaired surplus and in no event shall the purchase of such stock result in [a bank's] acquiring more than 5 per centum of any class of voting securities of such bank or company.

Id.

136. H.R. REP. NO. 69-83, at 3-4 (1926); S. REP. NO. 69-473, at 7 (1926); see *Federal Reserve Rulings*, *supra* note 129, at 29 (statement of William McChesney Martin, Jr., Chairman, Board of Governors, Federal Reserve System) (citing H.R. REP. 69-83: "in 1927 the Congress recognized the authority of national banks under the incidental powers clause to establish an [operating] subsidiary"). *But see* 75 CONG. REC. 9899-9904 (1932) (copy of November 6, 1911, letter of Solicitor General to Attorney General that questioned the authority of national banks to own subsidiaries, though apparently subsidiaries in question would be banks themselves or would engage in activities seemingly not within the range permitted by section 24 (Seventh)). This verbose and baffling opinion is of questionable authority, particularly in light of the Supreme Court's recent recognition of bank securities powers and activities prior to Glass-Steagall. See *NationsBank of North Carolina v. Variable Annuity Life Insur. Co.*, 115 S. Ct. 810, 814 (1995). References to this letter, however, occasionally appear in modern debates on bank authority. See 1995 Dingell Letter, *supra* note 113, at 2-3.

reach to suggest that authority to own shares of a safe-deposit company may be found in the proviso itself.

The foregoing points serve to establish that national banks have historically had authority to utilize the subsidiary form as an incidental matter in the conduct of their business, but this answers only a part of the argument, made by Representative John Dingell and others, that national banks presently lack such authority. These critics of OCC's actions also contend that Glass-Steagall, enacted in 1933, served to deprive national banks of any authority they might have had to own the stock of other companies, including the stock of subsidiaries, unless Congress has affirmatively granted such authority. This is a somewhat more difficult question, but OCC again clearly has the better of the argument.

The full text of the provision in question, added in 1933 by section 16 of Glass-Steagall and now appearing as the fifth sentence of section 24 (Seventh), is as follows: "Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by [a national bank] for its own account of any shares of stock of any corporation."¹³⁷ Read most restrictively, this sentence prohibits all ownership by national banks of stock of other corporations except as expressly set forth in section 24 (Seventh) or as otherwise expressly permitted by other independent and specific statutory grants of authority. On this restrictive reading, ownership of an operating subsidiary that is not specifically authorized by statute is flatly prohibited. Operating subsidiaries purportedly organized or acquired solely under the incidental powers clause are thus seen as beyond the authority of OCC to authorize.¹³⁸

Section 24 (Seventh) itself contains a rambling collection of exceptions to its general proscriptive language, which includes, in addition to the stock purchase prohibition quoted above, limitations on banks' dealing in and underwriting of securities.¹³⁹ For instance, national banks may own limited amounts (no more than 10% of capital) of

137. 12 U.S.C. § 24 (Seventh).

138. This is the position taken by Representative Dingell and (though less categorically) by the Security Industry Association in their written comments to OCC in response to its request for comments to the Proposed Part 5 Rules. 1995 Dingell Letter, *supra* note 113, at 2-4; 1994 Dingell Letter, *supra* note 103, at 2-4; SIA Letter, *supra* note 103, at 14.

139. The relevant part of section 24 (Seventh) provides:

The business of dealing in securities and stock by the [bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock.

12 U.S.C. § 24 (Seventh).

“investment securities,” meaning debt securities, as further defined by OCC.¹⁴⁰ The proscriptions, moreover, do not apply to an extended list of government-issued and -guaranteed securities.¹⁴¹ Nothing in this collection of exceptions in section 24 (Seventh) itself, however, would save OCC’s operating subsidiary concept.

Thus, the critical exception category is the second one in the stock purchase prohibition: “except as . . . otherwise permitted by law.” This looks beyond the scope of section 24 (Seventh) itself and without question includes the statutorily specified bank subsidiaries that OCC refers to as “statutory subsidiaries,” such as bank service corporations.¹⁴² According to the most restrictive view, this is all that the second exception includes. Power to own any other kind of subsidiary that banks might have had as a matter of their incidental powers was thus, on this view, eliminated when Congress enacted the “stock purchase prohibition” in 1933.¹⁴³

Another way to characterize this branch of the restrictive argument is that Congress, by its action in 1933, implicitly repealed any existing authority to utilize subsidiaries under the incidental powers clause. It certainly did not repeal such authority expressly. Of course, any suggestion that the stock purchase prohibition of Glass-Steagall implicitly repealed preexisting authority of banks to conduct business in the subsidiary form collides with the general rule of statutory construction that implicit repeals are disfavored.¹⁴⁴ There is, however, no need to deal further with the maxim against implicit repeals, and its attendant convolutions and exceptions, since there is a better reading (actually two possible readings) of the meaning of the stock purchase prohibition that leaves intact preexisting incidental powers authority to conduct business through subsidiaries.

140. *Id.*

141. Examples include obligations of the United States, general obligations of a state or political subdivision of a state, and certain obligations of others that are insured by the Secretary of Housing and Urban Development. *Id.*

142. OCC defines “statutory subsidiaries” to be corporations a national bank may own by virtue of some express statutory provision, *see supra* note 57, such as 12 U.S.C. § 24 (agricultural credit corporations), 12 U.S.C. §§ 601, 618 (foreign branching and banking corporations), and 12 U.S.C. § 1861 (bank service corporations); and 15 U.S.C. § 682(d) (1994) (small business investment companies).

143. As Representative Dingell would have it:

Congress . . . added the stock purchase prohibition . . . to make it clear that, if national banks had any pre-existing authority to own corporate stock (including affiliates or subsidiaries), that authority was extinguished, except as expressly provided by statute.

1995 Dingell Letter, *supra* note 113, at 3.

144. *See* NORMAN J. SINGER, SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 23.10 (5th ed. 1993).

The stock purchase prohibition of Glass-Steagall section 16 states that, except as permitted under the two categories of exceptions discussed above, "nothing herein contained" permits a bank to purchase stock of any other corporation. Read cold, the quoted words are a rather peculiar way to express the concept that banks are broadly prohibited from buying stock of other corporations. What did the drafters of those three words have in mind? Two readings seem possible. One is that "herein" refers to all of section 24 (Seventh) and the other is that "herein" refers to the provisions added to section 24 (Seventh) by section 16 of Glass-Steagall. OCC obviously prefers the latter reading¹⁴⁵ and for a variety of reasons, including the statutory history of Glass-Steagall section 16 and the implications of other parts of Glass-Steagall and existing law, that reading is superior.

Statutory history suggests that the words "nothing herein contained" were inserted into early versions of the House and Senate bills that ultimately became Glass-Steagall to limit the impact of a state bank powers parity provision that appeared in all versions of the statute prior to the final version that emerged from the conference between representatives of the House and Senate. The deleted provision granted national banks the power to engage

in all forms of banking business and [to undertake] all types of banking transactions that may, by the laws of the State in which such bank is situated, be permitted to banks . . . incorporated under the laws of such State, except insofar as they may be forbidden by the provisions of any Act of Congress.¹⁴⁶

This broad grant of powers would have, among other things, permitted national banks to take advantage of state banking laws that allowed state banks to invest in corporate securities in a fashion that Glass-Steagall sought to prevent. The words "nothing herein con-

145. See OCC Response to Dingell, *supra* note 57, at 1-2. The response states:

The 1933 Act [Glass-Steagall] spelled out in greater detail what types of securities activities were permissible for national banks. It added a new sentence to 12 U.S.C. § 24 (Seventh): "Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase [by the bank] of any shares of stock of any corporation." This disclaimer sentence clarified that nothing in the changes being made to 12 U.S.C. § 24 (Seventh), *i.e.*, "nothing herein contained", should be deemed to increase banks' existing stock-ownership authority, "except as hereinafter provided", *i.e.*, except as the stock-ownership authority was increased by language added following the disclaimer in 12 U.S.C. § 24 (Seventh). The disclaimer sentence, by saying that the 1933 Act changes were not intended to increase or decrease banks' stock-ownership authority in 12 U.S.C. § 24 (Seventh), in effect confirmed that authority and left it intact.

Id.

146. S. 1631, 73d Cong. § 16 (1933); H.R. 5661, 73d Cong. § 14 (1933); see S. REP. NO. 73-77, at 16 (1933); H.R. REP. NO. 73-150, at 3, 18 (1933).

tained” thus served to give national banks most of the general benefits of the state parity provision without undoing Glass-Steagall’s new limitations on their securities investment powers. The Conference Committee, however, deleted the parity provision but failed to delete as well the stock purchase prohibition perhaps because that prohibition had some additional applicability due to the investment securities provision also added by Glass-Steagall section 16.¹⁴⁷

In any event, the authority of banks to create and own operating subsidiaries under the incidental powers clause predated and thus survived adoption of the stock purchase prohibition in 1933. As already noted,¹⁴⁸ prior to 1933 Congress acknowledged and confirmed that particular exercise of incidental power. As a result, banks were plainly “otherwise permitted by law” to have operating subsidiaries, which were accordingly not captured by the “nothing herein contained” wording of the stock purchase prohibition.

Added support for this conclusion may be found elsewhere in Glass-Steagall itself. Section 14 of that Act¹⁴⁹ added a provision (section 24A) to the Federal Reserve Act that limits the extent of a bank’s investment in the stock of a corporation that owns the bank’s premises.¹⁵⁰ Section 14 does not itself authorize a bank to own such stock. It merely regulates the manner in which (the extent to which) the bank owns such stock and accordingly assumes that the bank is already empowered to own the stock. Section 14 is thus very much like the safe-deposit business proviso added to section 24 (Seventh) in 1927.¹⁵¹ Both demonstrate congressional acknowledgment of the pre-existing power of banks to own stock of other corporations in the conduct of their business. In both cases that power must arise from the incidental powers clause. In neither case does the “nothing contained

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

148. See *supra* notes 133-36 and accompanying text.

149. 12 U.S.C. § 371 (1994).

150. Section 14 of the Act provides:

No national bank, without the approval of the Comptroller of the Currency, and no State member bank [that is, no state-chartered bank that is a member of the Federal Reserve System], without the approval of the Board of Governors of the Federal Reserve System, shall (1) *invest* in bank premises, or *in the stock*, bonds, debentures, or other such obligations *of any corporation holding the premises of such bank*, or (2) make loans to or upon the security of the stock of any such corporation, if the aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation which is an affiliate of the bank, as defined in section 221a of this title, will exceed the amount of the capital stock of such bank.

Id. (emphasis added).

151. See *supra* notes 133-36 and accompanying text.

herein" language of Glass-Steagall section 16 take back what the incidental powers clause of the original National Bank Act grants.

Indeed, the underlying structure of the regulatory scheme imposed with enactment of Glass-Steagall is rife with bank subsidiary elements without any express authority (other than the incidental powers clause) for bank ownership of subsidiaries, starting with the very definition of "affiliate" in section 2(b),¹⁵² which includes any entity "of which a member bank, directly or indirectly, owns or controls . . . a majority of the voting shares."¹⁵³ If the stock purchase prohibition of Glass-Steagall section 16 was a blanket bar on bank ownership of subsidiaries, such a definition would have been unnecessary and even nonsensical. This definition is expressly cross-referenced, for instance, in Glass-Steagall section 20, which is the key limitation in that Act on bank affiliation with any organization "principally engaged" in the underwriting of securities.¹⁵⁴ That limitation by its terms thus applies to bank subsidiaries. It, too, is a regulatory and not an enabling provision. What it purports to regulate (subsidiaries of banks) must accordingly be otherwise authorized.

Other legislative history of Glass-Steagall supports the conclusion that the Act did not eliminate banks' preexisting authority to own subsidiaries. One might argue that it is appropriate to find that the stock purchase prohibition of section 16 was intended by Congress to repeal that authority, notwithstanding the lack of express language to that effect, if such a result would serve the broad underlying purposes of Glass-Steagall. Such is plainly not the case here. Glass-Steagall was clearly aimed at a very different problem—the perception by many in Congress that bank speculation in the securities markets was responsible for the numerous bank failures that occurred after the Crash.¹⁵⁵ In enacting Glass-Steagall, Congress tried to achieve a degree of separation between investment and commercial banking that would insulate commercial banks from the dangers associated with such

152. 12 U.S.C. § 221a(b).

153. *Id.* § 221a(b)(1) (emphasis added). All national banks are "member banks." *Id.* § 221.

154. *Id.* § 377. This section states:

After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title [section 2(b) of the Act] with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities

Id.

155. See, e.g., Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61 (1981); Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 716 F.2d 92, 97 (2d Cir. 1983), *aff'd*, 468 U.S. 207 (1984).

speculation and other risky securities activities,¹⁵⁶ including, of course, any such risks arising from securities activities carried on by bank securities subsidiaries.¹⁵⁷

One searches the legislative history in vain, however, for any suggestion that Congress intended in Glass-Steagall to limit bank utilization of subsidiaries in the conduct of their business as a general matter. A bank's acquisition of the stock of an operating subsidiary is a far cry from investing depositors' funds in speculative securities. As Fed Chairman William M. Martin testified in connection with an earlier congressional investigation of the use of operating subsidiaries, society errs if it presumes that Congress intended to reverse its 1927 confirmation of bank authority to own operating subsidiaries when it enacted the Depression-era legislation dealing with quite different issues.¹⁵⁸ Indeed, in dealing with the securities speculation issues at the heart of Glass-Steagall, Congress did so in a manner that contemplates that banks do possess authority to own subsidiaries. Section 20 regulates bank affiliation (which as a matter of statutory definition plainly includes affiliation with bank subsidiaries¹⁵⁹) with organizations engaged in securities underwriting (prohibiting affiliation with organizations "engaged principally" in underwriting but permitting affiliations where such "engagement" is less than "principal"¹⁶⁰), but it does not itself authorize the creation of any such subsidiary.

Thus, it seems clear that banks do have general authority, under the incidental powers clause, to create and own operating subsidiaries and that any suggestion that the stock purchase prohibition in Glass-Steagall section 16 was intended to or does deny that authority overshoots the proscriptive mark of that provision. It simply proves too much.¹⁶¹

156. Commercial bank involvement in "speculation in corporate stocks" was "high on the list of abuses" that Glass-Steagall was intended to correct. *Federal Reserve Rulings*, *supra* note 129, at 30 (statement of William M. Martin, Jr., Chairman, Board of Governors, Federal Reserve System); *see* S. Rep. No. 73-77, at 11 (1933) (after citing "constitutional weaknesses" of banks in the conduct of their business, the report notes that legislation would deal with this by, *inter alia*, "[m]ore careful restriction of investments"); S. REP. NO. 72-584, at 11 (1932) (similar report concerning predecessor bill); 77 CONG. REC. 3924 (1933) (debating whether Congress should pass legislation to prevent banks from engaging in "wild speculation" with depositors' funds); 76 CONG. REC. 2401 (1933) (stating that the purpose of legislation's drafters was "to prohibit the national banks from dealing in securities that could not be very readily convertible and that would be likely to be frozen in their hands").

157. *See* 75 CONG. REC. 9911 (1932); WILLIAM N. PEACH, *WALL STREET AND THE SECURITIES MARKETS: THE SECURITY AFFILIATES OF NATIONAL BANKS* 18 (1941).

158. *Federal Reserve Rulings*, *supra* note 129, at 30.

159. *See supra* notes 152-54 and accompanying text.

160. *See supra* notes 77-86 and accompanying text.

161. In addition to the many points raised in text there is yet another problem with a broad reading of section 16 to prohibit bank ownership of any shares of stock of any other corporation

Particularly in light of the substantial deference that the Supreme Court has held that federal courts owe to OCC's interpretation of the meaning of the National Bank Act,¹⁶² such a broad interpretation as is urged by opponents of the New Part 5 Rules will surely fail if litigated.

IV. MAY BANKS OWN LESS THAN 80% OF OPERATING SUBSIDIARIES? MUST OPERATING SUBSIDIARIES BE CORPORATIONS?

OCC's rationale for decreasing the amount of voting stock in the operating subsidiary that a bank must own from "at least 80 percent" in the Old Part 5 Rules¹⁶³ to "more than 50 percent" in the Proposed Part 5 Rules¹⁶⁴ and for further loosening the degree of control to either "more than 50 percent" or when the "bank otherwise controls the subsidiary" in the New Part 5 Rules¹⁶⁵ is that banks would thereby be afforded greater "flexibility" in structuring their operating subsidiaries.¹⁶⁶ Flexibility, in this context, generally refers to organizational structures that are more attractive to potential minority investors in operating subsidiaries who bring useful assets to the table. Decreasing the bank's ownership requirement would no doubt attract interest from other businesses with significant marketing and technical expertise and other resources that could assist the operating subsidiary in entering or creating new markets or in improving its existing products and services. A substantial (though still not controlling) interest in an operating subsidiary would no doubt be more appealing to at least

except as expressly permitted in other statutes. It would seem to call into question bank ownership of stock that is acquired by the bank through foreclosure or similar procedure in connection with its lending business. *See supra* note 57.

162. *See, e.g.,* *Smiley v. Citibank (South Dakota)*, 116 S. Ct. 1730, 1733 (1996); *VALIC*, 115 S. Ct. 810, 813 (1995).

163. 12 C.F.R. § 5.34(c) (1996).

164. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,056 (Proposed Part 5 Rules § 5.34(d)(2)). In addition, no other party could "control" the operating subsidiary. *Id.*

165. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(d)(2)). For instance, a bank holding less than a majority of voting stock in an operating subsidiary might nonetheless achieve effective control of the subsidiary by other means, such as by provisions appearing in a contract or in the subsidiary's charter or bylaws. In such instances, however, no other party could hold more than 50% of the voting interest in the operating subsidiary. *Id.*

166. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,349; Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,039. Because of the possibility that other parties could obtain a larger measure of ownership interest under the proposed and new rules, OCC stressed that the bank must in any event retain "control" or "effective control" over the operating subsidiary. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,349-50; Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,039.

some potential investors whose participation is eagerly sought by banks.

A number of prominent bankers have said recently that affiliating with a technologically advanced partner (perhaps a telecommunications or media business) would be a desirable means of remaining current with technological changes that could be useful to providers of financial services, resulting, for example, in on-line banking or data processing services that are markedly better than what banks offer today.¹⁶⁷

In addition, putting aside for the moment (until Part V) the question of new kinds of activities for operating subsidiaries, at the very least the greater organizational flexibility in the conduct of traditional businesses afforded by the new rules promises to increase their utilization by banks and to augment bank profitability. Banks often favor conducting activities related to banking within their operating subsidiaries rather than within subsidiaries of their bank holding company parents because the banks enjoy more direct control over their own subsidiaries than those of indirect affiliates and because of cost savings attainable in the operating subsidiary structure.¹⁶⁸ This expansion and

167. See *Bankers Support Leach Bill, with Caveats, supra* note 39 (Lewis W. Coleman, Vice Chairman and Chief Financial Officer of BankAmerica Corporation, stating that Bank of America seeks more "flexibility to affiliate with potential technology partners so that it can be competitive in providing financial services in a new era of electronic commerce"); John L. Douglas, *OCC Op Sub Letter Facilitates Investments in Technology Companies*, 1 ELEC. BANKING L. & COM. REP. 18 (1996); Nicholas Bray & Paul B. Carroll, *Banks Go to the Source To Cut Phone Bills: Communications Companies Find Allies in Major Customers*, WALL ST. J., Oct. 6, 1995, at A10.

In this connection, others have noted that changes in the kinds of services that financial intermediaries (including banks) offer have in large part been driven by technological change. See 74 Fed. Res. Bull. 91 (1988) (statement of Alan Greenspan, Chairman, Board of Governors, Federal Reserve System); Isaac & Fein, *supra* note 19, at 292-93; Macey, *supra* note 19, at 206-07.

