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Nonbank Banks: Who's Minding the Store?

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NONBANK BANKS: WHO'S MINDING THE STORE?

In 1984, the Federal Reserve Board (the Board) amended Regulation Y[1] to redefine "bank" in hopes of closing the "nonbank bank" loophole created by the statutory definition of "bank" found in Section 2(c) of the Bank Holding Company Act of 1956 (BHCA).[2] Since its most recent amendment in 1970, Section 2(c) defines a "bank" as any institution "which (1) accepts deposits that the depositor has a legal right to withdraw on demand, *and* (2) engages in the business of making commercial loans."[3] Because it is phrased in the conjunctive, Section 2(c) allows a company to circumvent the definition of bank by conducting activities meeting only one of the statutory elements; in so doing, such a company is not technically a "bank" and escapes Board regulation under the BHCA.[4] Provisions of the BHCA regulating bank acquisitions require Board approval prior to the acquisition of any "bank" as defined therein. By broadening the definition of bank, Regulation Y expanded the scope of the BHCA such that acquisitions of "nonbank banks" would also require Board approval. Dimension Financial Corporation challenged Regulation Y as an unauthorized expansion of the Board's jurisdiction, resulting in the Board's refusal to approve its application

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1. 12 C.F.R. § 225.5(a)(1)(A) (1985).
2. 12 U.S.C. § 1841-1850 (1984).
3. 12 U.S.C. § 1841(c) (1984) (emphasis added).
4. For a general discussion of the issue, see Schellie & Climo, Nonbank Banks: Current Status and Opportunities, 102 Banking L.J. 4 (1985). The article outlines three basic advantages of nonbank bank status. First, nonbank banks avoid the strict limitations on product lines and permissable activities that are imposed on banks. Id. at 10. Thus, banking and general commercial activities can be mixed. As a result, "the wall between general commerce and banking has been very badly eroded, if not destroyed . . . ." Id. Second, nonbank banks avoid the geographical restrictions imposed on banks by the Douglas Amendment to the BHCA. Under Section 1842(d), a bank holding company may not operate another bank outside its home State unless the other State expressly allows it. Id. at 5 n. 1. Nonbank banks, however, may operate on an interstate basis. The third advantage is that nonbank banks avoid state usury ceilings. Id. at 12. In short, the nonbank bank "looks like a bank, it can be insured like a bank, can perform all activities other than the activity it has elected to forego to avoid being a 'bank,' can even be chartered as a national bank, but it is not a bank for purposes of the Act." Id. at 9. Examples of familiar companies which own nonbank bank operations include E. F. Hutton, Merrill Lynch, J. C. Penney, Sears, Parker Pen Co., etc. Id. at 7, 10.

to open thirty-one nonbank banks in twenty-five states.[5] Affirming the tenth circuit's decision in favor of Dimension,[6] the United States Supreme Court held the Federal Reserve Board acted beyond the scope of its statutory authority by redefining "bank" in Regulation Y. *Board of Governors v. Dimension Financial Corp.*, 54 U.S.L.W. 4101 (1986).

When the BHCA was first enacted in 1956, a bank was defined as "any national banking association or any State bank, savings bank, or trust company."[7] This charter-based definition proved too broad, as it subjected even industrial banks and nondeposit trust companies to the Board's regulation.[8]

As a result, Section 2(c) was amended in 1966, and "bank" was defined functionally as an institution that accepts "deposits the depositor has a legal right to withdraw on demand."[9] This definition also swept too broadly, as it would include "institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial loans."[10] Thus, the current two-prong definition was adopted in 1970, requiring that an institution both "(1) [accept] deposits that the depositor has a legal right to withdraw on demand, and (2) [engage] in the business of making commercial loans"[11] to qualify as a "bank."

In response to the growing number of nonbank banks that have been established as a result of the statutory loophole, the Board amended Regulation Y to redefine both elements of the statutory definition of "bank." The regulation redefines "demand deposit" to mean "any deposit with transactional capability that, *as a matter of practice*, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument."[12] By replacing the requirement that the depositor must have a legal right to withdraw on demand, the regulation expands the scope of the BHCA to include institutions offering NOW accounts. NOW accounts are accounts, some of which are interest bearing, that, in practice, are payable on demand to the depositor. However, most NOW accounts grant to the financial institution a technical legal right, seldom exercised, to require prior

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5. Top Court Clears Limited-Service Banks And Deals Major Blow to Power of Fed, Wall Street Journal, Jan. 23, 1986, at 3, col. 3.

6. Dimension Fin. Corp. v. Bd. of Governors, 744 F.2d 1402 (10th Cir. 1984), aff'd, 54 U.S.L.W. 4101 (1986).

7. 12 U.S.C. § 1841(c) (1964 ed.).

8. See S. Rep. No. 1179, 89th Cong., 2d Sess. 7, reprinted in 1966 U.S. Code Cong. & Ad. News 2385, 2391.

9. 12 U.S.C. § 1841(c) (1966 ed.).

10. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 24, reprinted in 1970 U.S. Code Cong. & Ad. News 5519, 5541.

11. 12 U.S.C. § 1841 (c) (1984).

