Regulating the One-Bank Holding Companies—Precluding Zaibatsu?

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INTRODUCTION

The Japanese term Zaibatsu stands for the feudal control of huge industrial combinations and banking institutions.\(^1\) It is a generic term used to describe the large industrial and financial conglomerates which ruled the Japanese economy immediately prior to World War II. Mitsui, for instance, was the largest Zaibatsu in existence during this period. Its holdings vividly demonstrate the remarkable size these conglomerates reached. It controlled companies comparable to Westinghouse, Youngstown Sheet and Tube, Allied Chemical and Dye, American Woolen, Celanese, International Paper, American Sugar Refining, Anheuser-Busch, and United States Rubber, with innumerable subsidiaries.\(^2\) Combined it controlled 78 percent of Japan's paper industry, 5 percent of Japan's commercial banks, 17 percent of its trust business, 2 percent of its life insurance industry, 40 percent of Japan's imports and exports, and 32 percent of Japan's department stores.\(^3\) Each of the huge Zaibatsu dominated certain areas of commerce, industry or finance, while carefully refraining from entering into direct competition with one another. “Students of the Japanese economy say that a zaibatsu is probably the world’s most effective instrument for the concentration of economic power, at least outside the Communist bloc.”\(^4\) The two main reasons for the growth of the Zaibatsu were concessions made by the Japanese government and easy access to credit. Government concessions were owed to the founders of the various Zaibatsu who had aided in the restoration of the Meiji Dynasty in 1847. Because of their aid, they were sold state properties and given financial assistance and other assets at extremely low costs. Access to capital was a rather simple matter for the huge Zaibatsu, for they owned the banks! The four largest Zaibatsu controlled one bank each, and these four banks collectively held over one-third of the deposits in Japan's commercial banks. They also controlled 70 percent of the trust deposits and 20 percent of the life insurance.\(^5\) With this

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\(^3\) Id. at 187.


\(^5\) Henderson, supra note 2, at 189.
set of fortuitous circumstances, it is no wonder that the Zaibatsu attained their tremendous size.

After World War II, General Douglas MacArthur outlawed the Zaibatsu and nearly terminated them forever. However, he was forced to allow their reorganization in order to revitalize the Japanese economy and save it from communist encroachment. In recent years the Zaibatsu again has become a most significant factor in the Japanese economy. Mitsubishi is now the largest. In 1967, it accounted for 7 percent of Japan's gross national product. By comparison, an American conglomerate, accounting for the same percentage of the United States gross national product in the fields of commerce and finance, would control Sears & Roebuck, American Export Lines, the First National City Bank of New York, and the Prudential Life Insurance Co. The only real difference between the pre-war and post-war Zaibatsus is that Japanese law no longer permits banks to form holding companies. For this reason it is felt that as huge as the Zaibatsu presently are, they will not be able to regain the position of dominance that they held before World War II.

Before the war the Zaibatsu, through their dominance over large financial institutions, were able to exercise control, whether directly or indirectly, over every aspect of the Japanese economy. With regard to industry, if a competing industrial company needed a loan or other financial assistance, it was forced either to go to a bank which the Zaibatsu owned or to go to a bank which the Zaibatsu indirectly controlled. A competitor of the Zaibatsu was therefore at its mercy if in need of financial assistance. Moreover, where the competitor was fairly successful in hurting the Zaibatsu's endeavors in that particular area of industry, it could possibly find itself without credit.

The Zaibatsu's monopolistic control of certain aspects of Japan's economy generated large profits. These profits were used to buy out existing competitors in the fields they were engaged in and also to enter into new fields of economic activity. By the beginning of World War II, 15 Zaibatsu, which had been formed in 1847, controlled 70 percent of the entire Japanese trade and industry. Because of American termination of the Zaibatsu's traditional method of operation during our occupation of Japan, there is no way of knowing how much larger the Zaibatsu would have grown. It does, however, seem safe to state

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6 Halloran, supra note 4. In the industrial field this giant conglomerate would include U.S. Steel, General Motors, General Electric, Eastman Kodak, Mobil Oil, Celanese, International Paper and Anaconda. Id.
8 Henderson at 187.
that they would have continued to develop and merge until they reached a point where a few Zaibatsu would have controlled nearly all of Japan's trade and industry.