168. See Olaf de Senerpont Domis, *Green Light for Banks To Sidestep Holding Cos.*, AM. BANKER, Nov. 21, 1996, at 1 (Proposed Part 5 Rules "expected to markedly reduce the expenses that banking companies now rack up in such fields as securities underwriting and data processing"; one banking organization (Norwest Corp.) forecast by Lehman Brothers analyst Michael Mayo expects to save \$100 million of annual expenses from changes); Letter from Michael E. Bleier, General Counsel, Mellon Bank, N.A., to OCC 2 (Jan. 26, 1995) (on file with the *DePaul Law Review*) (speaking of the Proposed Part 5 Rules: "Should the proposed amendments be adopted, many banks may begin to conduct activity through operating subsidiaries rather than as subsidiaries of the related bank holding company. Such a change in operating structure often results in lower funding costs for the operating subsidiary."); Letter from Michael J. Halloran, Group Executive Vice President and General Counsel, Bank of America, to OCC 6 (Jan. 27, 1995) (on file with the *DePaul Law Review*) [hereinafter Halloran Letter] (in general, operating subsidiaries "provide substantially more efficient funding capabilities for a bank's activities than are possible with a non-subsidiary affiliate" and "permit bank management to maintain a closer control over its activities than can be maintained when the activities are conducted by a non-subsidiary affiliate").

proliferation of operating subsidiaries should result in more profitable and efficiently run banks.¹⁶⁹

Moreover, simply reducing the voting share ownership requirement was not the only possible means that OCC might propose by regulation for increasing organizational flexibility. There was no immediately apparent reason why banks had to conduct activities generally found in operating subsidiaries in the corporate form of business organization to the exclusion of many others, such as limited liability companies, limited partnerships, and limited liability partnerships. When OCC requested public comment on these further possible elements of organizational flexibility in connection with the Proposed Part 5 Rules,¹⁷⁰ numerous banks and other interested parties responded favorably with innovative proposals for organizational form.¹⁷¹

169. See de Senerpont Domis, *supra* note 168, at 1.

170. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. at 61,039.

171. In their comments to OCC on the Proposed Part 5 Rules, banks, industry organizations, and lawyers associated with them endorsed such alternative business organization forms as limited partnerships, limited liability companies and formal joint ventures and suggested further that majority voting stock ownership was not necessary where the corporate form is adopted. Letter from Walter C. Ayers, representing Virginia Bankers Association, to OCC 1 (Feb. 7, 1995) (on file with the *DePaul Law Review*) (proposing that OCC amend regulations to allow bank ownership of operating subsidiaries formed as limited liability companies and ownership by operating subsidiary of less than majority control of separate limited liability company); Letter from Jill M. Considine, President, New York Clearing House, to OCC 12-13 (Feb. 15, 1995) (on file with the *DePaul Law Review*) (endorsing bank operating subsidiaries formed as limited liability companies and permitting bank ownership of less than a majority of voting stock of subsidiaries); Letter from Forrest S. FitzRoy, Senior Vice President and General Counsel, Boatmen's Bancshares, Inc., to OCC 2 (Jan. 27, 1995) (on file with the *DePaul Law Review*) (urging OCC approval of bank operating subsidiaries in forms of limited liability companies and limited partnerships); Letter from Roman J. Gerber, Executive Vice President, Bank One Corporation, to OCC 7 (Jan. 27, 1995) (on file with the *DePaul Law Review*) (recommending OCC authorize banks to utilize limited liability companies and joint ventures as operating subsidiaries and ownership of less than majority of voting stock); Halloran Letter, *supra* note 168, at 7-8 (endorsing alternative business organization forms of a joint venture, limited liability company, and limited partnership as alternatives for operating subsidiaries); Letter from William H. McDavid, General Counsel, Chemical Bank, to OCC 4 (Feb. 2, 1995) (on file with the *DePaul Law Review*) (in support of allowing bank use of joint ventures and limited liability companies as operating subsidiaries and less than majority ownership of voting stock); Letter from Leo F. Mullin, President and Chief Operating Officer, The First National Bank of Chicago, to OCC 2 (Jan. 27, 1995) (on file with the *DePaul Law Review*) (encouraging greater opportunities for banks by allowing banks to establish operating subsidiaries in limited liability company form); Letter from Charles A. Neale, Counsel, National Bank of Commerce, to OCC 2 (Jan. 30, 1995) (on file with the *DePaul Law Review*) (limited liability company); Letter from E. Norman Veasey, Chair, Section of Business Law, American Bar Association, and Harold B. Finn III, Co-Chair, Banking Law Committee, Section of Business Law, American Bar Association, to OCC 9 (Feb. 2, 1995) (on file with the *DePaul Law Review*) (recommending operating subsidiaries in forms of limited liability companies, limited partnerships, and joint ventures); Letter from David Wells, Operations Officer, First National Bank of Omaha, to OCC 2 (Jan. 25, 1995) (on file with the *DePaul Law*

OCC responded to these comments by modifying its proposal to provide that “an operating subsidiary in which a national bank may invest includes a corporation, limited liability company, or similar entity.”¹⁷² It concluded that these additional forms provided safe alternatives to the corporation and enhanced the flexibility of banks in structuring their operations to take advantage of the unique tax and limited liability features available in them.¹⁷³

In fact, neither use of a non-corporate form as an operating subsidiary nor bank ownership of less than 80%, or even less than a majority, of an operating subsidiary corporation’s voting stock is a radical new idea. Prior to publication of the Proposed Part 5 Rules, OCC had already approved at least one bank application proposing a limited liability company for conducting operating subsidiary activities.¹⁷⁴ In a similar vein, OCC’s original formalization of its approval of the operating subsidiary concept in 1966 required that the bank have “control” of its operating subsidiary and provided that such control would “ordinarily” be achieved through ownership of “51 percent or more of the voting stock.”¹⁷⁵ It also noted even then, however, that a bank could, “under appropriate circumstances,” maintain “effective work-

Review) (proposing that the limited liability company form be included as a permissible form of operating subsidiary for banks); Letter from John D. Wright, Vice President and Senior Counsel, Wells Fargo Bank, to OCC 2 (Jan. 27, 1995) (on file with the *DePaul Law Review*) (suggesting the OCC interpret the revised rules as permitting banks to utilize limited partnerships as operating subsidiaries).

172. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(d)(2)).

173. In its commentary accompanying the New Part 5 Rules, the OCC observed:

LLCs and other similar entities, e.g., business trusts, have recently emerged in many states as an alternative to the corporate form of ownership. These entities are hybrid business organizations with characteristics of corporations (limited liability) and partnerships (tax treatment). As such, the entities have certain key attributes of corporations and joint ventures that the OCC has long permitted banks to participate in—bank control of the entity and limitation or insulation of the bank’s liability for the entity’s activities. Authorizing investment in these and similar types of entities as operating subsidiaries increases the flexibility of national banks to structure their operations. Moreover, to date, the OCC’s experience with LLCs has not revealed any additional risks unique to these entities.

Id. at 60,350.

174. OCC Interpretive Letter No. 645 [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,554 (Apr. 29, 1994) (granting approval of LLC Formation).

175. Acquisition of Controlling Stock Interest in Subsidiary Operations, 31 Fed. Reg. 11,459 (1966). “The Comptroller of the Currency has confirmed his position that a national bank may acquire and hold the controlling stock interest in a subsidiary operations corporation. . . . The controlling interest is ordinarily 51 percent or more of the voting stock issued by the corporation” *Id.*

ing control" of an operating subsidiary with less than 51% of its voting stock.¹⁷⁶

Indeed, OCC has already approved several bank proposals for operating subsidiary activity in which the bank has less than a controlling interest¹⁷⁷ and others in which the operating subsidiary itself owns less than a controlling interest in a business that is part of, or incidental to, the business of banking.¹⁷⁸

These various organizational form and control approaches reflect the needs and ingenuity of banking organizations in finding ways to enter into joint and cooperative arrangements with nonbank service providers.¹⁷⁹ In each case, OCC was satisfied that the enterprise in which the investment is to be made would engage in activities that are a part of, or incidental to, the business of banking and that the investment would be reasonably safe.¹⁸⁰

These parts of the New Part 5 Rules, the flexibility of form and reduction of ownership elements, have attracted significantly less opposition than the idea that operating subsidiaries may be able to engage in some activities that are off-limits for banks. Indeed, if one accepts OCC's original rationale for formalizing its approval of the operating subsidiary concept, which is that share ownership that furthers the business of banking is incidental to the business of banking and that Glass-Steagall section 16 did not impair the rights of national banks to utilize operating subsidiaries for this purpose,¹⁸¹ then it is

176. *Id.* "The controlling stock interest . . . may be a lesser percentage [less than 51%] of voting stock if, under appropriate circumstances, such lesser percentage constitutes effective working control of the corporation." *Id.*

177. OCC Interpretive Letter No. 677 [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 25, 1995) (operating subsidiaries of two national banks purchased company that develops and markets personal financial management software and other nonfinancial software, including games); Letter of James J. Saxon, Comptroller of the Currency (Oct. 12, 1966), reported in Douglas, *supra* note 167, at 19 (bank permitted to acquire minority interest in credit card clearinghouse owned by other institutions).

178. Douglas, *supra* note 167, at 18 (citing Letter from Steven J. Weiss, Deputy Comptroller, Bank Organization and Structure, to Robert Andersen (Jan. 26, 1996), stating that operating subsidiaries of affiliated banks may be permitted to invest in existing holding company that operates merchant credit card processing business; operating subsidiaries' investments made in form of contribution of banks' own merchant credit card businesses to holding company; operating subsidiaries' aggregate equity interest only 40% at outset, subject to further significant dilution in projected public offering; other initial investors include venture capital fund, telecommunications company and holding company management); OCC Interpretive Letter No. 689 [1995-1996 Transfer Binder] Fed. L. Rep. (CCH) ¶ 81,004 (Aug. 9, 1995) (operating subsidiary shares equity interest in merchant services company with subsidiary of existing nonbank merchant services company).

179. See Douglas, *supra* note 167, at 18-19.

180. See *id.* at 19.

181. See *supra* notes 137-60 and accompanying text.

difficult to see anything magical about the corporate form or about the 80% or even majority voting control elements.

The most significant argument in opposition to abandonment of the 80% requirement is that a lesser requirement is inconsistent with what the opposition (chiefly the securities industry) characterizes as the historical OCC justification for permitting banks to own stock of operating subsidiaries—that the operating subsidiary is merely an “incorporated department” of the bank, doing no more than what the bank is authorized to do.¹⁸² If another investor in the operating subsidiary has a sufficiently large equity interest, that investor could have such influence on the conduct of the affairs of the operating subsidiary that it would no longer be acting like a mere department of the bank.¹⁸³

This argument proves too much since even a 20% minority investor could, through blocking or other veto-like provisions in the operating subsidiary’s charter or bylaws, or in a separate shareholders or operating agreement, achieve significant influence over the conduct of the business.¹⁸⁴ OCC was aware of this potential problem when it finalized the new rules, which require that the bank have a stated equity interest (more than 50%) or otherwise achieve effective control and that, in the latter case, no other person controls more than 50% of the voting interest of the operating subsidiary.¹⁸⁵

182. See SIA Letter, *supra* note 103, at 20-21. The letter states:

We respectfully submit that proposed § 5.34(d)(2) is inconsistent with the restriction in § 24 (Seventh) prohibiting a national bank from purchasing the stock of any corporation. . . . [T]he prior justification utilized by the OCC to permit national banks to own shares of an operating subsidiary is that such a subsidiary is merely an incorporated department of the national bank. Based on this theory, the OCC consistently has required an operating subsidiary [sic—national bank] to own at least 80% of the stock of an operating subsidiary. By reducing the percentage to 50%, proposed § 5.34(d)(2) would permit a national bank to own shares of a corporation that no longer operated as a division of the bank. In this regard, we note that other shareholders of the corporation also could own a substantial percentage of the stock of that corporation, and thus could have at least the power to influence control of the corporation. Indeed, to the extent that the corporation’s constituent documents contained “super-majority” voting or various other types of provisions, even a higher percentage of ownership by the parent bank could be insufficient to assure that the bank could exercise control of the company. In such a case, another person could have a “blocking” impact on corporate actions.

Id.

183. *Id.*

184. Indeed a nonshareholder can achieve this kind of blocking power by contract. Percentage of ownership is not the issue here.

185. See Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,349-50 (1996) (to be codified at 12 C.F.R. pt. 5).

In any event, this particular argument against the abandonment of the 80% ownership requirement cannot be analyzed in isolation from the rest of the proposed rules. The argument rests upon the assumption that an operating subsidiary is legitimate only if it acts as if it were merely a department of the bank. The force of the argument against abandoning the 80% ownership requirement, such as it is, essentially disappears if the more controversial part of the proposed rules, the part that contemplates operating subsidiaries engaging in activities that banks may not undertake, is valid. If that part survives judicial scrutiny, then an operating subsidiary need not act as if it were merely an incorporated department of the bank. Thus, the Article segues to the main point of contention.

V. WHAT (ELSE) MAY OPERATING SUBSIDIARIES DO?

There has been considerable debate on this issue,¹⁸⁶ but it has not been definitively settled.¹⁸⁷ To Representative James Leach, Chairman of the House Banking Committee and author of several related bills intended to enact significant statutory reform in the current and prior terms of Congress,¹⁸⁸ the Proposed Part 5 Rules were clearly contrary to existing law¹⁸⁹ and would undermine or circumvent legislation dealing with holding companies.¹⁹⁰ He also believes that, in any event, the proposed rules are unwise since risky, nonbanking activities that newly liberated operating subsidiaries might undertake could

186. See SYMONS & WHITE, *supra* note 19, at 353-55 (for a summary of arguments on this point).

187. It has been suggested, for instance, that the 1982 amendments to the Bank Service Corporation Act, codified at 12 U.S.C. §§ 1861-65 (1994), which permit bank service corporations to engage in activities closely related to banking as bank subsidiaries, could be interpreted to mean that Congress has erased the distinction between bank subsidiaries and holding company subsidiaries in terms of what activities they may engage in, including activities not permitted to banks themselves, though Professors Symons and White also survey reasons why the distinction between what these two categories of bank organization affiliates (bank subsidiaries and bank holding company subsidiaries) may or should be maintained. *Id.* at 353-55.

188. Financial Services Competitiveness Act of 1997, H.R. 10, 105th Cong. (1996); Financial Services Competitiveness Act of 1995, H.R. 1062, 104th Cong. (originally H.R. 18); Financial Institutions Regulatory Relief Act of 1995, H.R. 1362, 104th Cong.; Financial Services Competitiveness and Regulatory Relief Act of 1995, H.R. 2520, 104th Cong.

189. See *Leach Blasts Comptroller's Office for Exceeding Statutory Authority*, 66 Banking Rep. (BNA) 391 (Mar. 11, 1996), available in LEXIS, BNA Library, BNABus File [hereinafter *Leach Blasts Comptroller's Office*]. Indeed, Representative Leach has stated publicly that there "is not a shred of statutory support for the notion that a national bank is authorized to conduct activities in a subsidiary that are not permissible for the bank itself." See Atkins, *supra* note 8, at 729. Representative Dingell, former head of the House Commerce Committee and a legislator with a long-standing interest in banking legislation, has agreed. See *id.*

190. See William M. Isaac, *A Rebuttal to Rep. Leach on Comptroller's Moves*, AM. BANKER, Mar. 28, 1996, at 4.

jeopardize the federal deposit insurance system¹⁹¹ and are plainly contrary to long-standing OCC policy and practice.¹⁹² The Securities Industry Association, a likely complainant in a judicial challenge to the New Part 5 Rules, expressed similar views in its comments to OCC concerning the proposed rules.¹⁹³

A. Preliminary Considerations

In considering these arguments about the authority of OCC to grant permission to operating subsidiaries to engage in new business activities, it is important to keep two things in mind at the outset: (i) the narrow scope of activities in which an operating subsidiary may engage under the New Part 5 Rules beyond those permitted to its parent bank and (ii) the fact that operating subsidiaries have engaged in activities prohibited to banks for some time without any difficulty or fanfare.

1. Limited Scope

While the New Part 5 Rules contemplate the possibility of OCC approval, on a case-by-case basis, of operating subsidiary activities that are "different from that permitted for its parent [national] bank,"¹⁹⁴ the scope of such activities is somewhat more limited than the alarmed expressions of concern would seem to suggest. For instance, one will not see national banks or their operating subsidiaries making use of the new rules to acquire, for example, a toaster manufacturer because the activities of the manufacturer would not be "a part of or incidental to the business of banking" (or otherwise permitted by statute), as required by the New Part 5 Rules.¹⁹⁵

Moreover, OCC has committed in the new rules "to ensure that any new activities are conducted safely and soundly."¹⁹⁶ OCC has retained its general authority to impose conditions on its approval of any application that it determines may be appropriate under the cir-

191. See Atkins, *supra* note 8, at 729. Senate Banking Committee Chairman Alphonse D'Amato has strongly criticized the New Part 5 Rules as unwise, because they may expose federally insured banks to "excessive risks," and ill-timed, since they may impede broad legislative reform. See Campbell, *supra* note 12.

192. See Atkins, *supra* note 8, at 4.

193. SIA Letter, *supra* note 103, at 14-33.

194. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,351 (1996).

195. Rules, Policies, and Procedures for Corporate Activities, 12 C.F.R. § 5.34(d)(2) (1996).

196. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,351.

cumstances for assuring safe and sound banking practices.¹⁹⁷ Furthermore, if OCC later determines that the operation of the subsidiary is in violation of law or regulation or that the manner of operation of the subsidiary is unsafe or unsound or otherwise threatens the safety or soundness of the bank, OCC has committed that it will direct "the bank or operating subsidiary to take appropriate remedial action," including disposition or liquidation of the subsidiary or discontinuation of the offending activity.¹⁹⁸

In any event, the parent bank's exposure to loss as a result of the activities of its operating subsidiary is further reduced by the new rules' limitations on investments that the bank may make in the operating subsidiary. The new rules impose the standards of section 23A of the Federal Reserve Act¹⁹⁹ where the operating subsidiary is engaging as a principal in an activity approved under New Part 5 Rules section 5.34(f), the provision dealing with activities that the parent bank may not conduct. The imported standards of section 23A limit a bank's investment in and loans to a bank affiliate to 10% of the bank's capital and surplus.²⁰⁰

197. *Id.* at 60,366 (to be codified at 12 C.F.R. § 5.13(a)(1)); *see id.* at 60,353-54 (stating that OCC "has available a number of measures to address safety and soundness issues that may arise in connection with activities conducted under the authority of this section [5.34]," one of which was authority to "impose appropriate conditions in connection with the approval of a particular operating subsidiary application in order to ensure bank safety and soundness"); *id.* at 60,354 (stating that "OCC retains the authority to impose additional safeguards, either on a case-by-case or activity-by-activity basis, to address safety and soundness issues presented by particular types of operations").

198. 12 C.F.R. § 5.34(d)(3)). OCC also noted in its commentary to the New Part 5 Rules, *see* Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,354, that the new rules serve to emphasize and promote the separate identity of the operating subsidiary and thus to insulate, as a legal matter, the parent bank from problems that may arise in connection with activities of the operating subsidiary, *see id.* at 60,376 (to be codified at 12 C.F.R. § 5.34(f)(2)). Finally, OCC observed that its ability to monitor and supervise operating subsidiaries and respond to any problems that might arise in connection with them has been strengthened by a number of recently enacted laws, including, *inter alia*, the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236, which enables it to take prompt corrective action where banks fail to meet capital requirements, including ordering divestiture of a subsidiary if it poses a significant risk to the bank. *Id.* at 60,354-55.

199. 12 U.S.C. § 371c (1994). The standards of this provision of the Federal Reserve Act, as well as section 23B of that Act, *id.* § 371c-1 (requiring transactions with bank affiliates to be conducted only "on terms and under circumstances . . . that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies;" *id.* § 371c-1(a)(1)(A) (1994), are incorporated into the New Part 5 Rules and must be applied by OCC with respect to transactions between a bank and its operating subsidiary under the terms of 12 C.F.R. § 5.34(f)(3). *See* Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,354.

200. 12 U.S.C. § 371c(a)(1)(A).