12. 12 C.F.R. § 225.2(a)(1)(ii)(A) (emphasis added).

notice of withdrawal.[13] "Under a literal reading of the statute, the institution—even if it engages in full scale commercial lending—is not a 'bank' for the purposes of the Holding Company Act because the prior notice provision withholds from the depositor any 'legal right' to withdraw on demand."[14] Regulation Y also redefines "commercial loan" to include "any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments."[15]

The Supreme Court's 8-0 decision,[16] written by Chief Justice Burger, addressed the demand deposit and commercial loan elements separately, then moved on to a general rejection of the Board's rationale and authority. As will be seen, the Court relied on a rigid reading of the statutory terms in curtailing the Board's power. While this approach is not clearly wrong in that there is precedent which supports the plain meaning rule,[17] the Court has often espoused a more flexible method of statutory construction, which perhaps would have been better suited to this case.

Demand Deposit

In attacking the Board's definition of "demand deposit," the Court relied on a literal reading of Section 2(c). "If the statute is clear and unambiguous '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.'"[18] The Court refused to accord the "traditional deference."[19] to the Board's interpretation, which "would now define 'legal right' as meaning the same as 'a matter of practice.'" The Chief Justice further remarked that "no amount of agency expertise—however sound may be the result—can make the words 'legal right' mean a right to do something 'as a matter of practice.'"[20]

Although *Dimension* appears to announce an absolute and invariable rule, such literalism is notably absent from other instances of judicial review of agency interpretation. For example, in *Mourning v. Family*

13. 54 U.S.L.W. at 4103.
14. Id.
15. 12 C.F.R. § 225.2(a)(1)(ii)(B).
16. Justice White did not participate in the decision.
17. The Court cited Chevron U.S.A., Inc. v. National Resources Defense Council, 467 U.S. 837, 104 S. Ct. 2278 (1984), TVA v. Hill, 437 U.S. 153, 98 S. Ct. 2279 (1978), and Richards v. United States, 369 U.S. 1, 82 S. Ct. 585 (1962), in support of the plain meaning doctrine.
18. 54 U.S.L.W. at 4103.
19. Id.
20. Id.

Publications Services, Inc.,[21] also authored by Chief Justice Burger, the Court upheld the Board's authority in promulgating the "four installment rule" under the Truth in Lending Act (TILA).[22] Section 121 of the TILA, as it stood at the time of the decision, required merchants to disclose certain contract information "to each person to whom consumer credit is extended *and upon whom a finance charge is or may be imposed.*"[23] The four installment rule, appearing in Regulation Z[24] and struck down by the fifth circuit,[25] was upheld in *Mourning*, despite its application to consumer credit extensions "for which either a finance charge is or may be imposed or which pursuant to an agreement, is or may be payable in more than four installments."[26]

The fifth circuit determined the Board had exceeded its statutory authority in establishing the four installment rule, which they found to be in direct conflict with Section 121 of the TILA. As the regulation would require disclosure in some instances where credit was extended with no attendant finance charges, the regulation "constituted an administrative endeavor to amend the law as enacted by Congress and to thereby make the Act reach transactions which the Congress by its statutory language did not seek or intend to cover by its enactment."[27]

In reversing the fifth circuit's decision, the Supreme Court held the rule was well within the broad authority delegated to the Federal Reserve Board "to prescribe regulations . . . necessary or proper to effectuate the purposes of [the Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith."[28]

The BHCA contains a grant of authority similar to that in the TILA under Section 5(b), which empowers the Board "to issue such regulations and orders as may be necessary to enable it to administer

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21. 411 U.S. 450, 93 S. Ct. 1652 (1973).
22. 15 U.S.C. § 1602-1693 (1982).
23. 15 U.S.C. § 1631 (emphasis added).
24. 12 C.F.R. § 226.2(K) (1972 rev.).
25. Mourning v. Family Publications Serv., Inc., 449 F.2d 235 (5th Cir. 1971).
26. 12 C.F.R. § 226.2(K) (1972 rev.) (emphasis added).
27. 449 F.2d at 245.
28. The authority granted under the TILA is more specific, as the provision states that the "regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions as in the judgment of the Board are necessary . . . ." 15 U.S.C. § 1604. This additional language seems appropriate in light of the type of activity the TILA is designed to address, namely, the danger of consumer fraud through the non-disclosure of financing terms. Congressional suspicion that the TILA would likely be fraught with attempted evasions would no doubt be stronger in the consumer credit area than in the financial institutions arena. Thus, any distinction of *Mourning* based on the fact that the power to prevent evasion is more specifically spelled out in the TILA appears meritless. One would think that with regard to the BHCA, the authority to make exceptions, etc., enumerated in the TILA is implicit in the general phrase "to prevent evasion," found in both Acts.

and carry out the purposes of this Act and prevent evasions thereof."[29] While the Chief Justice in *Dimension* minimized the importance of Section 5(b) by referring to it merely in a footnote,[30] he gave the TILA's similar grant of authority great attention in *Mourning*:

> Whatever legislation was passed had to deal not only with the myriad forms in which credit transactions occurred, but also with those which would be devised in the future. To accomplish its desired objective, Congress determined to lay the structure of the Act broadly and to entrust its construction to an agency with the necessary experience and resources to monitor its operation. Section 105 delegated to the Federal Reserve Board broad authority to promulgate regulations necessary to render the Act effective. The language employed evinces the awareness of Congress that some creditors would attempt to characterize their transctions so as to fall one step outside any boundary Congress attempted to establish. It indicates as well the clear desire of Congress to insure that the Board had adequate power to deal with such attempted evasion.[31]

It is curious that the Chief Justice was unwilling to apply the same rationale to the banking industry's predicament in *Dimension*. The fact that the consumer credit area carries with it a certain aura of suspicion, such that Congress may have foreseen that merchants might seek to evade disclosure requirements, should not mean that the authority to prevent "evasions" under the TILA has a broader scope than the identical grant under the BHCA.[32] If "evasion" means what *Mourning* says it does, i.e., an attempt to characterize activity so as to fall one step outside any boundary Congress might draft, then certainly nonbank banks have evaded the BHCA, and the Board, by virtue of its grant of authority in Section 5(b), should be able to remedy the situation.