In the late 1960's, Congress took note of the fact that an americanized Zaibatsu System was coming into being. This potentiality was created by a gaping loophole in the Bank Holding Company Act of 1956, as amended in June, 1966. This loophole simply was that the legislation did not include a corporation which owned or controlled only one bank. By late 1968, over 780 one-bank holding companies, with combined assets of over 108.2 billion dollars, had been formed to take advantage of this statutory imperfection. The reason that this form of organization was so attractive was that, while the 1956 Act made it compulsory for companies owning or controlling 25 percent of two or more banks to register with the Federal Reserve Board and seek its approval for their proposed activities, there was no such restriction placed on corporations owning only one bank. In 1956, Congress decided that there was no need to regulate one-bank holding companies and in 1966, it again reached the same conclusion. The reason given was that existing one-bank holding companies were relatively small companies controlling relatively small banks. They were not seen as a dominant factor in the United States economy at that point. However, in 1967 a trend developed for extremely large banks (assets over 1 billion dollars) to form one-bank holding companies and then take advantage of the fact that they were free to enter into non-financial activities without being regulated by any government agency. Thus the nation's six largest banks, which cumulatively held more than 20 percent of the entire deposits in the nation's banking system, formed one-bank holding companies.

These six banks and all others operating within the one-bank holding company structure were allowed to enter into non-financial fields by setting up subsidiaries of the holding company. The only major restriction placed on their freedom was that the bank could not legally lend more funds to an affiliate unless the loan was secured

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10 Hearings, supra note 1, at 1.
11 1956 Act, supra note 9, § 2(a)(1), (2), (3).
12 Id.
by collateral in the form of bonds, stocks, etc., which had a market value of at least 20 percent more than the amount of the loan when made or of at least 10 percent if secured by the obligations of a state or any political subdivision thereof. This restriction was no problem for the giant multi-billion dollar one-bank holding companies. The growth record of these financial conglomerates illustrates that the loan-to-affiliate restriction did little, if anything, to prevent their formation. The problems created by entry of these gigantic one-bank holding companies into non-financial areas were essentially the same as those created by the Zaibatsu in Japan, i.e., they were easily able to stifle competition because they controlled the lines of credit in broad geographical areas of the country. This was accomplished either directly or indirectly. The bank would either condition a loan on the customer's promise to use the services of the holding company's subsidiaries or a potential lendee would utilize the holding companies' other subsidiaries instead of its competitors in the hope of receiving favorable treatment when it applied for its assistance.

As of September 1, 1968, one-bank holding companies were known to be active in 99 different non-financial activities. Commenting on the potential dangers of this situation, President Nixon stated that

left unchecked, the trend toward the combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. This must not be permitted to happen; it would be bad for banking, bad for business, and bad for borrowers and consumers.

The strength of our economic system is rooted in diversity and free competition; the strength of our banking system depends largely on its independence. Banking must not dominate commerce or be dominated by it.

To protect competition and the separation of economic powers, I strongly endorse the extension of Federal Regulation to one-bank holding companies and urge the Congress to take prompt and appropriate action.

Congress, in December of 1970, enacted amendments to the 1956

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15 For an exhaustive list demonstrating that one-bank holding companies had entered into more than ninety five (95) different non-financial activities which ranged from farming to manufacturing of tires and inner tubes, see Staff Report for House Comm. Banking and Currency, 91st Cong., 1st Sess. (1970). The Growth of Unregistered Holding Companies—Problems and Prospects, Table 10 at 49-50 (GPO 1969), as cited in H. Potter 24-25.
Bank Holding Company Act. This note will provide comprehensive treatment concerning the history of the one-bank holding company, its potential ruinous effect on competition in both financial and non-financial areas, and the method by which Congress has decided to deal with these financial institutions.