In other words, any such new or differing activities approved under the New Part 5 Rules would have to be a reasonable part of the modern conception of the business of banking and could not be likely to jeopardize the financial health of the parent bank.²⁰¹ To be sure, it is possible that OCC from time to time will be mistaken in its assessment of the impact of a proposed new operating subsidiary activity on the safety and soundness of the parent bank, but the possibility of such mistake in judgment is hardly unique to this new circumstance. If OCC arrives at an overbroad view of what constitutes part of, or is incidental to, the business of banking, objecting parties can promptly challenge its order. As the Supreme Court has recently noted in a different context, OCC's discretion in determining that a particular activity is part of the business of banking "must be kept within reasonable bounds."²⁰²

Moreover, even where an activity is seemingly a part of, or incidental to, banking and can apparently be carried on with reasonable safety, insofar as other provisions of banking law are clearly applicable to or limit such activities when carried on by an operating subsidiary, OCC must obviously observe such provisions and limitations in granting approvals. Glass-Steagall section 20 is obviously such a limitation.²⁰³

2. *History of Bank Operating Subsidiary Activities That Are Not Permissible for Banks*

The second point to keep in mind at the outset is that operating subsidiaries have for some time, and apparently without great fanfare or controversy, engaged in certain activities that national bank parents may not. Some ninety years ago, the Supreme Court held in *Merchants' National Bank v. Wehrmann* that a national bank may not serve as the general partner of a partnership.²⁰⁴ This was not because of any statute specifically denying to national banks the authority to become general partners but because of the unlimited personal liability for the obligations of the firm that a general partner assumes. The assumption of such unlimited liability was, the Court concluded, beyond the bank's power.²⁰⁵ Since 1984, however, OCC has permitted

201. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,353-54; Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,033, 61,039 (1994).

202. *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 814 n.2 (1995).

203. 12 U.S.C. § 377 (1994); see *infra* notes Part V.B.

204. 202 U.S. 295, 301 (1906).

205. The national bank had taken a 9/40ths interest in a general partnership as security for a debt. *Id.* at 298. The partnership was in the business of acquiring, developing, and selling a

operating subsidiaries to act as general partners in a number of circumstances: in a partnership operating an ATM network;²⁰⁶ in a limited partnership investing in real estate mortgage-related assets;²⁰⁷ in a limited partnership holding a commodity pool of foreign currency spot, forward, futures, and option contracts;²⁰⁸ and, in a partnership issuing asset-backed securities.²⁰⁹

OCC has reasoned that the prohibition in *Wehrmann* of a bank's ownership of a general partnership interest did not apply in the case of ownership of the interest by an operating subsidiary because the interposition of a corporate entity (the operating subsidiary) between the bank and unlimited liability for partnership obligations sufficiently (though not absolutely) insulated the bank.²¹⁰ In each such case, the partnership was engaged in activities well within the business of banking, and OCC imposed further conditions intended to protect the bank against being called upon to answer for the obligations of the partnership.²¹¹

This, then, is an example of operating subsidiaries having authority to engage in activities that their national bank parents must avoid. The particular activity would appear to be generically appropriate for a national bank. The riskiness involved, however, arguably called the bank's authority to conduct the activity itself into legitimate question

leasehold. *Id.* The bank became the owner of this interest in satisfaction of the debt, subject to any limitation to its powers as a national bank to engage in the transaction. *Id.* The partnership was unsuccessful and its partners were required to contribute toward payment of its debts. *Id.* The national bank basically raised the defense of *ultra vires*, an argument that was sustained by the Court, which held that a national bank had "no authority" to become "a member of the firm . . . with an unlimited personal liability." *Id.* at 301. The Court contrasted this circumstance (being a general partner) to the situation of the holder of shares of stock of a corporation. A stockholder's exposure is generally limited to the amount of the holder's investment. *Id.* at 299-300. Thus, the key to the Court's holding of lack of national bank authority was the factor of unlimited liability as a general partner, which placed the bank's status as general partner outside its incidental powers under 12 U.S.C. § 24 (Seventh) (1994); see *Merchants' Nat'l Bank v. Wehrmann*, 68 N.E. 1004, 1007 (1903), *rev'd on other grounds*, 202 U.S. 295 (1906); OCC Interpretive Letter No. 289 (May 15, 1984), 1984 OCC Ltr. LEXIS 27 (in response to bank's proposal to create a partnership with one of its subsidiaries, the OCC voiced concerns about the *Wehrmann* prohibition (of partnership activity by national banks) but found in this case that bank would be shielded from unlimited liability and did not object to the proposal).

206. OCC Interpretive Letter No. 289 (May 15, 1984), 1984 OCC Ltr. LEXIS 27.

207. OCC Interpretive Letter No. 423, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85, 647 (Apr. 11, 1988).

208. OCC Interpretive Letter No. 496, [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,087 (Dec. 18, 1989), *modified*, OCC Interpretive Letter No. 541, [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,253 (Feb. 6, 1991) (expanding the subsidiary's activities).

209. OCC Conditional Approval 150 (Aug. 8, 1994), 1994 OCC Ltr. LEXIS 108.

210. OCC Interpretive Letter 289 (May 15, 1984), 1984 OCC Ltr. LEXIS 27.

211. See *supra* notes 206-09 (citing OCC approvals).

since national banks must, as a general matter, conduct their operations in a safe and sound manner.²¹² If they fail to do so, they may be subject to a cease and desist order to discontinue the unsafe or unsound practice,²¹³ they may lose deposit insurance coverage,²¹⁴ and their managers may be removed.²¹⁵

Much the same rationale has been offered by OCC in connection with its approval of an operating subsidiary created in the form of a limited liability company to originate and service residential real estate loans: the activity is within the business of banking and "the bank is shielded from unlimited liability for the acts of other partners or venturers."²¹⁶ No doubt other safety-related instances of operating subsidiaries engaging in activities that are inappropriate for national banks will arise in the future.

The more interesting and difficult cases, however, involve a bank operating subsidiary engaging in activities that are specifically prohibited by statute to a national bank.²¹⁷ Interested observers anticipate that these activities will involve dealing and underwriting in securities,²¹⁸ as to which there are significant statutory impediments to direct bank involvement. It is to such possible bank-ineligible activities by operating subsidiaries that this Article next turns. This will entail looking, in Part B below, at the kinds of bank-ineligible securities activities in which nonbank affiliates of bank holding companies may engage. This will be followed, in Part C, by a consideration of reasons why the statutory provisions that permit holding company subsidiaries to engage in such securities activities ought to be equally applicable to bank operating subsidiaries under the New Part 5 Rules, notwithstanding the prohibition on direct bank involvement in them. Finally, this Article will consider, in Part D, several other important arguments offered by opponents of the New Part 5 Rules to involvement by bank operating subsidiaries in bank-ineligible securities activities.

212. See SYMONS & WHITE, *supra* note 19, at 196 ("The first principle defining the business of banking is safety, soundness or absence of substantial risk to deposited funds and the monetary system.").

213. 12 U.S.C. § 1818(b)(1) (1994) ("engaging . . . in an unsafe or unsound practice in conducting" its banking business).

214. *Id.* § 1818(a) (same).

215. *Id.* § 77.

216. OCC Interpretive Letter No. 645 [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,554 (Apr. 29, 1994).

217. There was no such specific statutory prohibition in the *Wehrmann* case. See *supra* notes 204-05 and accompanying text.

218. See *supra* notes 86-93 and accompanying text.

B. Section 20 Subsidiaries—The Meaning of “Engaged Principally”

As noted earlier,²¹⁹ Glass-Steagall sections 16 and 21²²⁰ place an outright prohibition on most types of national banking underwriting and dealing.²²¹ Glass-Steagall section 20,²²² on the other hand, more loosely forbids bank affiliation with entities that are “engaged principally” in underwriting and dealing, which the courts have accepted as meaning that bank affiliates may engage *to some degree* in the underwriting of and dealing in those securities that banks themselves may not underwrite or deal in,²²³ that is, the so-called bank-ineligible securities. In the past, the bank affiliates engaging in these securities activities with bank-ineligible securities have been bank holding company subsidiaries, which are regulated by the Federal Reserve Board.²²⁴ Because (for reasons given later²²⁵) the experience of these so-called “section 20 subsidiaries” may have a bearing on the implementation of, and possible challenges to, the New Part 5 Rules, the recent history and likely future direction of their bank-ineligible activities bear examination.

In trying to give content to the concept of “engaged principally,” the Board first concluded generally that the subsidiary would not be so engaged unless its underwriting and dealing activities in bank-ineligible securities were a “substantial line of business activity” for the subsidiary.²²⁶ It then adopted an arithmetic test for assuring that the subsidiary’s bank-ineligible securities activities were not “substantial”: the subsidiary’s bank ineligible underwriting and dealing revenues could not exceed a specified percentage of its gross revenues.²²⁷ There is no statutory or other easily determined bright-line test for

219. See *supra* notes 78-80 and accompanying text.

220. 12 U.S.C. § 24 (Seventh) (1994); *id.* § 378(a)(1) (1994).

221. Banks are permitted to underwrite and deal in government-issued and -guaranteed securities and certain other types of securities. *Id.* § 24 (Seventh).

222. *Id.* § 377.

223. See *supra* notes 81-86 and accompanying text.

224. See *supra* note 82.

225. See *infra* Part V.C.2.

226. Bankers Trust New York Corp., 73 Fed. Res. Bull. 138, 142 (1987); see Citicorp, 73 Fed. Res. Bull. 473, 481-83 (1987), *aff'd*, Securities Indus. Ass’n v. Board of Governors of the Fed. Reserve Sys., 839 F.2d 47 (2d Cir. 1988).

227. For purposes of this calculation, the Board excluded revenues derived from the subsidiary’s dealing in or underwriting of securities that banks themselves could underwrite or deal in. Since the Glass-Steagall Act permitted banks themselves to engage in such activities, affiliate involvement in them ought to be irrelevant, said the Board, for purposes of the “engaged principally” test of section 20 of the Act. See Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, 61 Fed. Reg. 40,643 (1996).

what percentage is the upper permissible limit for this purpose.²²⁸ At the outset in 1987, the Board concluded that underwriting and dealing revenues consisting of 5% of the subsidiary's gross revenues would be so insubstantial as to reflect an activity in which the subsidiary was not "principally engaged."²²⁹ Two years later, the Board reconsidered the issue and raised the limit to 10% of the subsidiary's gross revenues.²³⁰

In the years after 1989, banking organizations from time to time asked the Board to revisit this topic.²³¹ By 1996, many of their larger

228. See Order Approving Modifications to Section 20 Orders, 79 Fed. Res. Bull. 226, 227-28 (1993) (citations omitted):

Although the statutorily-imposed "engaged principally" limitation on ineligible activities represents a "hard and fast limit" that may not be administratively modified, . . . nothing in section 20 itself dictates what criteria must be used to determine compliance with that limit. Indeed, the statutory term "engaged principally" is "intrinsically ambiguous." . . . Thus, the statute gives the Board discretion in selecting the criteria for determining when ineligible securities activities become substantial.

229. Citicorp, 73 Fed. Res. Bull. at 486; see Bankers Trust New York Corp., 73 Fed. Res. Bull. at 146.

230. See Modifications to Section 20 Orders, 75 Fed. Res. Bull. 751 (1989). The Board had anticipated the possibility of permitting an increase to 10% of revenues, based upon its assessment of the subsidiary's performance over a period of time, in one of its 1987 orders. Citicorp, 73 Fed. Res. Bull. at 485.

231. In 1993, the Board further adjusted the test, as requested by holding companies, to take account of unexpected and unusual fluctuations in the levels and structure of interest rates, which had an unforeseen impact on calculations under the revenue test. See Order Approving Modifications to Section 20 Orders, 79 Fed. Res. Bull. 226. Specifically, because bank-eligible securities (for example, government securities) tend to carry shorter terms than bank-ineligible securities, when the steepness of the yield curve grew, revenues derived from bank-eligible securities declined in relative importance to revenues from bank-ineligible securities, thus distorting the relative importance of bank-ineligible activities in the total mix of holding company securities subsidiary activities. *Id.* at 228; see Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 40,644 (referring to the 1993 modification, the Board observed that "an increase in the steepness of the yield curve had caused the revenue earned by at least some section 20 subsidiaries from holding eligible securities to decline in relation to ineligible revenue, even as the relative proportion of eligible and ineligible securities activities being conducted by these subsidiaries remained unchanged").

Thus, after this further modification, the holding company subsidiary was permitted to obtain up to 10% of its gross revenues (adjusted by indexation to the 1989 interest rate structure) from securities activities not permissible for banks themselves. Order Approving Modifications to Section 20 Orders, 79 Fed. Res. Bull. at 229. The indexation alternative divided securities into thirteen categories by duration of maturity. Each category was assigned a separate numeric factor (ranging in the original order from 2.7 for durations of one month to .97 for durations of thirty years.) intended to be multiplied against revenues from securities in the category. The numeric factors were to be updated by the Board on a quarterly basis. *Id.*

This modification obviously entailed more costly and burdensome compliance efforts, requiring more sophisticated systems analytical abilities that many banks did not possess. The Board therefore allowed banks to opt for continued use of the older, non-indexed test. *Id.* at 228-29. Dissenting Governors Mullins and Angell found this modification to be "an unduly complex and burdensome solution to the problem it is intended to address, i.e., the unreliability of the current 10 percent revenue limit." *Id.* at 231. The dissenters pointed out that, in light of the imprecise nature of section 20's limitations on bank-ineligible activities as well as the Board's "considera-

section 20 subsidiaries were close to the 10% limit²³² and, indeed, the Board imposed a substantial fine on at least one for exceeding the limit.²³³ In that environment; the Board began considering taking action to raise the limit but has been reluctant to do so while significant statutory reform was possible during the last Congress.²³⁴

Finally, after the collapse of efforts in Congress to enact major Glass-Steagall reform in the summer of 1996, the Board proposed a further modification of its rules to raise the revenue limit to 25%.²³⁵ It did so based upon its conclusion that the holding company subsidiaries had "operated in a safe and sound manner without adverse effects on their affiliated banks or the public" over the preceding nine years.²³⁶ The new revenue limits became effective on March 6, 1997.²³⁷

ble experience" in regulating section 20 subsidiaries, the Board should take the more fundamental step of increasing the 10% limit rather than merely fine-tuning the poorly functioning current approach. *Id.*

Banks agreed. A year later, in 1994, about thirty banks suggested that the 10% revenue limit should be raised to 25%; see *Foreign, Domestic Banks Ask Fed To Raise Section 20 Revenue Cap*, 63 Banking Rep. (BNA) 115 (July 25, 1994), available in LEXIS, BNA Library, BNABus File, and some bank lawyers and commentators then suggested that the limit be raised promptly to 49%. See, e.g., Fox, *supra* note 10, at 1; Jaret Seiberg, *Shadow Panel: Raise Limit on Banks' Securities Revenue*, AM. BANKER, Feb. 13, 1996, at 2; *Shadow Regulators Urge Agencies To Deregulate Within Existing Law*, 66 Banking Rep. (BNA) 262 (Feb. 19, 1996) [hereinafter *Shadow Regulators*], available in LEXIS, BNA Library, BNABus File.

232. See Laurie Hays & John R. Wilke, *Banks Bump Against Cap on Dealing*, WALL ST. J., Mar. 29, 1996, at C1.

233. See *id.* (Swiss Bank Corp. fined \$3.5 million when its securities subsidiary exceeded revenue limit).

234. See Pamela Atkins, *SAIF's Legislative Prospects Said To Hinge on Budget Accord*, 66 Banking Rep. (BNA) 209, 211 (Feb. 12, 1996), available in LEXIS, BNA Library, BNABus File (statement by Board General Counsel Virgil Mattingly, Jr.: Board deferring to Congress in delaying action on proposals to increase 10% revenue limitation); Fox, *supra* note 10, at 1 (Board working on proposal to modify revenue limit; Federal Reserve Governor Susan M. Phillips said Board would definitely consider raising limit if Congress did not enact significant reform); Hays & Wilke, *supra* note 232, at C1 (Fed officials considering bankers' pleas to raise limit but no proposal would move forward "until congressional efforts to overhaul Glass-Steagall have run their course").

235. See *Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities*, 61 Fed. Reg. 40,643 (1996).

236. *Id.* at 40,644. After major reform efforts collapsed, Representative Leach strongly encouraged the Board to take such action. See Campbell, *supra* note 47 (quoting Representative Leach: "I am writing to urge the Federal Reserve Board to use its authority, which is clear and unquestionable, to address the changes in the marketplace by increasing the percentage limitations on the amount of securities underwriting that can be conducted by Section 20 affiliates."). He applauded the action after it was announced. See R. Christian Bruce, *Fed Proposes Easing of Restrictions on Section 20 Subsidiaries*, 67 Banking Rep. (BNA) 197 (Aug. 5, 1996), available in LEXIS, BNA Library, BNABus File.

237. *Rules, Policies, and Procedures for Corporate Activities*, 61 Fed. Reg. 68,750 (1996).

This significant increase in the limit, plus some contemporaneously proposed and since finalized changes in the manner in which it is calculated²³⁸ and a relaxation of certain "fire walls" within banking organizations,²³⁹ will undoubtedly result in a major increase in bank holding company subsidiary securities activities. These regulatory reforms will surely not only encourage holding companies to extend the securities activities of their existing affiliates but may also make outright acquisition of presently independent broker-dealers both attractive and feasible.²⁴⁰ It can be expected that demands for further increases will be made by large banking organizations that will approach the new 25% limit within a short period of time.²⁴¹ Indeed, at least one petitioner has already asked the Board to raise the limit to 49%,²⁴² a proposal that has support in other quarters.²⁴³ Even the more modest increase in the revenue limit to 25%, however, was controversial and may very well attract serious judicial challenge.²⁴⁴

238. *Id.* See Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, 61 Fed. Reg. at 40,643 (proposal to exclude from calculation of revenue limit any interest earned on certain kinds of debt securities that a bank is entitled to hold for its own account). See *Fed Changes Revenue Treatment of Interest Earned by Bank Securities Units*, 67 Banking Rep. (BNA) 386 (Sept. 16, 1996), available in LEXIS, BNA Library, BNABus File [hereinafter *Fed Changes Revenue Treatment*] (proposal finalized September 20, 1996, to take effect March 6, 1997).

239. Review of Restrictions on Director and Employee Interlocks, Cross-Marketing Activities and the Purchase and Sale of Financial Assets, 61 Fed. Reg. at 40,640 (proposal to ease or eliminate prohibitions on (i) director, officer, and employee interlocks between section 20 subsidiaries and affiliated banks, (ii) cross-marketing efforts by affiliated banks for section 20 subsidiaries and (iii) transfers of financial assets between section 20 subsidiaries and affiliated banks). See Niles S. Campbell, *Fed Tears Down Key Glass-Steagall Firewalls Separating Banking and Securities Affiliates*, 67 Banking Rep. (BNA) 731 (1996), available in LEXIS, BNA Library, BNABus File (proposal finalized October 30, 1996, to take effect January 7, 1997).

240. See Jeffrey Taylor & Stephen E. Frank, *Fed Set To Ease Bank Underwriting Curbs*, WALL ST. J., Aug. 1, 1996, at A2 (possible reconsideration by Bayerische Vereinsbank of the acquisition of Oppenheimer & Co., which was proposed but dropped when the German bank realized that acquisition would place it in violation of section 20 under the then current rules).

241. *Id.* (Chase Manhattan Corp.'s section 20 subsidiary could exceed 25% limitation "within a few years") (statement of Donald H. Layton, Vice Chairman).

242. See Atkins, *supra* note 234, at 211 (statement by Board General Counsel Virgil Mattingly, Jr.).

243. See, e.g., Fox, *supra* note 10, at 4 (bank counsel); Seiberg, *supra* note 231, at 1 (Shadow Financial Regulatory Committee) (summarizing the committee's thoughts).

244. The Board's action in increasing the revenue limit to 25% was promptly criticized by the Securities Industry Association (Board's action, combined with recent OCC initiatives, unfairly favors banks' penetration further into securities business, while securities firms are restrained from entering banking business) and the Independent Bankers Association of America (Board's action will permit common ownership of large commercial banks and large securities firms, resulting in further concentration of financial services industry that should be dealt with by Congress). See Campbell, note 47, at 3. In defending its revenue limit increase the Board will have to contend with its own statement in the 1987 Citicorp Order, 73 Fed. Res. Bull. 473 (1987), that an applicant's proposal for a "10 to 15 percent of activity" test would "exceed the levels which

C. *Applicability of Section 20 to Bank Operating Subsidiaries*

The foregoing developments are obviously important for the future role of holding company section 20 subsidiaries, but they may also be important for bank operating subsidiaries. The revenue limits heretofore established by the Board are not directly applicable to subsidiaries of banks, which are for the most part beyond the regulatory jurisdiction of the Board.²⁴⁵ It is quite likely, however, that OCC will closely examine and, where appropriate, adopt the reasoning of the Board if OCC decides to approve an applicant bank's proposal that its operating subsidiary engage in underwriting and dealing,²⁴⁶ particularly in light of the fact that the Board's general approach (though not

the Board believes represent an appropriate interpretation of the provisions of section 20 that is consistent with both its language and the intention of Congress. In the Board's judgment, at the levels proposed by Applicants, the proposed affiliates would be clearly engaged principally in underwriting and dealing in securities." *Id.* at 485. It would, of course, be appropriate for the Board's "judgment" to be affected by its experience in the interim with section 20 subsidiaries' operations under the 10% limit. Moreover, the financial markets have changed in a fashion that makes reconsideration appropriate as well. *See Atkins, supra* note 234 (statement by Board General Counsel Virgil Mattingly, Jr.). A reading of the Board's statement above that 10-15% is an absolute limit in all circumstances would not be based upon any readily identifiable statutory language or other historical documentation.