In its brief construction of "demand deposit," the Court refused to delve into the legislative history; such was deemed unnecessary, as the statute was "clear and unambiguous."[33] This limited analysis, however, is at odds with the familiar teaching of *Holy Trinity Church v. United States*,[34] "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers."[35]

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29. 12 U.S.C. § 1844(b) (1984)
30. See 54 U.S.L.W. at 4105 n.6.
31. 411 U.S. at 365, 93 S. Ct. at 1658.
32. See supra note 28 and accompanying text.
33. 54 U.S.L.W. at 4103.
34. 143 U.S. 457, 12 S. Ct. 511 (1892).
35. Id. at 459, 12 S. Ct. at 512.

This rule was expanded further in *United States v. American Trucking Ass'ns.*[36] Recognizing that the words chosen by Congress are "sufficient in and of themselves to determine the purpose of the legislation,"[37] the Court added that when absurd or futile results follow, the Court should look "beyond the words to the purpose of the act."[38] Taking it a step further, the Court stated as follows: "Frequently, however, even when the plain meaning [does] not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words."[39]

Had the *Dimension* Court tempered its literalism as suggested by *Holy Trinity, American Trucking*, and a host of other Supreme Court pronouncements,[40] their analysis of "demand deposit" may have led them to conclude that the Board's definition, though not clearly within the letter, fell within the spirit of the BHCA.

The legislative history of the BHCA was explored by the third circuit in *Wilshire Oil Co. v. Board of Governors.*[41] Plaintiff, a producer of oil and gas, owned several subsidiaries, one of which was the Trust Company of New Jersey (TCNJ). As TCNJ's activities qualified it as a "bank," plaintiff was a one-bank holding company and, as such, was required by Section 4(a)(2) of the BHCA either to divest its oil and gas

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36. 310 U.S. 534, 60 S. Ct. 1059 (1940).

37. Id. at 543, 60 S. Ct. at 1063.

38. Id., 60 S. Ct. at 1064.

39. Id., 60 S. Ct. at 1064.

40. See, e.g., Griffin v. Oceanic Contractors, 458 U.S. 564, 571, 102 S. Ct. 3245, 3250 (1982) ("[when] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters, . . . those intentions must be controlling."); Watt v. Alaska, 451 U.S. 259, 267 n. 9, 101 S. Ct. 1673, 1678 n. 9 (1981) ("[I]t is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning."); United Steelworkers v. Weber, 443 U.S. 193, 201, 99 S. Ct. 2721, 2726 (1979); United States v. Rutherford, 442 U.S. 544, 552, 99 S. Ct. 2470, 2475 (1979); Regents of Univ. of Cal. v. Bakke, 438 U. S. 265, 284-85, 98 S. Ct. 2733, 2745 (1978) ("[A]s Mr. Justice Holmes declared, '[a] word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances. . . . We must, therefore, seek whatever aid is available in determining the precise meaning of the statute . . . .'"); Train v. Colorado Pub. Interest Research Group, 426 U.S. 1, 10, 96 S. Ct. 1938, 1942 (1976); United House Found., Inc. v. Forman, 421 U.S. 837, 849, 95 S. Ct. 2051, 2059 (1975); United States v. Am. Trucking Ass'ns, 310 U.S. 534, 542-43, 60 S. Ct. 1059, 1063 (1940) ("To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the statute, particularly in a law drawn to meet many needs of a major occupation.").

41. 668 F.2d 732 (3d Cir. 1981).

operations or to cease being a bank holding company by December 31, 1980.[42]

In seeking to comply with Section 4(a)(2), Wilshire retained its interest in both the oil and gas operations and in TCNJ; TCNJ was changed, however, into a "nonbank." This attempt to remove TCNJ from the scope of the BHCA was accomplished by converting TCNJ's demand deposits into NOW accounts, and by notifying its customers that it reserved the right to require a fourteen day notice of withdrawal.[43]

In affirming the Board's order that TCNJ was still a "bank" despite its reservation of the right to require notice of withdrawal, the third circuit recognized the Board's authority to prevent evasion of the BHCA under Section 5(b), and "to look to the practical effect of the private transaction, as well as the purpose of Congress in enacting the statute."[44]

The legislative history of the 1966 amendments to the BHCA states that "the bill redefines 'bank' as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank."[45] Looking to the circumstances surrounding this amendment, the third circuit reasoned as follows:

> The reason why Congress did not consider in its definition of "bank" an institution such as TCNJ that offers accounts that are non-interest bearing and *not* accessible on demand was simply because such accounts were not commonly used. Congress did not choose the words "accepts deposits that the depositor has a legal right to withdraw on demand" because it was concerned with the distinction between a depositor's *legal* right to withdraw on demand and the ability *in practice* to withdraw on demand. The more reasonable interpretation of why Congress selected those terms is that stated in the Senate Report, *supra*: Congress

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42. 12 U.S.C. § 1843(a)(2) (1976).

43. The notice added: "The Trust Co. has never exercised its right to require notice and has no intention of exercising a notice provision on any type of account." 668 F.2d at 734.