**Development of the One-Bank Holding Company**

To appreciate the effect of the 1970 amendments to the Bank Holding Company Act, it is first necessary to understand the 1956 Act. It defines a bank holding company as any organization which directly or indirectly owns, controls or has power to vote 25 percent or more of the voting shares of two or more banks. Only a corporation is covered by the Act—an individual or partnership being exempted from its regulations. Apparently, these two categories were excluded from the purview of the statute since they represented an impractical means of carrying on a venture such as a bank holding company with its vast capital requirements. Also exempted are (a) banks holding shares in a fiduciary capacity, (b) a company engaged in underwriting securities held for brief periods of time, (c) companies formed solely for the purpose of participation in a proxy solicitation, and (d) a company which owns only one bank. Under the Act, a company may not become a bank holding company, as defined, without prior approval by the Federal Reserve Board, and it is also illegal for a holding company to acquire bank stock or assets or to merge with another bank holding company without the consent of the Federal Reserve Board. This approval is necessary if, after the proposed acquisition of stock, the bank holding company will own or control more than 5 percent of the voting shares of the other bank. It is also needed if the holding company or one of its non-banking subsidiaries wishes to acquire almost all of the assets of another bank. There are minor exceptions to this needed approval. Section 3 of the Act establishes the procedure by which the Federal Reserve Board will either approve or disapprove each application. The application is considered on the basis of what effect the proposed acquisition or merger would have on the safety of depositors' funds and whether it will provide the banking public with

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18 1956 Act § 2(a)(1).
19 Id. § 2(b)(3).
20 Id. § 3(a)(1).
21 Id. § 3(a)(3), (4).
22 Id. § 3(a)(2).
23 Id. § 3(a)(3).
adequate banking services. In addition the Act provides for judicial review of disapproved applications in certain instances.\(^\text{24}\)

The most important section of the 1956 Act and one of the reasons one-bank holding companies were formed is section 4(2)(1). This section forbade a holding company from acquiring ownership or control of the voting shares of any company that is not a bank. Therefore registered bank holding companies under the 1956 Act could not become engaged in non-financial activities. They were permitted to participate only in whatever services banks were allowed to perform. Moreover, the Act called for complete divestiture of all non-bank holdings within two years of its passage.\(^\text{25}\) But, there was a ceiling on this austere approach as registered bank holding companies were permitted to acquire

shares of any company all the activities of which are of a financial, fiduciary or insurance nature, and which the board after due notice and hearing, and on the basis of the record made at such hearing, by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this chapter.\(^\text{26}\)

The subsidiary bank was also forbidden to make loans either to the holding company or to another subsidiary.\(^\text{27}\) This section of the Act was repealed in 1966,\(^\text{28}\) and now the held-bank is free to make loans to both the holding company and its subsidiaries. The Act also reserves to the states the right to enact more stringent legislation than that which exists in the federal realm.\(^\text{29}\) Several states have taken advantage of this and have prohibited bank holding companies from being formed in their jurisdictions.\(^\text{30}\)

As previously mentioned, Congress in passing the 1956 Act, did not include within its coverage companies owning only one bank.\(^\text{31}\) Accordingly, the method of avoiding the strict prohibitions of the 1956 Act was available. Now let us examine some of the considerations

\(^\text{24}\) Id. § 9.
\(^\text{25}\) Id. § 4(a)(2).
\(^\text{26}\) Id. § 4(c)(6).
\(^\text{27}\) Id. § 6(a)(4).
\(^\text{28}\) See note 14 supra.
\(^\text{29}\) 1956 Act § 7.
\(^\text{30}\) See, e.g., ILL. ANN. STAT. ch. 16½, §§ 71-76 (Smith-Hurd 1963); IND. ANN. STAT. §§ 18-1814 to 18-1817 (1964); KAN. STAT. ANN. §§ 9-504 to 9-507 (1964); NEB. REV. STAT. §§ 8-901 to 8-904 (1970); OKLA. STAT. ANN. tit. 6, § 502 (1966); PA. STAT. tit. 7, §§ 6001-05 (1967).
\(^\text{31}\) See note 12 supra.
which prompted banks to avail themselves of the one-bank holding company advantages.

First, by 1960 there were severe governmental controls on bank mergers, the expansion of banks, and registered bank holding companies. Because of the increased amount of big bank mergers in the 1950's, the enactment of the Bank Merger Act of 1960, coupled with a 1963 Supreme Court decision\textsuperscript{32} which held that bank mergers are subject to antitrust laws, led banks to fear that any expansion into larger geographical areas through merger would possibly be ruled violative of the antitrust laws and accordingly they looked for other means of growth.