Any further increase to the 49% level suggested by applicants and others, *see supra* note 231, will also have to contend with the Board's rejection of that idea in its 1987 Bankers Trust Order, 73 Fed. Res. Bull. 138 (1987), where it concluded that activity accounting for less than 50% could nevertheless amount to an activity in which the subsidiary is "engaged principally" under section 20, *id.* at 141, since a broader reading "would substantially negate the purpose of section 20 by allowing affiliations between large member banks and the largest investment banks in the country, the precise situation at which the Glass-Steagall Act was directed," *id.* at 142. Moreover, when the Board finalized the 25% revenue limitation rule, Federal Reserve Board Governors Lawrence Lindsey, Edward W. Kelley, Susan Phillips, and Laurence H. Meyer suggested that, in their view, the Board had gone as far in loosening the revenue limitations as it could, given the statutory restraints. *See Campbell, supra.*

This Article will not further explore the merits of what particular level of bank-ineligible activity is the outer limit of what section 20 permits, nor whether these prior statements by the Board necessarily disenable it from rethinking the relevant issues. The political and business development momentum is plainly in the direction of expanded holding company subsidiary involvement in underwriting and dealing and it seems clear that the Board has discretion to raise the current limits to some degree, *see Campbell, supra* (House Banking Committee Chairman Leach agrees that new 25% revenue limit is permissible under current statutory restraints and "represents a progressive step forward in providing consumers a more competitive financial marketplace" even if the upper limit is not entirely clear); *see, e.g., Melanie L. Fein, The New Business of Banking: What Banks Can Do Now* (Corporate Law and Practice Course Handbook Series No. B4-7123 1995), available in 912 WL PLI/Corp 91, at *21; *supra* notes 235-37 and accompanying text. In any event, this momentum will no doubt spill over into thinking about bank operating subsidiaries.

245. *See infra* Part V.D.1.

246. *See Shadow Regulators, supra* note 231, at 262-63 (Shadow Financial Regulatory Committee suggests that OCC adopt reasoning of Board in permitting bank subsidiaries to participate in securities activities, perhaps up to 50% of revenues).

the current 25% revenue limit) has already been blessed by the courts.²⁴⁷

The New Part 5 Rules are written in a manner that invites a national bank to apply for permission to launch a subsidiary for purposes of engaging in such securities activities. The bank would assert that the statutory limit on its authority to deal and underwrite, section 16 of Glass-Steagall,²⁴⁸ is an example of what OCC referred to, in its commentary accompanying the Proposed Part 5 Rules, as "a specific restriction that applies to the parent bank but not necessarily to its subsidiaries."²⁴⁹ Thus, OCC could conclude that, within proper limits (presumably similar to limits imposed on holding company section 20 subsidiaries by the Board), the operating subsidiary could deal and underwrite "to an extent or in a manner different from the way the activity is conducted at the parent bank level."²⁵⁰ As contemplated by the New Part 5 Rules, this would be "an activity authorized under § 5.34(d) for the subsidiary but different from that permissible for the parent national bank."²⁵¹

OCC has been publicly reticent to address this specific issue, no doubt to avoid unnecessarily raising hackles in Congress and elsewhere while statutory reform was under serious consideration. In any event, it is in the nature of the new rules that OCC need not address the appropriateness of a particular operating subsidiary activity, including securities activities, until an applicant makes a specific proposal.²⁵² It is, however, certainly clear from a review of the comments submitted in response to publication of the Proposed Part 5 Rules²⁵³ that the interested parties (chiefly the banks and their investment banking competitors) saw underwriting and dealing by operating sub-

247. *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 839 F.2d 47 (2d Cir. 1988).

248. 12 U.S.C. § 24 (Seventh) (1994).

249. Rules, Policies, and Procedures for Corporate Activities, 59 Fed. Reg. 61,033, 61,039 (1994) (Proposed Part 5 Rules § 5.34(d)(2)).

250. *Id.*

251. Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,376 (1996) (to be codified at 12 C.F.R. § 5.34(f)). This would be "an activity that is permissible for the subsidiary under [new] standards but different from that permissible for the parent national bank." Rules, Policies and Procedures for Corporate Activities, 61 Fed. Reg. at 60,351.

252. Under the new rules, OCC did not give blanket permission for banks to establish securities operating subsidiaries. Rather, a bank would have to apply for permission to create such a subsidiary (or to expand an existing subsidiary's activities to include underwriting and dealing). OCC would then make a case-specific determination of the safety and soundness of the proposal for the bank, whether the activity is a part of or incidental to the business of banking and whether it is legally permissible for an operating subsidiary if the parent bank may not engage in the activity. *Id.* at 61 Fed. Reg. at 60,351-54.

253. On file with the author.

subsidiaries as an important issue in connection with final approval of the proposed rules.

Since Glass-Steagall, banks have been unable to engage in underwriting and dealing in bank-ineligible securities and, in fact, their subsidiaries have not engaged in this activity either. Opponents of the New Part 5 Rules maintain that Glass-Steagall section 16's prohibition on such activity by banks is equally applicable to bank operating subsidiaries, which are no more than incorporated departments of banks.²⁵⁴ Supporters of the proposed rules suggest that section 20's less rigid approach to underwriting and dealing applies to operating subsidiaries.²⁵⁵

1. *Underwriting and Dealing as Part of the "Business of Banking"*

In attempting to resolve this central dispute, it is useful to note at the outset that underwriting and dealing in securities, bank-eligible or -ineligible, is part of the "business of banking." Glass-Steagall served to place limits (indeed, quite severe ones) on the securities activities of banks, but it did not itself delete securities activities from the underlying concept of the "business of banking." It is true that the listing of bank powers in section 24 (Seventh), which refers in general terms to taking deposits, making loans, negotiating notes and drafts, and dealing in currency, does not expressly refer to securities activities.²⁵⁶ It is also true, however, that banks have engaged in securities transactions for quite a long time.²⁵⁷ OCC's annual reports early in this century referred to substantial bank securities activities²⁵⁸ and

254. See, e.g., Atkins, *supra* note 8; Leach Blasts Comptroller's Office, *supra* note 189; SIA Letter, *supra* note 103, at 14-33.

255. See, e.g., Shadow Regulators, *supra* note 231.

256. 12 U.S.C. § 24 (Seventh) (1994). Section 24 states that national banks possess all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes.

Id.

257. See Clarke v. Securities Indus. Ass'n, 479 U.S. 388, 407-08 (1987); VINCENT P. CAROSSO, INVESTMENT BANKING IN AMERICA: A HISTORY 97-98 (1970); PEACH, *supra* note 157, at 11-20; 2 F. REDLICH, THE MOLDING OF AMERICAN BANKING: MEN AND IDEAS 389-93 (1951).

258. See OCC Ann. Rep. 78 (1926); OCC Ann. Rep. 12 (1924) (observing that a substantial number of national banks "now buy and sell investment securities and the office of the comptroller has raised no objection because this has become a recognized service which a bank must render"; thus, proposed legislation amending Federal Reserve Act with respect to the power of national banks to buy and sell securities would not result in significant change to the existing situation); OCC Ann. Rep. 8-9 (1909) (discussing the extent of bank securities activity at that time).

early cases involving bank ownership of municipal securities,²⁵⁹ which were decided before banks were given express statutory authority to own or deal in government securities in section 24 (Seventh), suggest that banks have always had the power to engage in securities transactions as an inherent part of the business of banking.

When Congress set about limiting bank powers to engage in securities transactions in the 1920s and 1930s; that body was well aware of the history of bank engagement in such activities. For instance, a committee report accompanying a bill introduced in 1924 to impose limitations on such activities observed that national banks at that time were

engaged to a greater or lesser extent in buying and selling investment securities. There is no express power given in the national banking laws authorizing the conduct of this character of business. Nevertheless, this is a form of service demanded by banks, and it has come to be recognized as a legitimate banking service.²⁶⁰

Three years later, the McFadden Act did impose limits on bank securities dealing powers, but it did so in a fashion that makes clear that Congress assumed banks had preexisting securities powers, presumably as a part of, or incidental to, the business of banking: “[T]he business of buying and selling investment securities shall *hereafter* be limited to buying and selling without recourse marketable obligations evidencing indebtedness.”²⁶¹ The Act’s legislative history is even clearer on this point. The House report notes:

It is a matter of common knowledge that national banks have been engaged in the investment-securities business . . . for a number of years. *In this they have proceeded under their incidental corporate powers to conduct the banking business.* Section 2(b) recognizes this situation but declares a public policy with reference thereto and . . . regulates these activities.²⁶²

That report also states that a proviso added to section 24 (Seventh) by the Act “affirms the existence of a type of business [the investment securities business] which national banks *are now conducting under their incidental charter powers.*”²⁶³

259. See, e.g., *Newport Nat'l Bank v. Board of Educ. of Newport*, 70 S.W. 186 (Ky. 1902); *First Nat'l Bank of North Bennington v. Bennington*, 9 F. Cas. 97 (C.C.D. Vt. 1879).

260. S. REP. NO. 68-666, at 6 (1924).

261. McFadden Act of 1927, ch. 191, § 2, 44 Stat., Part 2, 1224, 1226 (emphasis added).

262. H.R. REP. NO. 69-83, at 2 (1926) (emphasis added).

263. *Id.* at 3 (emphasis added). The new wording added by the Act

recognizes the right of national banks to continue to engage in the business of buying and selling investment securities. . . . In this connection it may be noted that this is a business regularly carried on by State banks and trust companies and has been engaged in by national banks for a number of years. The national banks hold to-day [sic] in the

The congressman for whom the Act was named certainly understood that banks in the 1920s possessed securities powers. His testimony explaining the purposes of the McFadden Act included a passage in which he summarily rejected the suggestion that banks lacked authority to engage in securities activities.²⁶⁴ Glass-Steagall, of course, added further and much more draconian limits on bank securities powers beyond the McFadden Act, but even Glass-Steagall's legislative history makes clear that Congress realized that it was limiting a bank power that already existed.²⁶⁵

Indeed, the very structure of section 24 (Seventh) makes clear that the business of banking must include engaging in securities activities. The extended text of the section commencing with its second sentence serves to impose an elaborate structure of limitations on, and permission to exercise certain types of bank powers involving, "underwriting" and "dealing in securities."²⁶⁶ However, with the possible exception of the limited traditional power of banks to negotiate evidences of debt, none of the more specific bank powers listed in the

neighborhood of \$6,000,000,000 of investment securities. The effect of this provision, therefore, is primarily regulative.

Id. at 3-4; see 67 CONG. REC. 2828 (1926).

264. *Consolidation of National Banking Associations: Hearings on S. 1782 and H.R. 2 Before a Subcomm. of the Senate Comm. on Banking and Currency, 69th Cong. 22 (1926)* (statement by Rep. McFadden). McFadden stated:

As to investment securities provisions in section 2(b) it has been said that we are permitting national banks to engage in a new business without proper safeguards. I shall not consume any time in impeaching the sincerity of this criticism for I am sure your committee well knows that the national banks have for many years been engaged in the business of buying and selling investment securities without any restrictions whatsoever except such credit criticisms as may be made by the comptroller and such limitations as the board of directors themselves may see fit to make. . . . The authority under which this business is carried on may be found in section 5136 of the Revised Statutes of the United States which empowers national banks among other things to negotiate "other evidences of debt."

Section 5136 is now section 24 (Seventh). Representative McFadden also testified:

Modern banking requires the conduct of an investment securities business and the purpose of section 2(b) of this bill is to restrict it to proper and reasonable limits both as to the aggregate amount of any issue which may be held and as to the character of securities that may be dealt in. The section is, therefore, definitive and restrictive. The existing law *neither defines nor restricts*.

Id. (emphasis added).

265. See H. REP. NO. 73-150, at 3 (1933) (while provisions added by the Act would permit banks to continue to "purchase and sell investment securities for their customers to the same extent as heretofore," their ability to purchase and sell investment securities for their own account was "thereafter" limited).

266. See *supra* notes 20, 133-41 and accompanying text.

first sentence, which is derived almost unchanged from legislation enacted in 1863 and 1864,²⁶⁷ expressly includes securities powers.²⁶⁸

Thus, the more recently enacted limitations on securities powers of banks necessarily presuppose that banks have such powers to begin with, a point made by the Supreme Court in *VALIC*,²⁶⁹ where the Court rejected the assertion that national banks' powers were limited to those specific powers listed in the first sentence.²⁷⁰ As the prime example of why so limited a view of the extent of the powers encompassed within the concept of the "business of banking" is fundamentally faulty, the Court observed that Congress' actions in adding the second sentence limitations on dealing in securities "makes sense only if banks already had authority to deal in securities, *authority presumably encompassed within the 'business of banking' language which dates from 1863.*"²⁷¹

Therefore, the starting place in the discussion of whether subsidiaries owned by banks may engage in securities activities must be recognition that, absent further action by Congress, banks themselves possess the power to buy and sell securities. This makes good sense as a matter of the underlying role that banks play in the economy—financial intermediation.²⁷² Furthermore, as a general proposition,

267. Act of June 3, 1864, ch. 106, § 8, 13 Stat. 99, 101; Act of Feb. 25, 1863, ch. 58, § 11, 12 Stat. 668. The order of the clauses of these two versions of what is now the first sentence of section 24 (Seventh) was changed slightly, but with no intent on the part of Congress to alter the meaning; see Symons, *supra* note 18, at 700. Today's version is essentially identical to the 1864 version. See Smoot, *supra* note 13, at 721-22.

268. See *supra* note 256 (for the language of the first sentence).

269. *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

270. *Id.* at 814 n.2.

271. *Id.* at 814 (emphasis added).

272. See SYMONS & WHITE, *supra* note 19, at 1. In *NationsBank of North Carolina v. Variable Annuity Life Insurance Co.*, 115 S. Ct. 810 (1995), the Supreme Court referred approvingly to OCC's invocation of the "'power [of banks] to broker a wide variety of financial investment instruments' . . . which the Comptroller considers 'part of [banks'] traditional role as financial intermediaries' . . . and therefore an 'incidental powe[r] . . . necessary to carry on the business of banking.'" 12 U.S.C. § 24 (Seventh); see also Interpretive Letter No. 494 (Dec. 20, 1989) (discussing features of financial investment instruments brokerage that bring this activity within the "business of banking")." 115 S. Ct. at 814. After noting the insurance industry challenger's position that "the business of banking" is confined to the five activities listed in the first sentence of section 24 (Seventh) and activities incidental to those five and, thus "attribut[ing] no independent significance to the words 'business of banking,'" the Court said, "[w]e think the Comptroller better comprehends the Act's terms." *Id.*

The central passage of Interpretive Letter No. 494 (cited with approval by the Supreme Court as quoted above) "discussing features . . . that bring this activity within 'the business of banking'" is the following:

Providing brokerage services for financial instruments is within the business of banking as contemplated in section 24 (Seventh) because of the financial nature of the activity and the relationship of this activity to other traditional banking functions. National

and again absent further action by Congress, banks are permitted to conduct their business, including intermediation involving securities, using subsidiaries.²⁷³

2. *Glass-Steagall and the Distinction Between Banks and "Affiliates"—Operating Subsidiaries as "Affiliates"*

Of course, Congress *has* taken further action in this field, significantly restricting the securities powers of banks in Glass-Steagall. However, the action it has taken makes a clear distinction between banks themselves and their affiliates. While banks themselves may only underwrite and deal in certain types of securities (for example, government securities),²⁷⁴ their affiliates may not only underwrite and deal in those securities, but they may also, at least so long as they are not "engaged principally" in it, underwrite and deal in other kinds of securities as well.²⁷⁵

For purposes of securities powers, then, into which category do bank operating subsidiaries fall? Are they to be treated like banks themselves or like bank affiliates? The relevant statutory provisions provide a clear answer—operating subsidiaries are surely "affiliates" within the statutory definitional scheme of things. This answer is further supported by legislative history and by previous pronouncements of the Supreme Court.

banks possess various express or implied powers to invest in, trade, deal in, underwrite, and otherwise act in various capacities with a wide variety of financial, investment, and monetary instruments and other financial commodities (such as exchange, coin, and bullion). Banks are regular, active participants in the financial trading markets and normally will have trading expertise. It is a natural part of the same trading process for banks to serve as broker for their customers in other transactions where the bank could not or does not serve as principal but where the trading activity is essentially similar.

The participation of banks as principals in the financial trading markets is itself an aspect of the primary function of banks as financial intermediaries. The role of a bank is to act as an intermediary, a "dealer" in capital, facilitating the flow of money and credit among different parts of the economy. *See, e.g.,* *Auten v. United States Nat'l Bank of New York*, 174 U.S. 125, 142-43 (1899) (citing authorities); OCC No-Objection Letter No. 87-5, (July 20, 1987), reprinted in *Fed. Banking L. Rep. (CCH)* ¶ 84,034. This role takes many forms: providing payment transmission services, borrowing from savers and relending to users, participating in the capital markets as here, or using and adopting whatever new methods the economy, markets, and technology develop over time. As the recognized intermediaries between other, nonbank participants in the financial markets and the payment systems, banks possess the expertise to effect transactions between parties and to manage their own intermediation position.

OCC Interpretive Letter No. 494, [1989-1990 Transfer Binder] *Fed. Banking L. Rep. (CCH)* ¶ 83,083 (Dec. 20, 1989) [hereinafter Interpretive Letter No. 494].

273. *See supra* Part III.

274. *See supra* notes 140-41 and accompanying text.

275. *See supra* Part V.B.

a. Statutory Considerations

The plain meaning of the words of the relevant portions of Title 12 would seem to compel the conclusion that operating subsidiaries should be treated like affiliates, which they in fact are, and not like banks, which they patently are not. The outright prohibitions and other limitations contained in Glass-Steagall section 16 apply by their clear terms to "the association," that is, the national bank.²⁷⁶ There is nothing in the wording of that provision that suggests that it applies to entities other than banks, including affiliates of banks.²⁷⁷

Affiliates are dealt with separately in section 20. Section 20's prohibition on affiliation by a bank with a corporation or other organization "engaged principally in the issue, flotation, underwriting, public sale or distribution . . . of . . . securities"²⁷⁸ did not leave the meaning of "affiliate" undefined. As enacted, section 20 recited specifically that no bank "shall be affiliated in any manner described" in section 2(b) of Glass-Steagall with such a corporation or other organization engaged in such securities activities.²⁷⁹ Section 2(b),²⁸⁰ in turn, contained a broad definition of affiliation, which was broken into three categories. Two of the categories of affiliates of banks encompassed (i) organizations controlled by persons who control a bank²⁸¹ and (ii)

276. The pertinent language of section 16 is as follows:

The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no event for its own account, and the association shall not underwrite any issue of securities or stock.

12 U.S.C. § 24 (Seventh) (1994).

277. Similarly, section 21's reciprocal prohibitions on involvement by investment banking firms in banking refer to activities that may only be engaged in by a bank:

[I]t shall be unlawful . . . for any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing . . . securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor

Id. § 378(a)(1). As Justice O'Connor has observed, sections 16 and 21 "approach the same problem from different directions." *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 468 U.S. 137, 163 (1984) (O'Connor, J., dissenting). According to Justice O'Connor: "[B]roadly speaking, § 16 tells firms that engage in commercial banking that they cannot engage in certain securities activities; § 21 tells firms that engage in certain securities activities that they cannot engage in commercial banking." *Id.*; see *Board of Governors of Fed. Reserve System v. Investment Co. Inst.*, 450 U.S. 46, 62 (1981).