44. Id. at 740. While the Court in *Dimension* does not mention *Wilshire*, the tenth circuit's interpretation of *Dimension*, 744 F.2d 1402 (10th Cir. 1984), purports to distinguish *Wilshire* as an "obvious attempt . . . to evade the Act's definition." Id. at 1409. One wonders, however, what real difference exists between a bank already in existence that converts its demand deposits into NOW accounts in order to gain nonbank status, and an institution that commences nonbanking activities selected from the outset so as to avoid bank status. Isn't the latter similarly an obvious attempt to evade the Act's definition? The tenth circuit's distinction of *Wilshire* seems to exalt form over substance.

45. S. Rep. No. 1179, 89th Cong., 2d. Sess. 7, reprinted in 1966 U.S. Code Cong. & Ad. News 2385, 2391.

> was merely adopting "the commonly accepted test of whether an institution is a commercial bank."[46]

The eleventh circuit's decision in *Florida Department of Banking v. Board of Governors*,[47] now vacated and remanded by the Supreme Court for proceedings in light of *Dimension*, is also at odds with the Court's method of statutory interpretation:

> Although we believe the words used by Congress to define bank to be clear in the sense that a meaning is intelligible, that is not tantamount to a decision that we should inquire no further. Literalism in statutory interpretation, when it is contrary to an express purpose of the Act, cannot be a talisman.[48]

The third and eleventh circuits' opinions represent what, perhaps, would have been the better reasoned approach to analyzing the Board's interpretation of "demand deposit." Faced with two well established methods of statutory interpretation, the Court's application of the plain meaning rule seems unnecessarily strict, particularly in light of the Board's expertise and Congress' inaction in the area.[49] "The object designed to be reached by the act must limit and control the literal import of the words and phrases employed."[50]

Commercial Loan

Under Section 2(c), a "bank" not only must accept demand deposits, it must also engage in the business of making commercial loans.[51] Regulation Y redefines "commercial loan" to mean "any loan other than a loan to an individual for personal, family, household, or charitable purposes," including "the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances and similar money market instruments."[52]

The Court rejected the expansion of "commercial loan" to include what the Board labeled "commercial loan substitutes."[53] The Court reasoned that "money market transactions do not fall within the commonly accepted definition of 'commercial loans,'"[54] which it interpreted as the "direct loan from a bank to a business customer."[55] While the

46. 668 F.2d at 737 (emphasis in original).
47. 760 F.2d 1135.
48. Id. at 1139.
49. See infra notes 63-65 and accompanying text.
50. *Holy Trinity Church*, 143 U.S. at 460, 12 S. Ct. at 512.
51. 12 U.S.C. § 1841(c)(1984).
52. 12 C.F.R. § 225.2(a)(1)(ii)(B).
53. 54 U.S.L.W. at 4103.
54. Id. at 4103-04.
55. Id. at 4104.

Court recognized that money market transactions are used to provide an "indirect extension of credit"[56] to businesses, it was unwilling to categorize transactions lacking the "face-to-face negotiation of credit between borrower and lender"[57] as commercial loans.

In the report accompanying the issuance of Regulation Y, the Board asserted that the term "commercial loan" includes money market instruments because a debtor-creditor relationship is established in each.[58] Citing Black's Law Dictionary, the Board identified the three elements of "loan" as "a principal sum placed with a borrower, an agreement that interest is to be paid on that sum, and a recognition by the receiver of the money of a liability for the return of the principal amount with interest."[59]

The Court, however, rejected such a broad reading of "commercial loan" and further attacked the regulation as contrary to several Board interpretations, rulings, and correspondence prior to 1982, which excluded money market transactions from the definition of commercial loan.[60] In so doing, it implied that such inconsistency supports the invalidity of the regulation.

Prior decisions of the Court indicate, though, that an agency's change of position is not necessarily fatal to the challenged regulation. For example, in *American Trucking Ass'ns v. Atchison, Topeka & Santa Fe Railway*,[61] the Supreme Court upheld regulations made by the Interstate Commerce Commission despite their maintenance of a contrary stance for over twenty-five years.[62] The Court reasoned as follows:

> [F]aced with new developments or in light of reconsideration of the relevant facts and its mandate, [the Commission] may alter its past interpretation and overturn past administrative ruling and practice. . . . [T]his kind of flexibility and adaptability to changing needs and patterns . . . is an essential part of the office of a regulatory agency. Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy.

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56. Id.

57. Id.

58. 49 Fed. Reg. 794, 839 (1984).

59. Id.

60. 54 U.S.L.W. at 4104. The Court cited two Board decisions rendered during the 1970's that held that savings and loans, though they participate in the federal funds market, are not banks because they do not make commercial loans. Also cited is an internal memorandum issued in 1981 which states that money market instruments are not commercial loans under Section 2(c). See supra note 64 and accompanying text.

61. 387 U.S. 418, 87 S. Ct. 1608 (1967).

62. Id. at 415, 87 S. Ct. at 1618.

> They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.[63]

The Court in *Dimension* ignored any practical need of the Federal Reserve Board to respond to the dramatic increase in non-bank bank applications, despite Congress' failure to respond to the issue for sixteen years.[64] Choosing instead to adhere to the "common understanding of the term"[65] as it existed in 1970, the Court denied the Board any flexibility to adapt to the undeniably different banking environment of today.