Second, bank credit was significantly expanded in the 1960's. This can be explained by:

(1) The new freedom of commercial banks to compete for deposits, a consequence of the increases in the maximum permissible rates they could pay on time and savings deposits.
(2) the extraordinary increase in the volume of such funds.
(3) the incessant demands for commercial, industrial, and other loans.
(4) the willingness of the Federal Reserve to supply the necessary funds; and
(5) the recognition — following the Supreme Court decision in June 1963 in the \textit{Philadelphia National Bank} case — of the national policy favoring competition in the field of money, credit, and financial services.\textsuperscript{33}

Third, the growth of time and savings deposits together with the successively higher interest rates banks could pay on such funds\textsuperscript{34} caused a sharp rise in operating expenses. For example, the interest costs to 25 large banks in 1967 was five times their 1960 costs.\textsuperscript{35} Because of these tremendous additional expenses, banks were forced to seek higher yielding loans and investments. This necessitated entry into new fields where money, credit and financial services could be employed at a higher profit.

\textsuperscript{33} \textit{Congress and the Congenerics}, BANK STOCK Q., Sept. 1968, at 7, col. 1 (footnote omitted).
\textsuperscript{34} The rate of interest a commercial bank is permitted to pay on deposits is controlled by the Federal Reserve Board's Regulation Q. It was first set up at 2\textsuperscript{1/2} percent. This 2\textsuperscript{1/2} percent figure remained in force from January, 1936 until January of 1957 when it was raised to 3 percent. On Jan. 1, 1962 it was raised to 4 percent. On Nov. 24, 1964 it went to 4\textsuperscript{3/4} percent. An increase of one percent raised it to 5\textsuperscript{1/2} percent on Dec. 6, 1965 and another three-quarter percent increase raised it to 6\textsuperscript{1/4} percent on Apr. 19, 1968. \textit{Id.} at 7 n.5.
\textsuperscript{35} Note 33 \textit{supra}. 
Fourth, the technological revolution which occurred in the United States in the 1960's has enabled the banks to vastly increase their markets. The use of the computer alone has given banks access to variegated data concerning potential customers which was never before available. Between the accessibility of the computer and the excellent telecommunications now available in the United States the service area of any large bank encompasses the entire country and not just its local area.

Because of the increased costs, technological advances and rigid antitrust laws, the banks were forced to undertake a variety of new services such as equipment leasing, factoring, mortgage banking, travel agencies, computer services, accounting, life insurance, mutual funds, auto dealerships, armored carrier and special courier operations, and stockbrokerage. There were also many other services which all banks would have desired to enter, but under the Bank Holding Company Act, they had to justify their non-banking activities as either "...of a financial, fiduciary or insurance nature..." and had to prove to the satisfaction of the Federal Reserve Board that these new services were "so closely related to the business of banking... as to be a proper incident thereto..." However, the banks were not satisfied with having to argue that a proposed new service was "closely related to banking" each time they formed a new division or subsidiary to provide an additional service. Even banks which did not choose to become bank holding companies are not permitted to conduct any activities which are not "incidental to the business of banking."37

Previously, banks attempted to expand into non-banking activities by broadly interpreting the "incidental powers" clause of the National Bank Act38 which authorizes general banking practices as well as any incidental powers necessary to carry on the business of banking.39

Due to the increasing costs and competition from non-banking sources,40 banks were hoping to expand their economic activities and began interpreting this incidental power clause liberally. Moreover,

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36 1956 Act § 4(c)(6).
38 For an excellent article dealing with the banks' efforts to expand on the "incidental powers" clause, see Edwards, The One-Bank-Holding Company Conglomerate: Analysis and Evaluation, 22 VAND. L. REV. 1275, 1278 et seq. (1969).
39 See note 36 supra.
40 During the 1960's, banks found themselves competing with many new entrants into the credit business. To purchase an expensive new consumer item such as an automobile, one no longer had to go to a bank for credit. The automobile manufacturers themselves set up subsidiaries to finance the consumer's new vehicle. This naturally cut into the banks' money lending abilities and decreased their profits.
the Comptroller of the Currency gave a beneficial boost to this movement by construing this clause to permit banks to enter into fields which had never before been seen as bank related. Thus, national banks became involved in equipment leasing, factoring, mortgage banking, travel agencies, computer services, accounting services, etc., all with the blessings of John Saxon, the Comptroller of the Currency.