278. 12 U.S.C. § 377.

279. *Id.*

280. *Id.* § 221a(b).

281. The relevant portion provides:

Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization . . . [o]f which control

organizations with a majority of directors who are also directors of a bank.²⁸² The remaining separate category of affiliates set forth in the 1933 definition consisted—clearly and unequivocally—of subsidiaries of banks.²⁸³ These three categories persist in the current statutory version of the definition,²⁸⁴ which differs from the original in only one significant respect—the addition of a fourth category of affiliate, consisting of any organization holding a control block of stock of a bank or otherwise possessing the power to elect a majority of a bank's directors, that is, basically a bank holding company.²⁸⁵ It is also to be noted that neither section 20 nor the cross-referenced statutory definition of affiliate contains, or at any time in the past contained, any hint that bank subsidiaries are not "affiliates" for purposes of section 20.

is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank.

Id. § 221a(b)(2).

282. The statute states in part:

Except where otherwise specifically provided, the term 'affiliate' shall include any corporation, business trust, association, or other similar organization . . . [o]f which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank.

Id. § 221a(b)(3).

283. The relevant portion of the statute states:

Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization . . . of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than fifty per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions.

Id. § 221a(b)(1).

284. *Id.* § 221a(b)(1)-(3).

285. The pertinent provision states:

Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization . . . [w]hich owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

Id. § 221a(b)(4). This provision was added in 1966, Pub. L. No. 89-485, § 13(a), 80 Stat. 242, but was derived from the former subparagraph (c), defining "holding company affiliate," which itself was repealed by Pub. L. 89-485, § 13(b), 80 Stat. 242 (1966). Actually, this definition of "affiliate" in section 221a(b) differs from the definition of bank holding company found in 12 U.S.C. § 1841(a) in several respects, none of which is important for purposes of this discussion.

It thus seems clear from the language of Glass-Steagall that Congress intentionally bifurcated its treatment of banking organization securities powers. Banks themselves received quite limited powers. Their affiliates received significantly more, though they must, of course, refrain from being “engaged principally” in bank-ineligible activities. This would seem to be the plain meaning of the language of the Act. It would thus appear that “Congress has directly spoken on the precise question at issue,”²⁸⁶ that is, whether subsidiaries of banks are affiliates of banks for section 20 purposes. If so, that should be “the end of the matter” and the courts “must give effect to the unambiguously expressed intent of Congress.”²⁸⁷ The wording of the relevant statutory provisions seems to leave no conclusion except that bank subsidiaries are affiliates. The alternative, treating subsidiaries of banks as if they are not “affiliates” for section 20 purposes but are instead banks for section 16 purposes, would require considerable statutory interpretational dexterity that seems unlikely to pass muster before the courts.

If further support for the idea that bank subsidiaries are affiliates, beyond the plain meaning of the statute on that precise question, is necessary, it may be found (i) in the pertinent legislative history of Glass-Steagall relating to the meaning of the term “affiliate” and (ii) in the Supreme Court’s admonition that sections 16 and 20 must be read together in a manner that gives meaningful effect to each.

b. Pertinent Legislative History

It is clear that key congressmen considered bank subsidiaries to be “affiliates” when they were discussing what became Glass-Steagall and the problems leading to its enactment. At the specific request of Senator Carter Glass,²⁸⁸ Senator Robert J. Bulkley, who was another leading proponent of that Act, addressed the Senate in 1932 on “the subject of security affiliates and the related subject of investment banking,”²⁸⁹ a subject into which the Senate Committee on Banking and Currency was looking. Senator Bulkley described at length the

286. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984).

287. “If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” *Id.* at 842-43.

288. Senator Glass’ subcommittee of the Senate Committee on Banking and Currency was empowered, S. Res. 71, 71st Cong. (1931), to look into the causes of the financial crisis of the Depression and to recommend measures to prevent a reoccurrence of it. *See* S. REP. NO. 73-77, at 1-2 (1933); 75 CONG. REC. 9909 (1932) (statement of Sen. Bulkley).

289. 75 CONG. REC. 9909 (statement of Sen. Bulkley).

history of securities activities by national and state banks,²⁹⁰ noting that such activities were typically carried on by bank affiliates, rather than the banks themselves.²⁹¹ One illuminating passage from his address follows:

Early in this century certain State banking institutions began setting up bond departments and began to engage in the origination, underwriting, and distribution of investment securities and also began to trade in them. There is still a considerable volume of such transactions carried on directly by banks of deposit, but a recognition of the risks involved has impelled many banks to set up subsidiary or so-called affiliate institutions in order that the capital stock and the stockholders' liability of the parent bank might be held inviolate for the protection of regular banking operations and for the benefit of depositors. Such affiliate corporations, whether of National or State banks, might be owned outright by the parent banks or by trustees for the benefit of the bank or of the bank's stockholders or perhaps by the same stockholders as the bank, with the restriction that stock of the affiliate might be transferred concurrently with stock of the parent bank and not otherwise.

This activity of State banking institutions spreading out into the investment-security field has been matched by many national banks²⁹²

The directly owned bank subsidiary was thus at the very heart of what the so-called Glass subcommittee was investigating. Senator Bulkley noted that, in preparing and recommending legislation for enactment by the Senate, the issue for the subcommittee was "whether the securities affiliate relationship is to be permitted to continue under strict regulation or is to be required to be terminated."²⁹³ He concluded his oral report to the Senate in 1932 by noting his "hope that the sections of this bill . . . prohibiting the carrying on of the investment security business by national and State member banks, whether through the medium of affiliates or otherwise, will be adopted."²⁹⁴ The bill that the subcommittee prepared in 1932 required outright ter-

290. *Id.* at 9909-13.

291. He ascribed the use of affiliates to two causes:

An investment affiliate might be desired by a bank which under its charter is not permitted to go into the investment business, as is the case with national banks, or it might be considered advisable to set up an affiliate for the purpose of segregating the capital employed in the investment-security business so that the risks involved would not be carried directly by the institution responsible for money received on deposit.

Id. at 9910-11. His assertion as to the then-extant securities powers of national banks was, at best, an overstatement, in light of *VALIC*.

292. *Id.* at 9911 (emphasis added).

293. *Id.* at 9910.

294. *Id.* at 9913.

mination of securities activities, whether directly or through affiliate operations.²⁹⁵

While this bill did pass the Senate in 1932,²⁹⁶ a somewhat different bill,²⁹⁷ which ultimately became Glass-Steagall, emerged a year later. The report on this later bill from Senator Glass' Committee on Banking and Currency noted that the "the outstanding development" in commercial banking in the period immediately prior to the Depression was "the appearance of excessive security loans, and of overinvestment in securities of all kinds."²⁹⁸ The most important reason for this development, continued the report, was "the growth of 'bank affiliates' which devote themselves in many cases to perilous underwriting operations, stock speculation, and maintaining a market for the banks' own stock often largely with the resources of *the parent bank*."²⁹⁹ Again Senator Glass' committee was focused clearly upon the bank subsidiary as "affiliate."

295. S. 4412, 72d Cong. (1932). Senator Bulkley described the important elements of this bill as follows:

The bill, in section 16, . . . provides for separating security affiliates from national banks after a period of three years and makes the same provision in section 5 . . . for State banks which are members of the Federal reserve system. These provisions are reinforced by section 18, . . . which provides that no national bank and no State member bank may hereafter be affiliated with any organization engaged in the investment security business. The provision of section 14 . . . requires national banks to get out of the business of underwriting and dealing in investment securities, and again, in section 5, . . . there is the same provision with respect to State member banks.

75 CONG. REC. 9909, 9909 (1932) (statement of Sen. Bulkley).

296. See S. REP. NO. 73-77, at 1 (1933).

297. S. 1631, 73d Cong. (1933).

298. S. REP. NO. 73-77, at 8 (1933).

299. *Id.* at 10 (emphasis added).

This report treats the securities activities that it describes as a "situation . . . never contemplated by the National Banking Act," *id.*; see *id.* at 8; 75 CONG. REC. 9909, 9911 (1932) (statement of Sen. Bulkley) ("Such a departure on the part of national banks was clearly never authorized by law, and it is difficult to understand why it should have been permitted to grow and develop as it has").

In light of the Supreme Court's conclusions in *VALIC* about national bank securities powers deriving from the enactment of the National Bank Act during the Civil War, *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 814 (1995), and the extended history of bank participation in securities activities, see *supra* Part V.C.1, such suggestions that national banks were "clearly" exceeding their statutory authority or congressional intent must now be seen as, at best, ill-founded. They are perhaps best seen as period hyperbole and overstatement reflecting (no doubt) the anxiety felt at the time and the need to blame someone or something for the bank failures that had occurred. See note 156 (discussing congressional concern during Depression with dangerous bank speculation in securities). Such "abuses" were ultimately in fact dealt with by a different statutory regime. See Isaac & Fein, *supra* note 19, at 289 ("The enactment of the securities regulation system, not Glass-Steagall, was the single most important factor in curtailing abuses in the securities business.").

The problem resulting from affiliate securities activities required "some legislative provisions" to deal with it and, said the report, "[i]t has been suggested from many quarters that the affiliate system be simply [] 'abolished.'"³⁰⁰ While "[t]his suggestion has much authority behind it,"³⁰¹ the committee rejected it largely for practical reasons.³⁰² It determined instead to recommend legislation that would separate banks and their affiliates "as far as possible,"³⁰³ limit bank loans to affiliates, and subject affiliates to careful periodic examination.³⁰⁴

More specifically, as described in the Senate report, section 20 of the proposed bill dealt with the affiliate situation by "[p]rovid[ing] for eliminating after a period of two years all affiliations by member banks with corporations, associations, business trusts, or other similar organizations *engaged principally* in the issuance, underwriting, or distribution of securities."³⁰⁵ In other words, as Senator Glass had suggested during committee hearings earlier, the committee "simply proposed to regulate . . . [investment affiliates], as we conceive, in a rational way" rather than "abolish [them] outright."³⁰⁶

From the foregoing, it is clear that the Congress that enacted Glass-Steagall was concerned about securities activities of bank affiliates (including most specifically securities activities of bank subsidiaries), but it did not abolish such activities outright and for this purpose did not distinguish bank subsidiaries from other kinds of affiliates. Instead, such activities were delimited in a number of respects, as a result of which a bank could no longer have an affiliate, including a subsidiary, that was "engaged principally" in forbidden sorts of dealing and underwriting. While this outcome obviously leaves to a later day resolution of the question of what level of affiliate activity constitutes less than principal engagement (and thus avoids violating section 20's prohibition), it surely forecloses an argument that the very affiliates about which Congress said that it was most concerned (bank sub-

300. S. REP. NO. 73-77, at 10 (1933).

301. *Id.*

302. The committee doubted that its legislation could ultimately succeed in preventing banks from engaging in all of the "well-known subterfuges to maintain control" and it noted that state legislation would no doubt continue to permit "the growth of affiliates in connection with State banks and trust companies." *Id.*

303. The legislation as enacted cannot reasonably be said to approach as complete a separation "as possible." See Smoot, *supra* note 24, at 92-98.

304. S. REP. NO. 73-77, at 10 (1933).

305. *Id.* at 16 (emphasis added).

306. *Hearings Before the Senate Committee on Banking and Currency*, 72d Cong. 1st Sess. (1932). More fully, Senator Glass remarked "that we had authoritative advice . . . that would have caused us to abolish investment affiliates outright. . . . Instead of doing that we have simply proposed to regulate them, as we conceive, in a rational way." *Id.*

sidiaries) were prohibited by Glass-Steagall from engaging in such lesser level of securities activity as was left to bank affiliates by the language that ultimately emerged in section 20.

c. A Word from the Supreme Court—*Board of Governors of the Federal Reserve System v. Investment Company Institute*

Previous pronouncements by the Supreme Court concerning the meaning of section 20, while not directly on point since they did not deal with cases involving bank subsidiaries, nevertheless cast useful light on this subject. In *Board of Governors of the Federal Reserve System v. Investment Company Institute* (“ICI”),³⁰⁷ the Court considered a challenge by the Institute³⁰⁸ to the Board’s action in amending its regulations to permit bank holding companies and their subsidiaries to offer the services of an investment adviser to closed-end investment companies.³⁰⁹ The Institute argued, first, that if a bank offered such services, it would be in violation of Glass-Steagall sections 16, 20, and 21.³¹⁰ Second, according to the Institute, since a bank itself could not offer such services, they could never be said to be “so closely related to banking . . . as to be a proper incident thereto,” which is a necessary prerequisite for Board approval of the services for holding companies and their subsidiaries.³¹¹ In rejecting both parts of the Institute’s argument,³¹² the Court gave useful guidance about the relationship of those parts of Glass-Steagall that relate to banks and those parts that relate to bank affiliates.

307. 450 U.S. 46 (1981).

308. Investment Company Institute (“ICI”) is a trade organization of open-end investment companies, *ICI*, 450 U.S. at 53, and a frequent party in bank securities powers litigation. See *Investment Co. Inst. v. Camp*, 401 U.S. 617 (1971) (invalidating authorization by OCC of common trust fund created and maintained by bank for collective investment of customers’ funds held by bank as managing agent); *Investment Co. Inst. v. Conover*, 790 F.2d 925 (D.C. Cir. 1986) (approving common trust fund created by bank for investment of IRA funds); *Investment Co. Inst. v. Clarke*, 789 F.2d 175 (2d Cir. 1986) (approving creation of mutual fund for IRAs).

309. Under the Bank Holding Company Act, the Board is authorized to permit bank holding companies to own shares of companies that engage in activities that are “so closely related to banking . . . as to be a proper incident thereto.” 12 U.S.C. § 1843(c)(8) (1994). The Board had amended its regulations to add the services of an investment adviser to closed-end investment companies to the list of such “closely related” activities. *Nonbanking Activities of Bank Holding Companies*, 37 Fed. Reg. 1463 (1972) (codified as amended at 12 C.F.R. pt. 225); *Interest in Nonbanking Activities*, 36 Fed. Reg. 16,695, 17,514 (1971) (codified as amended at 12 C.F.R. pt. 222); see 12 C.F.R. § 225.4(a)(5)(ii) (1980). The Institute challenged the Board’s statutory authority to take such action. *ICI*, 450 U.S. at 49.

310. *ICI*, 450 U.S. at 58.

311. *Id.* at 58-59.

312. *ICI*, 450 U.S. at 59-60.

The discussion in *ICI* involved activities that the Board had approved for bank holding company subsidiaries.³¹³ The Institute contended that sections 16 and 21 ought to be applicable to those subsidiaries because the bank and its holding company affiliates "should be treated as a single entity" for purposes of those sections.³¹⁴ The Court rejected this suggestion because, it found, the structure of Glass-Steagall "reveals a congressional intent to treat banks separately from their affiliates."³¹⁵ Thus, sections 16 and 21 "apply only to banks and not to bank holding companies."³¹⁶ Section 21, which prohibits organizations engaged in underwriting from accepting deposits³¹⁷ and thus prevents investment banks from acting as deposit-taking commercial banks, "cannot be read to include within its prohibition separate organizations [for example, in this case, holding company subsidiaries] related by ownership with a bank, which does receive deposits."³¹⁸ Section 21, in other words, applies to banks, not to their affiliates.

The inapplicability of section 16 to bank affiliates is even clearer. Section 16, said the Court, "by its terms applies only to banks."³¹⁹ Like section 21, section 16 "flatly prohibit[s] banks from engaging in the underwriting business. Organizations affiliated with banks, however, are dealt with by other sections of the Act."³²⁰ Under those sections, "bank affiliates may be authorized to engage in certain activities that are prohibited to banks."³²¹

313. *Id.* at 48-49.

314. *Id.* at 58-59 n.24.

315. *Id.*

316. *Id.*

317. 12 U.S.C. § 378 (1994); *see supra* note 20 (setting forth the relevant parts of the text of this provision).

318. *ICI*, 450 U.S. at 58 n.24; *cf.* *Securities Indus. Ass'n v. Federal Home Loan Bank Bd.*, 588 F. Supp. 749, 763 (D.D.C. 1984) (rejecting SIA's challenge to the Board's approval of applications of savings and loan associations to permit service corporation they owned to invest in other corporation offering certain brokerage and investment advisory services. The court stated that "[e]ven [if] it is assumed *arguendo* that the proscriptions of the Glass-Steagall Act apply to S&Ls, they are clearly inapplicable to service corporations that will not and cannot receive deposits.").

319. *ICI*, 450 U.S. at 58 n.24.

320. *Id.* at 59 n.24.

321. *Id.* at 60 (footnote omitted). In making this point, the Court cited its earlier decision in *Board of Governors of the Fed. Reserve Sys. v. Agnew*, 329 U.S. 441 (1947), for the proposition that there is an important difference "in the extent of prohibition of securities-related activities reflected in the use of the word 'engaged' in § 21 as opposed to the use of the words 'engaged principally' in § 20." *ICI*, 450 U.S. at 60 n.26. In other words, continued the Court, "a less stringent standard should apply to determine whether a holding company has violated § 20 than is applied to a determination of whether a bank has violated §§ 16 and 21." *Id.* at 60-61 n.26.

The most important of these “other sections,” of course, is section 20,³²² which the Court characterized as follows:

[I]mportantly, § 20 of the Act . . . prohibits national banks or state bank members of the Federal Reserve System *from owning securities affiliates*, defined in § 2(b), . . . that are “engaged principally” in the issuance or underwriting of securities. Thus the structure of the Act reveals a congressional intent to treat banks separately from their affiliates. The reading of the Act urged by respondent [that is, that provisions applicable to banks, like sections 16 and 21, apply as well to bank affiliates] would render § 20 meaningless.³²³

In other words, the various provisions of Glass-Steagall must be read in a fashion that gives them independent meaning, rendering none of these provisions superfluous.³²⁴

Returning finally to the operating subsidiary question, a reading of section 16 that would apply it to bank operating subsidiaries would do comparable violence to the meaning of section 20. Moreover, the Court’s unqualified reference in *ICI* to section 20’s application to securities affiliates “owned” by banks is, to say the least, striking. It was surely not mere inadvertence, sloppiness, or mistake. It surely reflects a most straightforward reading of that section and the cross-referenced definition of “affiliate,” not to mention the historical fact of bank ownership of securities subsidiaries at the time Glass-Steagall was enacted. It furthermore renders the argument that the relatively more permissive “engaged principally” standard applies only to bank holding company subsidiaries and not to bank operating subsidiaries even more precarious.

D. Other Arguments Against New Part 5 Rules

Opponents of the New Part 5 Rules advance two more important arguments. They argue, first, that the proposed rules would create a new and parallel system of securities subsidiaries that would exist in a sort of regulatory limbo since Congress has enacted legislation (and the Board has promulgated a body of implementing regulation) that deals with a number of important issues for holding company subsidiaries, but Congress has taken no such action for bank operating subsidiaries. Inconsistent regulation or incongruous results might ensue.

322. The Court also referred to section 19(e), since repealed, 80 Stat. 242, which provided that a holding company could not vote shares of bank subsidiary stock unless it first divested itself of any interest it held in a subsidiary that was “engaged principally” in issuing or underwriting securities. *ICI*, 450 U.S. at 58-59 n.24.

323. *Id.* (emphasis added).

324. See *Securities Indus. Ass’n v. Board of Governors of the Fed. Reserve Sys.*, 807 F.2d 1052, 1058 (D.C. Cir. 1986).

Second, opponents assert that the proposed rules contradict OCC's prior position that operating subsidiaries may do no more than their parent banks are permitted to do, that is, that operating subsidiaries are merely incorporated "departments" of banks.

The first argument misses the point that, as the courts have found, there presently are competent regulators concerning themselves with the affairs of operating subsidiaries (though not the Board), and the second misinterprets or overstates the significance of OCC's prior pronouncements. Whatever merit there may be in these arguments, moreover, they are hardly sufficient counterweight to overcome the direct points in favor of the New Part 5 Rules set forth in earlier parts of this Article.