One of the Board's main assertions was that the commercial loan provision was a "technical amendment to the Act designed to create a narrowly circumscribed exclusion from the Act's coverage."[66] This argument referred to the fact that at the time of the 1970 Amendments, only one institution, the Boston Safe Deposit & Trust Co., stood to be affected thereby, as it was evidently the only bank at the time which accepted demand deposits while not engaging in commercial lending per se.[67] The Court rejected the source of this information, however, as an improper instance of legislative history, and resorted once again to a rigid interpretation of commercial loan.[68]

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63. Id. at 416, 87 S. Ct. at 1618. See also Am. Trucking Ass'ns v. United States, 344 U.S. 298, 314, 73 S. Ct. 307, 316 (1953): "The mere fact that a contrary position was taken [by the ICC] during the war years . . . that the Commission has never before restricted [the activity now prohibited] and has in fact approved it from time to time, does not change [the Court's] function."

64. The Board justified its change of position as follows:

> The decisions in [those] cases [prior to 1982] represented a willingness by the Board to refrain from applying the full scope of the Act in conditions that did not appear to generate the potential for its evasion. Now that conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of the funds thus generated in money market commercial loans, regulatory action to apply the Act to all kinds of demand deposits and commercial loans is necessary."

49 Fed. Reg. at 842.

65. 54 U.S.L.W. at 4104.

66. Id.

67. Id.

68. The only reference to Boston Safe appears at 116 Cong. Rec. 25848 (1970), wherein Representative Gonzalez entered an extensive banking journal article detailing the bill into the record. The article notes that some of the "major changes in the bill were made for particular bank situations." Id. The pertinent paragraph reads as follows:

> Boston Safe Deposit and Trust Co.: A Brooke [Sen.; Mass.] amendment, pushed by lobbyist John Yingling, provided that, for purposes of the act, an institution is not defined as a bank unless it engages in commercial lending. Virtually the only bank which does no commercial lending and therefore fits the description is the Boston Safe Deposit and Trust Co., a subsidiary of the Boston Co. The

In addition to the Boston Safe issue, however, there are other indications in the legislative history which lend support to the Board's contentions. For example, hearings, the transcripts of which comprise over 1400 pages, were held before the Senate Committee on Banking and Currency in May of 1970,[69] during which virtually every aspect of the proposed bills were discussed in great detail. Yet, one could search these pages in vain to find more than one paragraph contemplating the significance of the commercial loan amendment. That paragraph appears in a letter from former Federal Reserve Chairman Burns to Chairman Sparkman of the Senate:

> S. 3823 would amend the definition of "bank" to exclude banks that make no commercial loans. To the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution. . . . [I]n view of the very limited application of this Amendment, the Board would have no objection to its adoption.[70]

Furthermore, in the Conference Report accompanying the 1970 Amendments, the commercial loan issue is not discussed as an amendment to the definition of bank, but rather as one of several exemptions to the BHCA's coverage.[71] The report did not elaborate on the commercial loan exemption, but rather emphasized the role of the Board:

> [M]any of the exemptions outlined above are neither permanent nor automatic, since the Board has the authority to withdraw, modify, or condition the exemptions in order to conform them to the purposes of the [BHCA] and be consistent with the public

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effect of the amendment is to exempt the Boston Co. from the bill. Id.

The Court declared that the above passage was "not 'legislative history' in any meaningful sense of the term . . . ." 54 U.S.L.W. at 4104. Moreover, even if it was, the Court stated it would not allow such a passage to "defeat the plain application of the words actually chosen by Congress . . . ." In light of the scarcity of bona fide "legislative history" on this issue, the Court's disdain of this excerpt from the Congressional Record seems overly harsh. "Where the mind labors to discover the design of the legislature, it seizes everything from which aid can be derived." Holy Trinity Church, 143 U.S. at 462, 12 S. Ct. at 513. No doubt the Court's attitude was spawned by the lower court's opinion in *Dimension*, 744 F.2d 1402 (10th Cir. 1984). The tenth circuit regarded Boston Safe as an early "signal . . . as to what was permissable," 744 F.2d at 1407, and concluded that such "permitted exception[s]," id., could not now be classified as "evasions." Id. Such reasoning is erroneous in light of the purposes of the BHCA. See infra notes 79-83 and accompanying text.

69. One Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1664, S. 3823; and H. R. 6778, before the Senate Committee on Banking & Currency, 91st Cong., 2d Sess. (1970).

70. Id. at 137, quoted in 49 Fed. Reg. at 834.

71. Con. Rep. No. 91-1747, 91st Cong., 2d Sess. 13, reprinted in 1970 U.S. Code Cong. & Ad. News 5561, 5573.

> interest. Others apply to a very small number of special cases that . . . require special treatment. The Board should interpret these exemptions as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered.[72]

The Conference Report also recognized that in administering the exemptions, the Board "may have to draw an arbitrary line . . . in order to keep [an] exemption from becoming such a large loophole that it would be substantially at variance with the purposes of the [BHCA]."[73]

Whether or not the Conference Report termed the change an "exemption" or a "redefinition," its comments highlight the fact that since the act was intended to separate banking from commerce, any significant exceptions were well within the intended authority of the Board to remedy.[74]

Rejection of Plain Purpose

The final segment of *Dimension* stresses the Court's refusal to consider the policy of the legislation as a whole. In response to the Board's contention that the "plain purpose" of the BHCA is "to regulate institutions 'functionally equivalent' to banks,"[75] the Court retorted that the "'plain purpose' of legislation . . . is determined in the first instance with reference to the plain language of the statute itself."[76]

Again, the Court ignored the rule which would have equipped it with the proper background to decide the case. When discerning the meaning of a statute, a court "properly looks at contemporaneous events, the situation as it existed, and as it was pressed upon the attention of the legislative body."[77] Furthermore, "[w]hen aid to construction of the meaning of words, as used in the statute, is available, there certainly

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72. Id. at 5574.