While they may have had the blessing of Mr. Saxon, they certainly didn't have those of their new competitors. The competitors took the banks to court, attempting to prove that these new banking activities were not incidental to the business of banking and that Saxon, as the Comptroller of the Currency, had no authority to permit banks to enter into these new activities.

The first case concerning this struggle between the banks and their new competitors was *Baker, Watts & Co. v. Saxon.* There, plaintiff investment brokers sought declaratory relief invalidating the Comptroller's regulation allowing a bank to underwrite obligations of states and political subdivisions thereof on the ground that such obligations were not secured by the general power of taxation. Plaintiffs also sought to enjoin the Comptroller from authorizing this new service. The court held for the plaintiffs, reasoning that the applicable federal law, which prohibits banks from underwriting securities, should be strictly construed and that national banks should not be allowed to underwrite these obligations unless they are issued by a governmental entity endowed with the general taxing power. Unfortunately, the court never discussed the issue of whether this banking service, had it been allowed, would have been "incidental to the business of banking."

The next court test came in *Georgia Association of Independent Insurance Agents, Inc. v. Saxon,* where the plaintiffs, a group of independent insurance agents, sought to enjoin the Comptroller of the Currency from issuing an alleged illegal administrative ruling permitting banks to operate as insurance agents in towns in excess of 5,000 population. Drawing upon a statutory mandate, the court held that this was in direct violation of section 92 of title 12, United States Code, which permits banks to act as insurance agents only in towns of less than 5,000 population. Again the court did not decide whether this activity was "incidental to the power of banking."

In the case of *Dickinson v. First National Bank* the Comptroller

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of the State of Florida contended that the defendant bank's policy of placing deposit receptacles and using armored cars to accept deposits was prohibited under Florida's branch banking statutes. The Comptroller of the Currency of the United States argued as intervenor for the defendants that the banks' activities "did not constitute 'branching' as defined . . . in the National Banking Act" and "therefore, [were] not within the coverage" of the Florida statute. The district court rendered judgment for the plaintiff because it felt that the Florida statute was not operative in this instance. The Fifth Circuit overruled this decision, on the ground that permitting the continuance of this activity by national banks while state banks were prohibited from this same endeavor would be violative of the competitive equality theory as set forth in the McFadden Act. Once more the court never reached the question of whether these activities were "incidental to the business of banking."

Standing to sue became an important issue in these cases. The Comptroller of the Currency defended on the grounds that a competitor of a bank does not have standing to sue the Comptroller concerning his administrative rulings, in the landmark case of Association of Data Processing Service Organizations, Inc. v. Camp. The district court ruled in favor of the Comptroller and denied standing to the plaintiff and the Eighth Circuit affirmed on appeal. But, the Supreme Court reversed and granted the plaintiffs standing. While this decision was impressive because it redefined those who have standing in the federal courts, it still did not answer the nagging question of whether data processing services are "incidental to the business of banking."

Due to the regulations concerning mergers, increasing costs, vastly improved technology and restrictive court decisions, the banks, finally, turned to the one-bank holding company as a vehicle for expansion. While this business structure had been available as a method of operation since 1956, it was not until 1968, when the First National City Bank of New York made taking advantage of this loophole respectable, by doing so itself, that banks began rushing to form one-bank holding companies.

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49 406 F.2d 837 (8th Cir. 1969).
The Economic Effect of One-Bank Holding Companies

The Effect on Competition

Many one-bank holding companies operate as financial congenerics in that they attempt to control the area of finance. They also endeavor to provide as many customer services as possible in order to increase profits. The problem created through this congeneric set-up is that there is a strong possibility of coercive activities. These tactics may be of a direct or indirect nature. Held-banks are easily able to force "borrowers, particularly small businesses, to purchase non banking services and goods from other subsidiaries of the holding company in order to obtain banking services, and credit, thus further tightening control and forcing a greater concentration of economic power." The one-bank holding company may also control segments of the economy indirectly.