1. Bank Holding Company Act and New Part 5 Rules as Potentially Warring Regulatory Schemes

The first point has been vigorously asserted by Representative John Dingell and the Securities Industry Association ("SIA") in their comments to OCC in opposition to the Proposed Part 5 Rules, and variants of it have made appearances in a number of cases involving the authority of the Federal Reserve Board over banks and their subsidiaries. Representative Dingell has asserted that the proposed rules:

may not be viewed as a "reasonable" interpretation of the law to the extent that they could result in the creation of a regulatory scheme that could compete with the Congressionally-enacted Bank Holding Company Act. The Bank Holding Company Act establishes specific permissible bank affiliate activities, separates affiliate capital from bank capital, and provides for tough . . . restrictions on transactions with affiliates. The OCC proposal, while it may have the benefits of flexibility, does not have the benefit of such publicly-debated and Congressionally-mandated standards.³²⁵

SIA's more detailed argument invokes both the requirements of the Bank Holding Company Act and the responsibilities of the agency that implements it, the Board of Governors of the Federal Reserve System.³²⁶ SIA begins with a general observation:

The BHCA [Bank Holding Company Act], which permits bank holding companies to engage in ineligible-securities activities through non-bank (i.e., Section 20) subsidiaries, provides the exclusive method by which Congress intended to permit bank affiliates to engage in activities other than those in which a bank could engage directly, such as ineligible-securities activities. Accordingly, . . . by virtue of the BHCA, the OCC lacks the authority to permit an oper-

325. 1995 Dingell Letter, *supra* note 113, at 5.

326. SIA Letter, *supra* note 103, at 30-33.

ating subsidiary of a national bank to engage in ineligible-securities activities.³²⁷

The argument then proceeds as follows: One purpose of the Bank Holding Company Act of 1956³²⁸ was “to promote ‘the general purposes of the Glass-Steagall Act—to prevent unduly extensive connections between banking and other businesses.’”³²⁹ In furtherance of that purpose, section 4³³⁰ of that Act prohibits bank holding companies from owning shares of nonbank subsidiaries, with certain exemptions, including most importantly one permitting holding company ownership of shares of a company engaged in activities that the Board determines “to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.”³³¹

The process contemplated by section 4 reflects Congress’ determination that a holding company may own a company engaged in activities that are beyond the powers of a bank itself. More importantly, continues the argument, this process reflects “the *exclusive* method by which an affiliate of a bank may engage in activities—such as limited ineligible-securities activities—that are ‘closely related to banking’ but in which the bank itself may not engage.”³³² Otherwise, a bank organization could avoid the specific requirements of section 4 (and other parts of the Act) by having the activities that are “closely related to banking” take place in an operating subsidiary rather than a holding company subsidiary. Congress, as SIA sees it, could not have intended this.³³³

Furthermore, says SIA, OCC may not interpret Glass-Steagall in a manner that is inconsistent with the interpretation given Glass-Steagall by the Board. This is because “the Board ‘has primary responsibility for implementing the Glass-Steagall Act.’”³³⁴ Next, SIA notes that any implementation of the operating subsidiary rule that permits a bank operating subsidiary to engage in bank-ineligible securities activities would be inconsistent with the Board’s interpretation of Glass-

327. *Id.* at 30. The words “ineligible-securities activities” in the above quotation mean the same thing as “bank-ineligible securities activities” as used throughout this Article.

328. 12 U.S.C. §§ 1841-1850 (1994).

329. SIA Letter, *supra* note 103, at 30 (quoting S. REP. NO. 89-1179 (1966), *reprinted in* 1966 U.S.C.A.N. 2385, 2386). This was the report accompanying the 1966 amendments to the Bank Holding Company Act. Bank Holding Company Act Amendments of 1966, Pub. L. No. 89-485, 80 Stat. 236 (codified at 12 U.S.C. § 1841 (1994)).

330. 12 U.S.C. § 1843 (1994).

331. *Id.* § 1843(c)(8).

332. SIA Letter, *supra* note 103, at 31.

333. *Id.* at 31-32.

334. *Id.* at 32-33 (quoting *Securities Indus. Ass’n v. Board of Governors of the Fed. Reserve Sys.*, 468 U.S. 207, 217 (1984)).

Steagall because the Board's Regulation Y³³⁵ "require[s] that any ineligible-securities activities performed by an affiliate of a bank must be performed by a section 20 subsidiary, as opposed to a subsidiary of the bank."³³⁶

Finally, an OCC interpretation of the operating subsidiary rule that permitted a bank operating subsidiary to engage in bank-ineligible activities would also undermine Congress' intention that the Board be primarily responsible for interpretation of Glass-Steagall since, insofar as operating subsidiaries engaged in such activities, Glass-Steagall issues related to the activities would have to be determined by OCC and not by the Board. This is because, as SIA acknowledges, "the Board generally lacks authority over operating subsidiaries of national banks."³³⁷

This last point amounts to an argument that OCC may not issue and interpret its regulations with respect to operating subsidiaries in a manner that would otherwise be appropriate for OCC, as the designated regulator with responsibility for national banks and their businesses, because (i) such interpretation could clash with the affiliate organization structures and rules that the Board has imposed by virtue of its responsibility over bank holding companies and their nonbanking subsidiaries and (ii) Congress has not given the Board authority over banks and their subsidiaries. This peculiar argument, which has the effect of giving the Board authority to determine what a bank operating subsidiary may or (more importantly) may not do, is a bit of a bootstrap and somewhat circular, at that. It also reveals the crack that opens up SIA's carefully constructed, step-by-step position: Generally speaking, the Board simply lacks authority to interfere in the affairs and regulation of banks (national- or state-chartered) and their subsidiaries, which have successfully resisted Board efforts to rein in activities approved by other bank regulatory agencies or permissible under other (non-Bank Holding Company Act) bank regulatory schemes.

Unlike Glass-Steagall, which is, on its face at least, reasonably clear in its treatment of banks and their affiliates, the text of the Bank Holding Company Act is quite complex and ultimately ambiguous in its treatment of bank subsidiaries of holding companies and subsidiaries of banks. The latter statute was enacted forty years ago to deal with, among other things, bank holding companies and their involve-

335. Regulation Y may be found at 12 C.F.R. pt. 225 (1996).

336. SIA Letter, *supra* note 103, at 33. This statement assumes, of course, that a bank operating subsidiary is not a section 20 affiliate. *But see supra* Part V.C.2.

337. SIA Letter, *supra* note 103, at 33.

ment in nonbanking activities.³³⁸ Under it, a bank holding company is any company possessing “control over any bank or over any company that is or becomes a bank holding company.”³³⁹

Congress enacted the Bank Holding Company Act after concluding that banking organizations were taking advantage of the holding company structure to avoid Glass-Steagall’s limits on nonbanking activities and other federal and state laws applicable to banks.³⁴⁰ Congress sought to remedy such evasions in Glass-Steagall by limiting both the share ownership rights of bank holding companies (the “ownership limitation”) and the activities in which bank holding companies may engage (the “activities limitation”). The ownership limitation provides that, except as otherwise permitted by law, a bank holding company may not acquire “direct or indirect ownership or control”³⁴¹ of voting shares of a company that is not a bank or retain “direct or indirect ownership or control”³⁴² of voting shares of a company that is not a bank or bank holding company. The activities limitation specifies that bank holding companies may not engage in any activities other than banking or managing or controlling banks or the activities permitted under section 1843(c)(8).³⁴³ Section 1843(c) consists of a list of exemptions to the ownership and activities limitations, of which the most important, contained in subsection (8), is for ownership of shares of a company engaging in activities that the Board determines “to be so closely related to banking . . . as to be a proper incident thereto.”³⁴⁴

Whether the limitations in the Bank Holding Company Act apply to bank operating subsidiaries depends in part upon whether the phrase “indirect ownership and control” refers to a bank’s ownership of

338. According to this Act, its purpose is to define holding companies, require them to divest themselves of inappropriate nonbanking interests, and limit their future acquisitions. Bank Holding Company Act of 1956, Pub. L. No. 84-511, §1, 70 Stat. 133.

339. 12 U.S.C. § 1841(a)(1) (1994). For this purpose, a “bank” is any bank whose deposits are insured under the Federal Deposit Insurance Act, *id.* §§ 1841(c)(1)(A), 1813(h), or any domestic institution that both accepts deposits and makes commercial loans, *id.* § 1841(c)(1)(B). This definition includes both national banks and state-chartered banks. A company has “control” over a bank or bank holding company if: (i) it directly or indirectly owns, controls or has power to vote 25% or more of any class of voting securities of the bank or bank holding company; (ii) it controls the election of a majority of the directors of the bank or bank holding company; or (iii) the Board determines that it exercises, directly or indirectly, “a controlling influence” over the bank or bank holding company. *Id.* § 1841(a)(2).

340. *See* H.R. REP. NO. 84-609, at 7 (1955); 101 CONG. REC. 8032 (1955) (statement of Rep. Rains).

341. 12 U.S.C. § 1843(a)(1).

342. *Id.* § 1843(a)(2).

343. *Id.*

344. *Id.* § 1843(c)(8).

shares of such subsidiaries. The Act provides that shares held "by any subsidiary of a bank holding company shall be deemed to be indirectly owned or controlled by such bank holding company."³⁴⁵ Finally, a company is a "subsidiary" of a bank holding company if (i) the holding company directly or indirectly owns or controls 25% or more of the company's voting shares, (ii) the holding company controls election of a majority of the company's directors, or (iii) the Board concludes that the holding company exercises a "controlling influence" over the company.³⁴⁶

From the foregoing, it might appear that a bank operating subsidiary is necessarily a "subsidiary" of the bank's holding company as a matter of the "plain meaning" of the statute, as a consequence of which the Bank Holding Company Act's limitations must apply to operating subsidiaries.³⁴⁷ Other definitional provisions of the Act, how-

345. *Id.* § 1841(g)(1). This provision was enacted ten years after the Bank Holding Company Act and probably means a good deal less than a quick and literal read suggests. See *infra* notes 396-99 and accompanying text.

346. 12 U.S.C. § 1841(d).

347. Indeed, one federal court has, at least briefly, so found. See *American Ins. Ass'n v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988). In this case, OCC concluded that the National Bank Act permitted a national bank to form a subsidiary for purposes of offering municipal bond insurance. The D.C. Circuit agreed. *Id.* at 281-84. OCC also concluded that the limitations of the Bank Holding Company Act did not impose any impediment to the subsidiary's activity because that Act did not apply to national bank subsidiaries. The court rejected this assertion and remanded for further action consistent with its opinion. The following passage constitutes the entirety of its statutory analysis of the Bank Holding Company Act issue:

A bank holding company . . . is prohibited from acquiring "direct or indirect ownership or control of any voting shares of any company which is not a bank," unless an exception applies. 12 U.S.C. § 1843(a)(1) (1982). . . . Shares owned or controlled by any subsidiary of a holding company are "deemed to be indirectly owned or controlled by such bank holding company." 12 U.S.C. § 1841(g)(1) Citicorp [the bank holding company] manifestly exercises indirect control over AMBAC [the national bank's subsidiary] because AMBAC's parent [the national bank] is Citicorp's subsidiary.

Id. at 285. The court bolstered this conclusion by citing certain of the Board's pronouncements and regulations on the subject, *id.*, but was utterly oblivious to the significant statutory language issues that seriously clouded so facile a finding, see *infra* notes 348-65.

In any event, shortly after issuing its decision, the D.C. Circuit panel granted petitions for rehearing filed by OCC, the United States, and the bank holding company. The panel vacated that part of the earlier decision related to the Bank Holding Company Act issue on the basis that "it was inappropriate for us to have reached" that issue in this case, since its outcome was not "essential" to OCC's determination under the National Bank Act and since OCC's conclusions on the Bank Holding Company Act issue in this case would not have any "precedential effect" if a party challenging the municipal bond insurance proposal sought to petition the Board concerning it. *Id.* at 287 (per curiam).

Moreover, the D.C. Circuit panel concluded that the "exceptional circumstances" that might require a court to cause OCC to "stay its hand" pending determination of an important Bank Holding Company issue, see *Whitney Nat'l Bank v. Bank of New Orleans & Trust Co.*, 379 U.S. 411, 426 n.7 (1965), were "not present," *Clarke*, 865 F.2d at 288. This too, reflected a change in the panel's thinking. *Whitney* is generally seen as limited to instances in which OCC is consider-

ever, befuddle any such simple reading.³⁴⁸ The definition of "subsidiary" refers to a "company" that is owned or controlled by a bank holding company.³⁴⁹ Under the Act, the word "company" means "any corporation, partnership, business trust, association, or similar organization,"³⁵⁰ a definition that would appear broad enough to encompass banks. However, the section defining "bank holding company" repeatedly treats "companies" and "banks" as "mutually exclusive" categories.³⁵¹ With that in mind and returning again to "subsidiary," insofar as the definition of "company" does not include "banks," then "subsidiary" must refer only to nonbank entities. Yet

ing the issuance of a new national bank charter in connection with which a "substantial" Bank Holding Company Act issue is raised, *see American Bank of Tulsa v. Smith*, 503 F.2d 784, 789 (10th Cir. 1974), as the panel acknowledged in its initial opinion, *Clarke*, 865 F.2d at 285 ("We are aware of no case that applies the substantial question doctrine outside the context of the chartering of a new bank, and we do not decide that question today.")

This did not prevent the panel from nonetheless reaching the Bank Holding Company Act issue in its initial decision, however. It did so on the rather puzzling basis that OCC could have, in its discretion, conditioned its approval of the municipal bond insurance program on subsequent resolution of the issue by the Board and, apparently, should have. OCC's failure to consider exercise of that discretion was inexcusable here, said the panel in its initial decision, because the Bank Holding Company Act issue (whether that Act's specific prohibitions on bank holding company involvement in insurance, 12 U.S.C. § 1843(c)(8) (1988), prohibited the municipal bond insurance program) was not frivolous. The panel therefore felt justified in deciding that issue in its original decision. *Id.* at 285-86.

The panel's original opinion did considerable violence to the "exceptional circumstances" doctrine and it seems clear that the panel was straining to reach the Bank Holding Company Act issue. The conclusion it initially reached on that issue and promptly vacated, however, is contrary to the conclusions reached (definitively) by other courts that have considered it. The panel plainly failed to give careful consideration to the broader range of questions that are appropriately addressed in connection with the issue. *See infra* notes 348-410 and accompanying text.

For purposes of the New Part 5 Rules, moreover, at least insofar as they involve securities activities to the extent permitted to bank "affiliates" under Glass-Steagall section 20, it should be noted that there is no "substantial" Bank Holding Company Act issue that is comparable to the insurance issue presented in *Clarke*. The Board has already satisfied itself that bank section 20 affiliates may engage to a limited degree in underwriting and dealing. *See supra* Part V.B.

348. *See* Carol S. Shahmoon, *Federal Reserve Board Authority over Bank Subsidiaries Under the Bank Holding Company Act of 1956*, 91 COLUM. L. REV. 965, 974-75 (1991) (the definition of terms, such as subsidiary and company, seem to vary among the different sections).

349. 12 U.S.C. § 1841(d). This section states:

"Subsidiary", with respect to a specified bank holding company, means (1) any company 25 per centum or more of whose voting shares . . . is directly or indirectly owned or controlled by such bank holding company . . .

350. *Id.* § 1841(b).

351. Shahmoon, *supra* note 348, at 975. Thus, a "company" is said to have "control over a bank or over any company" when certain circumstances exist. 12 U.S.C. § 1841(a)(2) (emphasis added). Where a "company" owns less than 5% of any class of voting securities of "a given bank or company," there is a presumption of lack of "control" for certain purposes. *Id.* § 1841(a)(3) (emphasis added). Similarly, for certain purposes a "company" may not be found to have "control" over "any given bank or company" unless that "company" owns or controls 5% or more of a class of voting securities "of the bank or company." *Id.* § 1841(a)(4) (emphasis added).

section 1843(a)(1) expressly prohibits a bank holding company from acquiring "any voting shares of any company which is not a bank."³⁵² As has been noted elsewhere, "[t]his language appears to indicate that banks may be a specific type of company."³⁵³ Under the circumstances, then, the text of the Bank Holding Company Act provides very mixed signals as to whether "banks" are "subsidiaries" that are subject to that Act's limitations, which in turn casts doubt on any easy conclusion that bank operating subsidiaries are subject to that Act's limitations.

The courts have also noted the lack of clarity of the text of the Bank Holding Company Act with respect to its applicability to banks and bank subsidiaries. In *Independent Insurance Agents of America v. Board of Governors of the Federal Reserve System*,³⁵⁴ the Board took the position that a bank holding company could retain the stock of two state-chartered banks that engaged in the general insurance business, as permitted by state law.³⁵⁵ Insurance industry trade organizations asserted that the prohibitions on such activities set forth in section 4 of the Bank Holding Company Act³⁵⁶ applied to these state banks, whose shares the holding company could not retain unless the subsidiaries ceased their insurance activities. The Board determined that those prohibitions did not apply to bank subsidiaries of a bank holding company.³⁵⁷ The Second Circuit observed at the outset of its statutory analysis of the applicability of section 4:

Though both sides support their views of the statute by relying on some of the statutory language, we cannot say that the provisions of the Act reveal an unambiguous congressional intent concerning the

352. 12 U.S.C. § 1843(a)(1).

353. Shahmoon, *supra* note 348, at 975.

354. 890 F.2d 1275 (2d Cir. 1989).

355. Merchants Nat'l Corp., 75 Fed. Res. Bull. 388 (1989). The two banks were chartered in Indiana, whose law permitted banks "to solicit and write insurance as agent or broker for any insurance company authorized to do business in this state, other than a life insurance company." *Id.* at 389 n.2 (citing IND. CODE ANN. § 28-1-11-2 (Michie 1986)).

The Board had previously approved the holding company's application for permission to acquire the two banks, subject to the holding company's agreement that it would cause the banks to divest their insurance operations within two years unless it obtained Board approval of retention of the insurance activities by the end of that period and that, in the interim, it would cause the banks to limit their insurance activities to renewal of existing policies. Merchants Nat'l Corp., 72 Fed. Res. Bull. 838 (1986).

356. 12 U.S.C. § 1843(c)(8). This provision permits bank holding companies to acquire or retain shares of any company whose activities are "so closely related to banking . . . as to be a proper incident thereto," but it further specifies that "for purposes of this subsection it is not closely related to banking . . . for a bank holding company to provide insurance as a principal, agent, or broker" with certain exceptions not here relevant. *Id.*

357. *Independent Ins. Agents*, 890 F.2d at 1279; see Merchants Nat'l Corp., 72 Fed. Res. Bull. at 838.

precise question at issue. . . . Both sides claim that the text of the Act supports their interpretations, and each can find some, but not overwhelming, support in various words and phrases.³⁵⁸

Thus, on the one hand, given the use of the phrase “directly or through a subsidiary” in an activities grandfathering proviso in section 4(a)(2),³⁵⁹ the absence of similar language in the main activities limitation language immediately preceding the proviso suggests that Congress deliberately chose not to limit the activities of bank subsidiaries. Similarly, the ownership limitation in that section prohibits bank holding companies from retaining “direct or indirect ownership” of voting shares of companies that are not banks or bank holding companies. The lack of similar wording in the activities limitation suggests the same choice by Congress.³⁶⁰ On the other hand, such differences in wording could reflect a lack of care in assembling the different clauses and standardizing their phrasing in the final assemblage.³⁶¹ It is also difficult to see how this line of reasoning may be confined to *banking* subsidiaries of holding companies.

Structural arguments looking broadly at the Bank Holding Company Act as a whole similarly support both positions. If the activities limitations in section 4(a)(2) apply to holding company subsidiaries, then it would appear that the ownership limitation therein would be redundant since the activities limitation would be sufficient by itself to prevent ownership of shares of a company that is not a bank or holding company.³⁶² Alternatively, the section 4(c)(8) exemption³⁶³ uses

358. *Independent Ins. Agents*, 890 F.2d at 1280-81. The court further observed:

We find no provision that says, in substance, “The Board may not regulate the activities of bank subsidiaries of bank holding companies,” or “Bank subsidiaries of bank holding companies may engage in nonbank activities to the extent permitted by their chartering authorities.” The Board reads the Act as if it contained such language. On the other hand, we find no provision that says, in substance, “Bank subsidiaries of bank holding companies may not engage in nonbank activities.” The [insurance industry trade group] reads the Act as if it contained this wording.