73. Id. at 5576.

74. H. R. 6778, which was enacted into law by the 1970 Amendments, did not contain the commercial loan provision in the original draft. Senator Brooke's bill, S. 3823, did contain it. See supra note 69. S. 3823 did not pass, but apparently, the commercial loan provision was added into the substituted version of H. R. 6778 without objection for the benefit of Boston Safe.

75. 54 U.S.L.W. at 4105.

76. Id. Here the Court cites Richards v. United States, 369 U.S. 1, 82 S. Ct. 585 (1962), which went on to say:

> We believe it fundamental that a section of a statute should not be read in isolation from the context of the whole Act, and that in fulfilling our responsibility in interpreting legislation, "we must not be guided by a single sentence, but [should] look to the provisions of the whole law, and to its object and policy."

Id. at 11, 82 S. Ct. at 591-92.

77. *Holy Trinity Church*, 143 U.S. at 463, 12 S. Ct. at 513.

can be no 'rule of law' which forbids its use, however clear the words may appear on superficial examination.''[78]

Although the BHCA and its accompanying history gave very little consideration to the redefinition of "bank," the Act is clear as to its overall purpose. The primary objective of the 1970 Amendments was to include one bank holding companies, formerly exempted under the 1956 enactment of the BHCA, within the Board's regulatory authority.[79] One bank holding companies were originally excluded in an attempt to avoid regulating small town banks which might need the competitive advantage of affiliating with a nonbanking company, and which posed no major threat to the overall economy.[80] By 1969, however, the nation's six largest banks had taken advantage of this loophole and had become affiliated with one bank holding companies, thus avoiding Board regulation over the acquisition of nonbanking subsidiaries.[81]

Congress' goal in bringing one bank holding companies, regardless of their size, within the reach of the BHCA was expressly "to guard against the possible future perpetration of abuses occasioned by a company's unregulated control of a single bank."[82] In addition, the legislation was deemed necessary to preserve the "long-standing policy of separating banking from commerce."[83]

With these purposes in mind, the Board sought to justify Regulation Y in the report issued together with its promulgation:

> It is inconsistent with the Congressional intent as expressed in the Act to suggest that at the same time Congress substantially expanded the Act's coverage to ensure the separation of banking and commerce it took the significant step, almost without debate, of creating a new class of depository institution that could be acquired by all types of nonbanking organizations.[84]

The Board also expressed concern that "understandings" could easily develop. For example, funds deposited in a nonbank bank could be placed with banking institutions that would "take a favorable view

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78. United States v. Am. Trucking Ass'ns, 310 U.S. at 543-44, 60 S. Ct. at 1064.

79. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 4, reprinted in 1970 U.S. Code Cong. & Ad. News 5519, 5522. Another major provision gave greater flexibility to the Federal Reserve Board to determine the scope of permissible nonbanking activities for bank holding companies. Id. at 5530.

80. Id. at 5521.

81. Id.

82. Id. at 5522.

83. Id. The BHCA was also responsive to President Nixon's urging that "[b]anking must not dominate commerce or be dominated by it." Id. at 5557.

84. 49 Fed. Reg. at 835. The Board also pointed out that Congress' desire to prevent evasion of the Act must have been strong indeed, for it rejected "a proposed exemption for very small banks which had no more than $3 million in net worth." Id. at 834-35.

toward lending to the nonbank bank's industrial or commercial affiliates."[85] Or, a nonbank bank could make consumer loans on terms that might encourage the consumer to do business with the nonbank bank's affiliates.[86] These hypotheticals are examples of the types of abuses that can result "from concentration of resources and/or from conflicts of interest that inherently arise in the common ownership of banks and commercial organizations . . . ."[87] Moreover, the Board's current concerns are identical to those which the BHCA was expressly designed to address.[88]

Nevertheless, the Court entertained none of the foregoing considerations. Its disregard of the BHCA's overall purpose is plainly evident in the following observation:

> Application of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard fought compromises. Invocation of the "plain purpose" of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent.[89]

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85. Id. at 835.

86. Id.

87. Id.

88. The Senate Report accompanying the 1970 Amendments quoted former Federal Reserve Board Chairman Martin's statement as to why the legislation was necessary:

> If a holding company combines a bank with a typical business firm, there is a strong possibility that the bank's credit will be more readily available to the customers of the affiliated business than to customers of other businesses not so affiliated. Since credit has become increasingly essential to merchandising, the business firm that can offer an assured line of credit to finance its sales has a very real competitive advantage over one that cannot. . . . This is why . . . if we allow the line between banking and commerce to be [erased], we run the risk of cartelizing our economy. . . . Just as we have seen the country's largest banks join the new wave of one-bank holding companies, we could later see the country's business firms clustering about banks in holding company systems in the belief that such an affiliation would be advantageous, or perhaps even necessary to their survival.

S. Rep. No. 91-1084, 91st Cong., 2d Sess. 4, reprinted in 1970 U.S. Code Cong. & Ad. News 5519, 5522. Undeniably, Regulation Y is grounded in the same basic concern for preserving the separation of banking and commerce, only in the context of the nonbank loophole.

89. 54 U.S.L.W. at 4105.

Hereinabove lies the fallacy of the plain meaning rule when strictly applied, for if the Court had allowed itself to delve into the legislative records, it would have found no "hard fought compromises" and no sharp differences of opinion regarding the amendment to the definition of bank. As stated earlier, the amendment was a minor provision lobbied and incorporated into the BHCA with one institution in mind.[90] Because neither the Board nor Congress foresaw any significant impact resulting from the provision, there simply were no "processes of compromise" on the issue! Ironically but not surprisingly, it is the Court's adherence to the plain meaning rule, rather than a consideration of the BHCA's plain purpose, that has "prevent[ed] the effectuation of congressional intent."

The Chief Justice concluded the opinion by conceding the desirability of regulating nonbank banks.[91] Notwithstanding the statute's possible flaws, however, he denied the Board's authority to correct them. "If the Bank Holding Company [Act] falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, not the Board or the courts, to address."[92]

The Chief Justice's strict standard of review evident above, seems at odds with his opinion in *Mourning*,[93] discussed earlier. Although in that case the Board had similarly made a rule in apparent conflict with the statute, the Court applied this "well-established"[94] principle:

> Where the empowering provision of a statute states simply that the agency may "make . . . such rules and regulations as may be necessary to carry out the provisions of this Act," we have held that the validity of a regulation promulgated thereunder will be sustained so long as it is "reasonably related to the purposes of the enabling legislation."[95]

This reasoning recognizes the distinction between "legislative rules" and "interpretative rules," a guide commonly used in deciding problems of administrative law,[96] yet totally ignored in the *Dimension* Court's

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90. See supra notes 66-68 and accompanying text.

91. 54 U.S.L.W. at 4105.

92. Id.

93. See supra notes 21-32 and accompanying text.

94. *Mourning*, 411 U.S. at 369, 93 S. Ct. at 1660.

95. Id. at 369, 93 S. Ct. at 1660-61.

96. Cases utilizing the distinction between legislative and interpretative rules include Batterton v. Francis, 432 U.S. 416, 425, 97 S. Ct 2399, 2405 (1977); Joseph v. Civil Serv. Comm'n, 554 F.2d 1140, 1153 nn. 24-26 (D.C. Cir. 1977); General Elec. Co. v. Gilbert, 429 U.S. 121, 140-42, 97 S. Ct. 401, 410-11 (1976); National Foods Ass'n v. Weinberger, 512 F.2d 688, 697 (2d Cir), cert. denied 423 U.S. 827 (1975); Skidmore v. Swift & Co., 323 U.S. 134, 139-40, 65 S. Ct. 161, 164 (1944); Maryland Cas. Co. v. United States, 251 U.S. 342, 349, 40 S. Ct. 155, 157-58 (1920).

rationale. Simply stated, an agency rule is "legislative" if promulgated pursuant to a grant by Congress of *rule-making* authority in the Act in question.[97] If the Act does not give the authority to make rules, but merely gives authority "to enforce," for example, the rules made are deemed "interpretative."[98]

If a rule is legislative, the court may not determine the content of the rule. "The court is bound by the rule if it is valid, and it is valid if (a) it is within the delegated authority, (b) it is reasonable, and (c) proper procedure was used in issuing it."[99] If the rule is interpretative, "the court's inquiry is not into validity but is into correctness or propriety. . . .The crucial question is whether the agency is exercising delegated legislative power to make law through rules; if it is, a valid rule is binding on the court as if the rule were a statute . . . ."[100] The grant of power "may be specific and clear, or it may be broad, general, vague, and uncertain."[101] Davis' treatise on administrative law goes even further:

> When an agency is exercising its delegated power under such a statute, its regulations may repeat the words of the statute; may paraphrase those words, may interpret those words, may go slightly beyond those words, and may go far beyond those words; the regulations clearly may be legislative even when they interpret the statute.[102]

Dimension not only avoids this approach, it buries any discussion of the BHCA's grant of rule-making authority to the Board in a footnote.[103] As Section 5(b) grants the Board authority "to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this Act and prevent evasions thereof,"[104] rules made by the Board are clearly pursuant to a delegation of rule-making authority. As such, the status of a "legislative rule" should attach under this analysis, entitling Regulation Y to deference unless arbitrary and capricious.[105]

Conclusion

The Court's analysis in *Dimension* cannot be said to be clearly wrong, as the Court has preserved the plain meaning rule as one method

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97. K. Davis, Administrative Law § 7:8 (2d ed. 1979).
98. Id.
99. Id. at § 7:13.
100. Id.
101. Id. at § 7:10.
102. Id. at § 7:11.
103. 54 U.S.L.W. at 4105 n. 6.
104. 12 U.S.C. § 1844 (b) (1984).
105. See F.C.C. v. Schrieber, 381 U.S. 279, 292, 85 S. Ct. 1459, 1467-68 (1965).

of tackling a challenged statute.[106] Undeniably, however, the *Dimension* Court was not compelled to adhere to this strict approach. The nonbank bank loophole has significantly eroded the line between banking and commerce; its development over the years flies in the face of the stated purpose of the BHCA. Thus, ample precedent would authorize a careful probe of legislative intent, no matter how clear the statutory definition of bank may appear.[107]

Alternatively, the Court could have recognized Regulation Y as a legislative rather than an interpretative rule, thereby furthering a more predictable body of administrative law.[108] Unfortunately, however, the decision in *Dimension* furthers the inconsistency pervasive in this area of the law as to which is the appropriate standard of review of an administrative regulation.[109] The strict standard employed by the Court in *Dimension* interferes unnecessarily in the administrative process. "It is not the province of a court to absorb the administrative functions to such an extent that the executive or legislative agencies become mere fact finding bodies deprived of the advantages of prompt and definite action."[110]

Judicial restraint would have been appropriate in *Dimension* not only from a theoretical standpoint, but from a practical one as well.