Id. at 1281 (citations omitted); see *Citicorp v. Board of Governors of the Fed. Reserve Bd.*, 936 F.2d 66, 69 (2d Cir. 1991) (reiterating the finding in *Independent Insurance Agents v. Board of Governors of the Federal Reserve System* that the Bank Holding Company Act is “not entirely clear” on the question of its applicability to bank subsidiaries of bank holding companies; opposing positions on this issue “could plausibly be based on some of the language of the Act, some aspects of the structure of the Act, and some passages from the legislative history”); *id.* at 76 (Bank Holding Company Act is “not clear as to whether it requires bank holding companies and all subsidiaries within their systems to observe a total separation from nonbanking activities”).

359. 12 U.S.C. § 1843(a)(2). This section states: “*Provided*, That a company . . . may also engage in those activities in which *directly or through a subsidiary* (i) it was lawfully engaged on June 30, 1968 . . . and (ii) it has been continuously engaged since June 30, 1968” *Id.* (emphasis added).

360. *Independent Ins. Agents*, 890 F.2d at 1281.

361. *Id.*

362. *Id.*

"company" to describe the organizations entitled to the exemption, and "company" is defined broadly enough³⁶⁴ to include banks.³⁶⁵

Since the language of the statute leaves the intentions of Congress more than a little opaque, legislative history may appropriately be consulted to help settle the question of the applicability of section 4's limitations to bank subsidiaries of holding companies.³⁶⁶ While some of the pertinent legislative history, particularly isolated statements by legislators speaking out broadly about the need to separate banking from nonbanking activities, is ambiguous,³⁶⁷ other parts suggest that Congress was well aware of state laws permitting state-chartered institutions to engage in a variety of nonbank activities and did not intend the Bank Holding Company Act to displace such activities.³⁶⁸

Indeed, it is useful to recall that the reason for the enactment of the Bank Holding Company Act in 1956 was to plug the holding company loophole in the nation's banking laws³⁶⁹ and not to supplant the extant system of state and federal banking laws giving primary regulatory authority to state and federal chartering bodies.³⁷⁰ As the comptroller more recently observed, his office and state bank authorities had been regulating banks for almost 100 years before Congress enacted the Bank Holding Company Act, by which Congress "did not intend to change this regulatory scheme."³⁷¹ Since banks were already them-

363. 12 U.S.C. § 1843(c)(8). This is the "closely related to banking" exemption.

364. *Id.* § 1841(b).

365. *Independent Ins. Agents*, 890 F.2d at 1282. Though this issue is not quite so simple. See *supra* notes 349-53 and accompanying text.

366. See *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-45, 859-63 (1984).

367. See, e.g., 102 CONG. REC. 6853 (1956) (statement of Sen. Barkley); 101 CONG. REC. 8184 (1955) (statement of Rep. Smith); 101 CONG. REC. 8035 (1955) (statement of Rep. Multer); 101 CONG. REC. 8033 (1955) (statement of Rep. O'Hara); 101 CONG. REC. 8030 (1955) (statement of Rep. Rains). It is not clear whether these statements apply to holding companies or to their bank subsidiaries and they seem to focus on ownership more than activity. *Independent Ins. Agents*, 890 F.2d at 1283.

368. See *Control and Regulation of Bank Holding Companies: Hearings on H.R. 2674 Before House Comm. on Banking and Currency*, 84th Cong. 536 (1955) (testimony of Ellery C. Huntington); *id.* at 553 (statements of Reps. Spence and Brown).

369. In contrast to the "considerable care" taken to enable state and federal banking authorities to control the activities of banks themselves, "there is at present only a very limited control over the activities of bank holding companies." S. REP. NO. 84-1095, at 2 (1955); see 102 CONG. REC. 6854 (1956) (statement of Sen. Capehart) (Act intended to prevent a bank holding company from doing "something that a bank may not do"); 101 CONG. REC. 8021 (1955) (statement of Rep. Spence) (limiting evasion of restrictions on branch banking); Shahmoon, *supra* note 348, at 976-77.

370. See S. REP. NO. 91-1084, at 31-32 (1970); 101 CONG. REC. 8037 (1955) (statement of Rep. Brown); PAULINE B. HELLER, FEDERAL BANK HOLDING COMPANY LAW § 4.02[6] (1996).

371. *Real Estate Investment Activities*, O.C.C. Q. J., June 1985, at 48 (citing Letter of C.T. Conover, Comptroller, to Board of Governors of Federal Reserve System).

selves adequately monitored, the Act had the more limited purpose of dealing with "organizations which should be included in the scope of [the Act] without unnecessarily encompassing organizations that need not be included in order to accomplish the purposes of the [Act]."372

In any event, consistent with the foregoing analysis, the Board in *Independent Insurance Agents v. Board of Governors of the Federal Reserve System* took the position that section 4 of the Bank Holding Company Act did not apply to bank subsidiaries of bank holding companies.³⁷³ The Board believed that the legislative history of the Act and its amendments show "a congressional purpose to leave the scope of permissible activities of bank subsidiaries of a bank holding company subject only to the authority that issued the banks' charter, without any further restriction from the Act itself."³⁷⁴

The Second Circuit found this interpretation to be reasonable. If this interpretation, which "confides decisions concerning the scope of insurance and other nonbank activities of bank subsidiaries to their national and state chartering authorities," is to be hereafter changed, said the Second Circuit, "Congress will have to enact suitable legislation."³⁷⁵ Left for another day because it was not squarely presented, however, was the question of the Board's authority over activities of

372. S. REP. NO. 84-1095, at 8 (1955). The Senate and House reports accompanying the Act contain no hint that the Act added any further restrictions on the activities of bank subsidiaries of holding companies. See *id.* at 11-12; H.R. REP. NO. 84-609, at 16-17 (1955); Shahmoon, *supra* note 348, at 978-82.

Even the seemingly troublesome wording of 12 U.S.C. § 1841(g)(1) (1994), which provides that "shares owned or controlled by any subsidiary of a bank holding company shall be deemed to be indirectly owned or controlled by such bank holding company," should not be read to suggest that Congress intended any expansion of coverage of the Act to encompass as well subsidiaries of holding company banks. See *Real Estate Investment Activities*, see *supra* note 371, at 48, 51 (quoting Letter of C.T. Conover, Comptroller, to Board of Governors of Federal Reserve System, as stating that the Bank Holding Company Act should not be seen as applying "to the subsidiaries of holding company banks, unless there is persuasive legislative history addressing the subsidiary question directly. To our knowledge, there is no such legislative history. . ."). This provision was not a part of the original incarnation of the Act and did not make its appearance until the 1966 amendments. Bank Holding Company Act Amendments of 1966, Pub. L. No. 89-485, § 6, 80 Stat. 236, 237. The little legislative history there is concerning this provision, S. REP. NO. 89-1179, at 8 (1966), provides very generally that its three subsections were intended to help the Board in ascertaining "whether a company indirectly controls another company."

There is reason to believe that 12 U.S.C. § 1841(g) (1994) is the direct result of a particularly notorious abuse of the holding company device of "shell" corporations to avoid the operation of the Bank Holding Company Act as then in force, see Shahmoon, *supra* note 348, at 979, and not to effect a major change in the meaning or coverage of the Act.

373. 890 F.2d 1275, 1279 (2d Cir. 1989)

374. *Id.* (footnote omitted).

375. *Id.* at 1284.

subsidiaries of bank subsidiaries of holding companies, that is, Board authority over bank operating subsidiaries.³⁷⁶

That day came less than two years later in *Citicorp v. Board of Governors of the Federal Reserve System*,³⁷⁷ which involved a challenge by a bank holding company to an order of the Board requiring one of the holding company's bank subsidiaries to terminate the insurance business of the bank's operating subsidiary.³⁷⁸ In this case, Delaware law³⁷⁹ permitted its state-chartered banks to conduct insurance activities either directly in a department of the bank or through a subsidiary of the bank.³⁸⁰ In either case, the bank was required to maintain substantial fire walls between insurance and banking activities to protect the bank's safety and soundness.³⁸¹ The Board had initially approved the insurance subsidiary as a subsidiary of the holding company that could engage in credit-related insurance activities that are expressly permitted under section 4(c)(8)(A) of the Bank Holding Company Act.³⁸² Thereafter, the holding company transferred the voting shares of its insurance subsidiary to the holding company's Delaware bank subsidiary for purposes of enabling the insurance subsidiary to take advantage of the broader range of insurance activities permitted under Delaware law than under the Bank Holding Company Act.³⁸³ When the bank operating subsidiary began engaging in insurance underwriting and related activities beyond the scope of section 4(c)(8)'s exemptions, the ever vigilant insurance industry trade groups petitioned the Board with their complaint that the insurance subsidiary's activities exceeded what was permissible under the Board's operating subsidiary rule contained in its Regulation Y.³⁸⁴

Under the Board's operating subsidiary rule, the operating subsidiary of a state-chartered bank subsidiary of a bank holding company may engage in such nonbank activities as are permitted to it under state law, so long as those activities conform to the limitations that would be applicable to a bank directly engaging in the activities.³⁸⁵ The Board responded to the petitions by concluding that the activities were not authorized by or exempted under Regulation Y and thus

376. *Id.* at 1282-83.

377. 936 F.2d 66 (2d Cir. 1991).

378. *Id.* at 68.

379. 67 Del. Laws 223 (1990).

380. *Citicorp*, 936 F.2d at 70.

381. 67 Del. Laws §§ 3, 5, 8, 10, 17, 38.

382. 12 U.S.C. § 1843(c)(8)(A) (1994).

383. *Citicorp*, 936 F.2d at 70.

384. 12 C.F.R. pt. 225 (1996).

385. *Id.* § 225.22(d)(2)(ii). The court noted the similarity to the operating subsidiary rule for national banks, § 225.22(d)(1). *Citicorp*, 936 F.2d at 70 n.1.

were in violation of the Bank Holding Company Act.³⁸⁶ Accordingly, the Board ordered the holding company to cause the bank operating subsidiary to discontinue insurance activities that exceeded what was permissible under section 4(c)(8)(A).³⁸⁷

In its petition to the Second Circuit challenging the Board's order, the bank holding company argued that the insurance activities of its bank operating subsidiary conformed with Regulation Y, a position that the court rejected, though with considerable reluctance.³⁸⁸ The holding company also asserted that the Board lacks authority under the Bank Holding Company Act to regulate the activities of the bank's operating subsidiary.³⁸⁹ On this point, the Second Circuit reminded the Board that another panel of the circuit had recently accepted as reasonable the Board's view that "Congress intended to leave unimpaired the primary regulatory authority of state and national bank chartering agencies to determine the activities of institutions under their jurisdiction."³⁹⁰ That first step, which was taken by the Board two years earlier with respect to the authority of bank chartering agencies over their chartered banks in the face of an effort to apply the Bank Holding Company Act to those banks, would decisively color the Second Circuit's consideration of the statutory issue raised in this second case concerning the authority of those chartering agencies over bank operating subsidiaries. This case would have to be resolved in a manner consistent with the rationale of the first case.³⁹¹

If the Bank Holding Company Act permits bank chartering agencies to retain authority to regulate the banks they have chartered, then the chartering agencies surely also have "ample authority to deter-

386. *Citicorp*, 936 F.2d at 71.

387. *Id.*

388. *Id.* at 72-73. The court found the Board's position on this point to be burdened with significant inconsistencies but ultimately decided to defer to the Board's reading of the meaning of its own regulations. *Id.*

389. *Id.* at 71.

390. *Id.* at 73. The court referred to its earlier consideration of "the extent to which banks are authorized to engage in nonbanking activities" in *Independent Insurance Agents v. Board of Governors of the Federal Reserve System*, 890 F.2d 1275 (2d Cir. 1989). *Id.* at 68; see *supra* notes 354-65 and accompanying text (discussing the Second Circuit opinion in more detail).

391. The court stated:

Thus, in the aftermath of [*Independent Insurance Agents v. Board of Governors*], we take the Act as if it said in terms, "The Board is without authority to limit the activities of a bank subsidiary of a bank holding company." Now the question is whether the Board may nonetheless regulate the activities of a bank subsidiary's subsidiary. The rationale of the position that the Board successfully urged upon us in [*Independent Insurance Agents*] requires an answer consistent with the interpretation the Board there urged us to adopt.

Citicorp, 936 F.2d at 73.

mine the permissible activities of the subsidiaries owned by the banks."³⁹² The Board offered no satisfactory reason why the chartering agency's jurisdiction should not extend to all entities controlled by the bank. Indeed, the detailed and careful fire-wall restrictions imposed by Delaware law and implemented by Delaware's bank regulators on insurance activities performed in a bank operating subsidiary were ample proof that the chartering agency had considerable interest in and authority over subsidiaries owned by the bank.³⁹³ The court found the "generation-skipping approach"³⁹⁴ of the Board to be so strange that it refused to believe that Congress could have intended such a thing, particularly in light of section 7 of the Bank Holding Company Act: "No provision of this chapter shall be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to . . . banks . . . and subsidiaries thereof."³⁹⁵

Nor does section 2(g)(1), which states that shares held by any subsidiary of a holding company (for example, by a bank) "shall be deemed to be indirectly owned or controlled by such bank holding company,"³⁹⁶ save the Board's position. The court refused to adopt any literalist reading of that provision that might, as a consequence of a finding that the insurance operating subsidiary is "owned" by the holding company, result in a prohibition on state-chartered bank sales of insurance, as fully permissible under state law, through an operating subsidiary.³⁹⁷ Congress could not have had such an outcome in mind when it enacted section 2(g)(1), which was altogether noncontroversial when enacted, seemingly aimed at a "technical question" of the definition of control.³⁹⁸ The Second Circuit took further comfort

392. *Id.*

393. *Id.*

394. *Id.* The court was referring to the Board's idea that, while the Board had authority over the activities of a bank holding company and over the subsidiary of the holding company's bank subsidiary, the bank itself, occupying the middle generation, was uniquely free from the Board's authority. *Id.* at 73-74.

395. 12 U.S.C. § 1846 (1988).

396. 12 U.S.C. § 1841(g)(1) (1994).

397. *Citicorp*, 936 F.2d at 74.

398. The Second Circuit stated:

Citicorp [the holding company] contends, and we agree, that the purpose of section 2(g)(1) was to make clear that the BHCA applied when a holding company's *nonbank* subsidiaries controlled, but did not wholly own, another company. See *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418 and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency, Pt. 1*, 89th Cong., 2d Sess. 342 (1966) ("Technical question[] ha[s] arisen" regarding applicability of phrase to situation in which a bank holding company "owns less than 50% of the voting shares of" a company that owns another company.). The 1966 amendment was noncon-

in its conclusion in the fact that the other two federal bank regulatory agencies also rejected the Board's reading of the Bank Holding Company Act to give the Board, rather than state chartering agencies, authority over bank operating subsidiaries.³⁹⁹

With the issue of Board authority over activities of state-chartered banks and activities of operating subsidiaries of state-chartered banks thus apparently settled, it is only a matter of awaiting the arrival of the right case for the remaining pieces of the picture to be completed. The reasoning of *Independent Insurance Agents v. Board of Governors of the Federal Reserve System* and *Citicorp v. Board of Governors of the Federal Reserve System* with respect to state-chartered banks and their operating subsidiaries, respectively, is readily applicable to national banks and their operating subsidiaries.⁴⁰⁰ In *Norwest Bank Minnesota National Ass'n v. Sween Corp.*,⁴⁰¹ a federal district court expressly adopted the reasoning of those two opinions in a case involving applicability of the Bank Holding Company Act to national banks.⁴⁰² The district court's approving reference to *Citicorp* suggests that it would have reached the same conclusion with respect to the applicability of that Act to national bank operating subsidiaries.⁴⁰³

Returning now to the controversy surrounding the New Part 5 Rules, it appears that, barring a change in judicial treatment of the subject,⁴⁰⁴ the Board simply has little or no role to play in the regula-

troversial and elicited no opposition from national or state bank regulators who surely would have objected, as they do now, to the contention that the amendment permits the Fed, and not these chartering regulators, to determine what activities may be engaged in by the operating subsidiary of a bank subject to their jurisdiction.

Citicorp, 936 F.2d at 74.

399. *Citicorp*, 936 F.2d at 75. "In our [the FDIC's] view, subsidiaries of state banks are beyond the scope of the Bank Holding Company Act." *Id.* (citing Letter of L. William Seidman to Alan Greenspan (Apr. 28, 1989)). "[T]he Office of the Comptroller of the Currency (OCC) does not believe that the BHCA gives the [Board] the authority to regulate or define permissible activities of state banks, whether conducted directly or through subsidiaries." *Id.* (citing Letter of Dean S. Marriott to William W. Wiles (Apr. 28, 1989)).

400. Indeed, in many critical passages, the Second Circuit did not limit its reasoning to state entities. See *supra* notes 390 & 398 and accompanying text (referring to national banks as well as state banks).

401. 916 F. Supp. 1494 (D. Minn. 1996).

402. *Id.* at 1507-08.

403. *Id.* at 1507.

404. These questions have not, of course, been addressed by the Supreme Court as yet, but inferences can be drawn from the Court's decision and reasoning in *ICI* that suggest that the Court would probably adopt the reasoning of the circuit and district court cases discussed above. In *ICI*, the Investment Company Institute challenged the Board's amendment to its Regulation Y, 12 C.F.R. § 225.4(a)(5)(ii) (1995), that by its terms permitted bank holding companies and their nonbank subsidiaries to act as investment advisors to closed-end investment companies. *ICI*, 450 U.S. 46, 53 (1981). In the course of its opinion, the Court noted that the Institute argued that the regulation it was challenging "authorizes banks as well as bank holding compa-

tion of bank operating subsidiaries, as in fact SIA conceded in its letter of comment to OCC.⁴⁰⁵ That does not quite end the point since SIA argued more generally that the Proposed Part 5 Rules, by permitting OCC to regulate activities for banks and their subsidiaries that are also, when carried out by bank holding companies and their non-bank subsidiaries, regulated by the Board, could introduce inconsistency and anomaly into banking regulation.⁴⁰⁶ "Congress could not have intended such a result," said SIA, "when it gave the Board primary responsibility for interpreting the Glass-Steagall Act."⁴⁰⁷

This is an argument in favor of preserving a particular view of coherence in the regulatory fabric by invoking the purposes of an act, here the Bank Holding Company Act, to achieve an outcome that is

nies and nonbank subsidiaries to act as investment advisors. . . . Respondent [Institute] contends that banks have relied on the interpretive ruling as authorization for them to sponsor investment companies." *Id.* at 59 n.25.

In rejecting this point, the Court suggested that the Board could not have granted such authority to banks, even if it intended to do so, because the Board had no power to confer permission to engage in such activities on banks. Specifically, the Court said:

The simple answer to this argument [that the challenged regulation authorized banks as well as holding companies and non-bank subsidiaries to act as investment advisors] is that not only does the interpretive ruling confer no authorization [on banks] to undertake any activities, but also the *Board does not have the power to confer such authorization on banks.*

Id. (emphasis added). The Court went on to quote with clear approval the Board's opinion on this point:

As the Board's opinion in this case stated: "[T]he Board's regulation was adopted pursuant to section 4(c)(8) of the Bank Holding Company Act and authorizes investment advisory activity to be conducted by a nonbanking subsidiary of the holding company. The authority of national banks or state member banks to furnish investment advisory services does not derive from the Board's regulation; such authority would exist independently of the Board's regulation and its scope is to be determined by a particular bank's primary supervisory agency."

Id.; see *Independent Ins. Agents v. Board of Governors of the Fed. Reserve Sys.*, 890 F.2d 1275, 1284 (2d Cir. 1989); *Cameron Fin. Corp. v. Board of Governors of Fed. Reserve Sys.*, 497 F.2d 841, 848 (4th Cir. 1974).

In yet another respect, the Supreme Court's reasoning in *ICI* is pertinent to this question of whether provisions of the Bank Holding Company Act can be found to restrain bank operating subsidiary activities that other provisions of law, in particular, Glass-Steagall, would seem to permit. After careful consideration in *ICI* of the convoluted history of enactment of the Bank Holding Company Act, the Court concluded:

Nothing in the legislative history of the Bank Holding Company Act persuades us that Congress in 1956 intended to effect a more complete separation between commercial and investment banking than the separation that the Glass-Steagall Act had achieved with respect to banks in §§ 16 and 21

450 U.S. at 71. In other words, the Bank Holding Company Act cannot be read to expand the reach of the bank-ineligible limitations contained in Glass-Steagall, whatever they are. Nor did subsequent amendments to that Act have any such expansive result. *Id.* at 71-73 n.49.

405. SIA Letter, *supra* note 103, at 33.

406. *Id.* at 32-33.

407. *Id.* at 33.

not to be clearly found in the actual words of the act. The Board itself has from time to time invoked such a general "plain purpose" of the Bank Holding Company Act argument. It typically falls on deaf judicial ears, however.⁴⁰⁸ As the Supreme Court stated in a related context, "[i]f the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the courts, to address."⁴⁰⁹ Similarly, if the inability of the Board to regulate bank operating subsidiaries is a serious impediment to protection of regulatory coherence, this is a problem for Congress to address.⁴¹⁰

2. *Operating Subsidiary as Mere Department of Bank—Prior OCC Statements and Policy*

The final point in the argument against the operating subsidiary element of the New Part 5 Rules is that OCC has historically limited the activities of operating subsidiaries to those which the operating subsidiary's bank parent could undertake. This is seen as part of the original rationale for the creation of operating subsidiaries. OCC, it is asserted, may not now, at this late date, undertake such a fundamental change in its regulatory approach, one indeed that is allegedly inconsistent with the basis for permitting operating subsidiaries.⁴¹¹

Without doubt, OCC has broken new ground with its suggestion that it would entertain, on a case-by-case basis, proposals for operating subsidiaries to engage in activities that, while within the "business of banking," are nonetheless beyond the authority of national banks.

408. See, e.g., *Synovus Fin. Corp. v. Board of Governors of the Fed. Reserve Bd.*, 952 F.2d 426 (D.C. Cir. 1991); *MCorp. Fin. v. Board of Governors of the Fed. Reserve Sys.*, 900 F.2d 852 (5th Cir. 1990), *rev'd on other grounds*, 502 U.S. 32 (1991); cf. *Board of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361 (1986).

409. *Dimension Fin. Corp.*, 474 U.S. at 37. The context of this case was that the Board attempted to assert its authority over institutions (so-called "nonbank banks") that reserved the right to require notice before withdrawal of funds from an account, typically a NOW (negotiable order of withdrawal) account. Thus, its depositors lacked a "legal right to withdraw on demand," which is a key part of the definition of "banks" that the Board could regulate. 12 U.S.C. § 1841(c) (1994). As a matter of course, these institutions rarely exercised this right of notice. Because of the explosive growth of NOW accounts that functioned very much like ordinary checking accounts, the Board was concerned that many financial institutions that were functionally equivalent to banks were escaping its regulatory reach. It accordingly amended its regulations to define "bank" to mean an institution that accepts deposits that "as a matter of practice" are payable on demand, even if the depositor has no "legal right" (the phrase in the statute) to demand immediate withdrawal. The Court rejected the regulation as being clearly contrary to the statute. *Dimension Fin. Corp.*, 474 U.S. at 367-68, 373-75.

410. See *Independent Ins. Agents v. Board of Governors of the Fed Reserve Sys.*, 890 F.2d at 1284 ("If that interpretation [that the activities of banks are beyond the Board's authority] is to be altered, Congress will have to enact suitable legislation.").

411. See 1995 Dingell Letter, *supra* note 113, at 6; SIA Letter, *supra* note 103, at 14-15, 18-20.

The prior version of its operating subsidiary rule provided that all rules applicable to banks were equally applicable to operating subsidiaries.⁴¹² When OCC first formalized its operating subsidiary rule in 1966, it described an operating subsidiary as “a corporation the functions or activities of which are limited to one or several of the functions or activities that a national bank is authorized to carry on.”⁴¹³ This approach has persisted in prior amendments to section 5.34.⁴¹⁴ Moreover, in describing the activities and operations of operating subsidiaries, OCC has frequently invoked the image or analogy of a “separately incorporated department of the bank.”⁴¹⁵

412. See Rules, Policies, and Procedures for Corporate Activities, 12 C.F.R. § 5.34 (1996); *supra* note 61 and accompanying text.

413. Acquisition of Controlling Stock Interest in Subsidiary Operations Corporation, 31 Fed. Reg. 11,459 (1966). The OCC stated:

It is antediluvian to contend, as some still do, that there is an inevitable tendency for banks to conduct operations of their subsidiary corporations in a way that is unsuitable for a part of a banking enterprise, to disregard pertinent restrictions and requirements, and, in particular, to venture through their subsidiaries into activities which are beyond the powers of the parent bank.

Id. at 11,460.

414. See Operating Subsidiaries, Other Equity Investments, Conversions, Changes in Equity Capital, Subordinated Debt, 55 Fed. Reg. 996-97 (1990) (“A national bank’s decision to carry on activities in an operating subsidiary as opposed to the bank itself is a business decision. National bank operating subsidiaries are treated under the National Bank Act . . . as part of the bank itself. The subsidiaries’ activities are limited to activities permissible for the parent national bank. . . . Thus, to determine whether a national bank operating subsidiary legally may conduct a particular activity, the OCC is governed by the rules applicable to national banks themselves.”); Corporate Applications; Operating Subsidiaries, 48 Fed. Reg. 1,732 (Jan. 14, 1983) (proposing amendments) (“An operating subsidiary of a national bank may perform only activities that can be performed within the corporate structure of its parent bank.”).

415. See SIA Letter, *supra* note 103, at 15 n.21 (quoting Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division, OCC, to James A. Peden, Jr., Stennet, Wilkenson & Ward (July 2, 1981)), stating that “[a]n operating subsidiary is, in effect, an incorporated department of the bank and may perform any business function which the parent bank is permitted to perform.”); *id.* at 18 n.28 (quoting Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division, OCC, to Eugene E. Henn, Vice President and Senior Counsel, American Fletcher National Bank (Mar. 15, 1983) that “[c]onceptually, the OCC regards operating subsidiaries as integral departments of the parent bank. All of the banking laws generally applicable to the parent bank also apply to its subsidiaries.”); *id.* at 14-15 (quoting Letter from Doyle L. Arnold, Senior Deputy Comptroller for Policy and Planning, to OCC (Apr. 18, 1984)) [hereinafter Arnold Letter]. The Arnold Letter states:

National Banks are generally prohibited by 12 U.S.C. § 24 (Seventh) from acquiring corporate stock. However, this Office has interpreted this prohibition as being inapplicable to a bank’s ownership of stock of an operating subsidiary. This interpretation is based on the fact that a bank’s operating subsidiaries are merely separately incorporated departments of the bank. This being the case, the ownership of the stock of such corporation does not involve the bank in speculation in securities that section 24 (Seventh) is intended to prevent. Rather, it represents a bank’s legitimate adoption of a particular organizational structure.

Id.

In response to critical commentary concerning the Proposed Part 5 Rules, OCC readily acknowledged that it has used the “department of a bank” descriptive tag, but it says that critics misunderstand the reasons for such use. This was intended, says OCC, as a shorthand phrase to capture the idea that a bank, like any other corporation, might find it preferable for reasons of convenience to conduct some of its business affairs through a subsidiary rather than within the bank itself.⁴¹⁶ In any event, neither use of that phrase nor prior versions of section 5.34 should be taken as an indication that OCC believes or believed that “a [bank operating] subsidiary’s functions *had* to be so limited,”⁴¹⁷ that is, limited to those functions or activities that a bank is permitted to undertake and no more.

By the same token, however, the class of activities that an operating subsidiary might undertake, but that a bank could not, is necessarily quite limited, by law and by the New Part 5 Rules themselves. Any such activity must in any event be part of or incidental to the “business of banking,” and furthermore, it must be a bank-related activity that, for one reason or another, the bank itself may not undertake but a subsidiary might. Where a disability to conduct a part of the business of banking is limited in its application to a national bank but does not apply to the bank’s subsidiary, OCC believes that it is perfectly appropriate for it to consider, on a case-by-case basis, whether the subsidiary may properly, consistent with safety, soundness, and other prudential concerns, undertake the activity that its banking parent may not.⁴¹⁸ Indeed, said OCC, with more than a little understatement:

The OCC’s proposal only establishes a process that enables the OCC to consider and act on a broader range of corporate activities than is currently permitted for operating subsidiaries. The OCC has not committed to approving any particular activity. In addition, consistent with past practice, the OCC will evaluate an application to engage in any new operating subsidiary activity on a case-by-case basis following a comprehensive review of any supervisory, policy, or legal concerns.⁴¹⁹

OCC has given only one example of the kind of activity that might fit into this narrow category: the bank operating subsidiary acting as

416. See OCC Response to Dingell, *supra* note 57, at 4 (“The so-called ‘department of the bank’ limitation . . . has been misunderstood. The OCC has often used the ‘department of the bank’ phrase as a shorthand way to express the idea that an operating subsidiary is a convenient and useful way to conduct activities permitted for the parent bank.”).

417. *Id.*

418. *Id.*; see Rules, Policies and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,350-55 (1996) (to be codified at 12 C.F.R. pt. 5).

419. OCC Response to Dingell, *supra* note 57, at 5.

general partner in a partnership, an activity that old judicial precedent determined to be beyond the authority of a national bank due to the financial risks involved in general partner status.⁴²⁰ It is perfectly clear, however, that the other obvious candidate for such treatment is underwriting and dealing in securities to the extent permitted by Glass-Steagall section 20 for bank affiliates, which, as argued earlier,⁴²¹ should properly include bank operating subsidiaries. The clear distinction that Glass-Steagall makes between such activities that may be carried on by banks (very little under sections 16 and 21) and by affiliates of banks (somewhat more under section 20)⁴²² is perfectly tailored to fit into the narrow category of activities that the New Part 5 Rules would permit OCC to consider in the context of specific applications for approval submitted by national banks. In light of the fact that such applications would present novel safety, soundness, and other issues for OCC to consider, it is perhaps understandable that the agency does not wish to commit itself to any particular policy or course or even to acknowledge that securities activities may be on its agenda at present.⁴²³

420. *Id.* at 4; *see supra* notes 204-11 and accompanying text.

421. *See supra* Part V.C.2.

422. *See supra* Part V.B.

423. OCC also no doubt wishes to avoid controversy in advance of when it is unavoidable, both because this could have a negative impact on the prospects for meaningful financial services reform in Congress, *see supra* note 51, and because, if such reform is enacted, OCC may conceivably be able to proceed as it wishes without making any unnecessary enemies.

Another reason for OCC's reluctance to address the bank-ineligible securities issue in connection with the New Part 5 Rules is suggested by SIA. *See* SIA Letter, *supra* note 103, at 10-14. A provision of the National Bank Act, 12 U.S.C. § 93a (1994), gives OCC certain rulemaking power with respect to its statutory responsibilities but carves out an unusual exception for rulemaking concerning Glass-Steagall. Section 93a provides in pertinent part:

Except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to another regulatory agency, the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office, except that the authority conferred by this section does not apply . . . to securities activities of National Banks under the Act commonly known as the "Glass-Steagall Act."

SIA Letter, *supra* note 103, at 10.

SIA interpreted this somewhat peculiar provision to deprive OCC of authority to adopt the critical operating subsidiary language in Proposed Part 5 Rules section 5.34(d)(3), since in SIA's view any use of that provision to grant operating subsidiaries bank-ineligible securities powers would confer on national banks powers that they do not have under existing substantive law. SIA Letter, *supra* note 103, at 10.

A quick look at the legislative history of section 93a, however, reveals a rather different picture of its meaning and intent. Congress was apparently concerned that it not be perceived, as a consequence of the very act of conferring rulemaking authority on OCC, as having given that agency authority to grant or recognize new or additional bank powers for national banks. *See* 126 CONG. REC. 6902 (1980) (statement of Senator Proxmire, floor manager of the bill that included what is now section 93a). According to Senator Proxmire:

As to the suggestion that OCC is contradicting its prior position, a careful reading of all of prior pronouncements by OCC and certain of its employees that have been marshaled to date by opponents of the new operating subsidiary rules shows no conclusion by OCC that the prior versions of the operating subsidiary provisions had exhausted the limits of what substantive law would permit operating subsidiaries to do. Most of the cited statements are no more than descriptive of the regulatory landscape that OCC had, at the time of the statements, approved.⁴²⁴ In light of the enormous changes in the financial services industry and growth in competition for banks over the last thirty years since OCC first formalized its operating subsidiary program, it is surely appropriate for OCC to reexamine its earlier approach and

Since the rulemaking authority [under section 93a] is only available to carry out the responsibilities of [the Comptroller,] it carries with it no new authority to confer on national banks powers which they do not have under existing substantive law. To give national banks authority under this rulemaking provision which they otherwise do not possess under existing substantive law would not be carrying out the responsibilities of the Comptroller since only Congress can define those responsibilities so as to confer powers on national banks.

See H.R. CONF. REP. NO. 96-842, at 83 (1980), reprinted in 1980 U.S.C.A.N. 298, 313 (language in section 93a makes clear that the rule-making provision carries no authority to permit "otherwise impermissible activities of national banks with specific reference to the provisions of . . . the Glass-Steagall Act").

The rulemaking limitation language contained in section 93a thus merely preserves the statutory status quo concerning securities powers. Any determination by OCC that bank operating subsidiaries may engage in bank-ineligible securities activities as bank "affiliates" under Glass-Steagall section 20 would not involve conferring any powers on banks themselves and would amount to no more than recognizing existing but heretofore dormant powers of operating subsidiaries as "affiliates," which is not at all the same thing as conferring new powers which "they do not have under existing substantive law."

SIA's position in this respect thus, in effect, assumes its conclusion, that is, that section 93a prevents OCC from adopting Proposed Part 5 Rules section 5.34(d)(3) because that might, with subsequent OCC connivance, permit operating subsidiaries to exercise bank-ineligible securities powers, which would amount to the granting of new powers since current substantive law would not permit operating subsidiaries to act as affiliates under Glass-Steagall section 20. I believe that the assumption at the end of that sentence is quite clearly faulty. If so, then so is SIA's reasoning in its section 93a point.

424. See *supra* notes 412-15. Moreover, many of the statements are apparently from private correspondence that is probably not sufficiently formal or official to establish that they reflect clear OCC policy. In *Smiley v. Citibank (South Dakota)*, 116 S. Ct. 1730 (1996), a party challenging OCC's position in litigation, on the basis, *inter alia*, that it was inconsistent with prior OCC positions, pointed to a letter from the Comptroller to a presidential committee and an opinion letter from OCC's Deputy Chief Counsel to several banks about the meaning of the statutory provision in question. The Supreme Court did not agree that these statements could be a basis for demonstrating inconsistency in OCC's position:

We doubt whether either of these statements was sufficient in and of itself to establish a binding agency policy—the former, because it was too informal, and the latter because it only purported to represent the position of the Deputy Chief Counsel in response to an inquiry concerning particular banks.

Id. at 1734. The same could be said about many of the statements cited by the rule opponents.

consider whether additional profitable activities may be conducted by bank operating subsidiaries in a manner conducive to safety and soundness. Indeed, presumably OCC would be seriously remiss in its responsibilities if it did not reexamine its policies from time to time in light of such developments.

Moreover, even if it were possible to read any of these statements as demonstrating that OCC had concluded earlier that its operating subsidiary activities regime had reached the outer limits of what the relevant statutes permitted, that hardly forecloses reconsideration by OCC, particularly in light of the fact that any such conclusion by OCC was surely (if so reached) incorrect, as this Article serves to demonstrate. As the Supreme Court recently observed in another bank case, *Smiley v. Citibank (South Dakota)*:⁴²⁵

Of course the mere fact that an agency interpretation contradicts a prior agency position is not fatal. Sudden and unexplained change . . . or change that does not take account of legitimate reliance on prior interpretation . . . may be "arbitrary, capricious [or] an abuse of discretion" But if these pitfalls are avoided, change is not invalidating, since the whole point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agency.⁴²⁶

425. 116 S. Ct. at 1734. This case involved the meaning of the term "interest" for purposes of 12 U.S.C. § 85 (1988), which permits a national bank to charge its borrowers "interest at the rate allowed by the laws of the State . . . where the bank is located." *Id.* at 1732. Specifically, at issue was whether late charges were "interest" for purposes of section 85. See *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978). A national bank card holder asserted that the more protective rules of her home state with respect to late charges ought to apply to the exclusion of the comparable rules of the bank's home state. *Smiley*, 116 S. Ct. at 1731. She also asserted that OCC had significantly changed its position on the question of whether late charges were part of "interest" for section 85 purposes. *Id.* at 1734.

426. 116 S. Ct. at 1734; see *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 817 (1995) (stating that "any change in the Comptroller's position might reduce, but would not eliminate, the deference we owe his reasoned determinations"); *Idaho v. Federal Reserve Sys.*, 994 F.2d 1441, 1445 (9th Cir. 1993) (stating that "[w]here an agency takes a position that is inconsistent with its previous views, the courts may owe less deference to the agency's position. . . . Nevertheless, if the agency is able to show both that its new position is reasonable and that a reasonable rationale existed for the change, its new position remains entitled to some weight").

The D.C. Circuit's decision in *Clark-Cowlitz Joint Operating Agency v. Federal Energy Regulatory Comm'n*, 826 F.2d 1074 (D.C. Cir. 1987) (en banc), contains a useful and relevant discussion of "the fundamental question as to an agency's ability to change its mind about the law and to act upon its new interpretation." 826 F.2d at 1078. In this case, the Commission's initial interpretation of a provision of the Federal Power Act was challenged and upheld in court. *Id.* at 1074. Some time later, the Commission reversed itself on this issue and arrived at a new interpretation, which was also challenged in court, on inconsistency as well as collateral estoppel and res judicata grounds. *Id.* at 1078-79. The D.C. Circuit made the entirely reasonable (to this author, at least) observation that more than one interpretation of a statute could be "reasonable" and thus deserving of judicial deference:

It should be noted, moreover, that any "change" in OCC policy at this point is purely hypothetical since OCC has (as yet) had no occasion to consider any applications under the New Part 5 Rules. Presumably, however, OCC will, as it has promised, carefully consider the issues and explain its decision. There is, furthermore, no reliance issue in this context.

Thus, while the best interpretation of the New Part 5 Rules is that they do not contradict earlier versions since the earlier versions did not reflect OCC's views of the maximum extent of operating subsidiary activity, even if the new rules are deemed to be inconsistent with OCC's earlier positions, it is plainly open to OCC to provide, if and when the time comes, a full explanation of and rationale for its change. This should not be a very difficult task.

CONCLUSION

OCC's New Part 5 Rules are at once bold and limited. They are bold in the sense that they may permit subsidiaries of banks to engage in (for them) new and potentially profitable business activities. They are limited since, in any event, operating subsidiaries may not stray from what is part of or incidental to the business of banking. In light of the enormous changes in the financial services industry in recent decades and the challenge those changes pose to the continued success and relevance of commercial banks, as well as the continued inability of Congress to untie itself from the knots in which it becomes caught whenever it seriously considers reforming our archaic statutory structure, it is surely appropriate for OCC to adopt them.

It is safe to assume that OCC will proceed cautiously with applications under the new rules both because it is potentially entering new territory and because Congress and numerous jealous nonbank participants in the financial services industry will be watching closely. The new rules, however, are sound as a policy matter.⁴²⁷ Congress

[The first] decision [finding that the Commission's initial interpretation] . . . [which] was both consistent with the statute and otherwise reasonable does not, as a matter of law or logic, resolve the distinct issue of whether [the Commission's] recent interpretation is also reasonable and in accordance with the statute. It should go without saying that an ambiguous or broadly worded statute may admit of more than one interpretation that is reasonable and consistent with Congressional intent. . . . That is to say, there may be more than one "right" interpretation if Congress has painted with a broad (or at least non-specific) brush so as to permit an agency flexibility in carrying out its duties.

Id. at 1079-80 (footnotes omitted; citations omitted). It is particularly appropriate for OCC to have some flexibility in dealing with operating subsidiaries, given recent enormous changes in the financial services industry.

427. See Statement of Shadow Regulatory Committee on Recent Fed and OCC Rulings on Permissible Bank Activities, Dec. 9, 1996, at 3 (on file with the *DePaul Law Review*) ("In our

should permit such limited agency reform to unfold. It may provide useful lessons for future legislative reform. It will probably provide needed additional income for banks. It is in any event a lawful exercise of OCC's regulatory authority and a fine example of incremental reform.

view, there is no meaningful difference between permitting a bank to engage in an activity through a subsidiary and permitting the same activity to be carried on by the parent of the bank or by an affiliate of the bank that is a subsidiary of the bank's holding company.").