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106. See Murphy, Old Maxims Never Die: The "Plain-Meaning Rule" and Statutory Interpretation in the "Modern" Federal Courts, 75 Col. L. Rev. 1299 (1975). Murphy suggests the courts seem to use the rule "as a heaven-sent excuse not to undertake the tedious 'archeological' inquiry into the bones and potsherds of legislative history . . . . [O]ne can almost hear the sigh of relief accompanying the 'no need to resort' language." Id. at 1315-16. He adds:

> [I]t seems fair to fault the courts for so completely failing to come up with a coherent approach to the job of statutory interpretation . . . . It does not take many instances of the same judge's embracing legislative history in one case and rejecting it in another to convince the already skeptical student that courts decide first how they want the case to come out and then find the evidence to support the result.

Id. at 1315.

107. See supra notes 35-40 and accompanying text.

108. See supra notes 95-102 and accompanying text.

109. This disparity is obvious when the rationale of *Dimension* is compared to that of *Mourning* and *American Trucking*. See supra notes 28-31, 61-63 and accompanying text.

110. Gray v. Powell, 314 U.S. 402, 412, 62 S. Ct. 326, 333 (1941). See also Zenith Radio Corp. v. United States, 437 U.S. 443, 450-51, 98 S. Ct. 2441, 2445 (1978); F.C.C. v. Schrieber, 381 U.S. 279, 290-91, 85 S. Ct 1459, 1467-68 (1965); Udall v. Tallman, 380 U.S. 1, 16-17, 85 S. Ct. 792, 801 (1965); Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 398-400, 60 S. Ct. 907, 915 (1940) ("[T]he effectiveness of both the legislative and administrative processes would become endangered if Congress were under the constitutional complusion of filling in the details. . . . Then the burdens of minutiae would be apt to clog the administration of the law and deprive the agency of that flexibility and dispatch which are its salient virtues." Id. at 398, 60 S. Ct. at 915.

Congress has remained silent on this issue since 1970, while more and more nonbank banks have taken advantage of a gaping loophole clearly unintended by Congress. For the Federal Reserve Board to consider their hands tied, and to continue to approve the "avalanche"[111] of nonbank bank applications, would seem to render meaningless their obligation to prevent evasions of the BHCA. As Justice Reed stated in *American Trucking*, "[I]t is an unnatural construction of the Act which would require the Commission to sit idly by and wink at practices that lead to violations of its provisions."[112]

Furthermore, the nonbank bank dilemma is currently one of the central issues facing Congress as they must decide whether and to what extent the banking industry should be deregulated and restructured.[113] Several states have enacted legislation in the past year to close the nonbank bank loophole,[114] and many proponents of the trend towards interstate banking view closure of the loophole an essential prerequisite to geographic deregulation.[115]

In such a complex and controversial area, one is reminded of Justice Powell's view of the Court's role in *Frontiero v. Richardson*.[116] "[R]eaching out to pre-empt by judicial action a major political decision which is currently in process of resolution does not reflect appropriate respect for duly prescribed legislative processes."[117] While the Court's

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111. *Florida Dept. of Banking*, 760 F.2d at 1138.

112. *American Trucking*, 344 U.S. at 311, 73 S. Ct. at 315.

113. In April of 1985, Paul Volcker, Chairman of the Board of Governors of the Federal Reserve System, made a statement before a House Subcommittee urging Congress to authorize some types of interstate banking. Volcker characterized the nonbank bank question as "inextricably related" to the issues of regional and interstate banking, and stressed the need for comprehensive banking legislation to remedy the status quo of the industry, which he termed "hardly satisfactory." Without Congressional action, "the legitimate pressures toward interstate operations that have impelled 'nonbank banks' would continue to seek 'unnatural' channels." P. Volcker, Statement before the Subcommittee on Financial Institutions of the Committee on Banking, Finance and Urban Affairs 1, 20 (April 24, 1985).

114. For example, Louisiana enacted a statute forbidding a bank holding company to acquire a financial institution unless the acquired institution is a bank as defined by the BHCA and is insured by the FDIC, or is a federal or state savings and loan or a federal savings bank insured by the FSLIC. See La.R.S. 6:521(A) (Supp. 1986).

115. Speaking on behalf of the American Bankers Association, James G. Cairns proposed a legislative package to the House Subcommittee on Financial Institutions. The three suggested elements endorsed by the ABA included the following: "(1) the elimination of the nonbank-bank loophole; (2) expansion of the list of permissible bank holding company activities; (3) Congressional authorization for geographic expansion within the spirit of states' rights . . . . " J. Cairns, Appendix to Statement before the Subcommittee on Financial Institutions of the Committee on Banking, Finance and Urban Affairs 1 (April 24, 1985).

116. 411 U.S. 677, 93 S. Ct. 1764 (1973).

117. Id. at 692, 93 S. Ct. 1773 (Powell, J., concurring).

decision in *Dimension* may spur Congress into resolving this issue in the coming months, the Board's exercise of its delegated authority should be overridden by Congress if necessary, but not by the Court.

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