Let us, suppose that the held-bank has as a client business concern, a trucking company, and that one of the companies in the bank holding complex is a leasing company whose business is buying trucks and leasing them to users. The leasing company buys trucks in quantity and leases them to the client trucking company. The trucker's lease payments are, of course in effect, payments of interest and principal on an agreed amount with the leasing company covering the purchase price of the trucks it uses—a sort of disguised long-term debt. The leasing company can arrange that the trucking company operate with trucks of this or that or the other truck manufacturer. Having that power, the holding company or its subsidiary, the leasing company, can bargain with the truck manufacturer. It will naturally favor the truck manufacturer whose sale price offers the most profit to the leasing company. It can then indicate to its client trucking concern that it had best use the vehicles of that manufacturer. Absent competition, the truck manufacturer and the truck hauler alike can be controlled even though the bank holding company does not own a share of stock in either.

There is also the possibility of the one-bank holding company's subsidiaries receiving business that they ordinarily would not have received because the customer wants to be looked upon favorably when he goes to the held-bank for credit. With the one-bank holding company in existence before the 1970 amendments, there was no way of checking to see to what extent this was occurring and while there was nothing illegal about it, it was severely detrimental to competitors of

52 Hearings at 2 (Introductory remark by Congressman Patman).
53 Id. at 18-19 (Statement of Professor A.A. Berle).
the one-bank holding companies' subsidiaries. Another adverse effect on competition was the fact that since the large one-bank holding companies were congenerics, i.e., they controlled the financial resources of an entire segment of the country, competitors of the holding companies' subsidiaries were forced to obtain credit from the holding companies' bank.

The system also had a deleterious effect on what little competition the small banks in the area offered to the huge held-bank. For example, most one-bank holding companies had travel-agency subsidiaries. The financial implications and monopolistic potentialities in this service were tremendous. The subsidiary bank financed the customers' vacation and the travel agency arranged it. As the holding companies' main interest in this venture was to gain maximum profits from the loan its bank made, it could afford to run the travel agency at a small loss if this were deemed necessary to attract customers. The travel agency would, of course, only perform its services for a customer if he agreed to have his vacation financed through the bank. This procedure is referred to as a tie-in, i.e., one of the bank holding companies ties in its services with an agreement that the customer will go to the held-bank for a loan. This has adversely affected other banks in that the travel agency controls which bank the customer goes to for credit and it obviously also has had a ruinous effect on other travel agencies to the point that it has driven many out of business.

The American Society of Travel Agents, Inc. appeared before the House Committee on Banking and Currency concerning the proposed legislation to restrict the activities of one-bank holding companies and clearly demonstrated many of the unfair competitive practices used by holding-company owned travel agencies to lure away independent travel-agency customers and employees. Those mentioned were:

1. "The travel agents must use banks for their deposits, receipts and payments. Therefore, the bank has a readymade source of information concerning anything the agency customer does."

2. The bank is in a fiduciary capacity with the travel agency customer. Yet, it is also a competitor.

3. "The bank can afford to subsidize its travel activities for a considerable period of time in order to attract more depositors."

4. The bank can afford to hire away all of the independent agency's best employees and take advantage of their knowledge.

5. "Banks can exercise extensive influence on the business, 

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fn 54 Id. at 808, 810.
commercial and industrial organizations who are their customers for placing their travel business with the bank as a part of the general service the bank makes available to them."

(6) The independent agent actually has to borrow money from its competitor.\textsuperscript{55}

Generally these arguments can be made against all of the new services into which one-bank holding companies have entered. The basic criticism is that the held-bank can dangle credit over the heads of the customers of the other subsidiaries' competitors and easily convince them to do business with the subsidiary and not the competitor.

For instance, in \textit{Fortner Enterprises, Inc. v. U.S. Steel},\textsuperscript{56} plaintiff sought treble damages and injunctive relief for alleged violations of sections 1 and 2 of the Sherman Act, by defendant, U.S. Steel, and its subsidiary, U.S. Steel Homes Credit Corp. Plaintiff alleged that it had been forced "to purchase at artificially high prices prefabricated houses manufactured by U.S. Steel" as a condition for obtaining credit. The Supreme Court here held for the first time that credit is to be treated in essentially the same manner as other goods and services, for trying it to demands for other transactions was deemed violative of the antitrust laws. While this was a step in the proper direction, it did not effectively deter one-bank holding company congeners since it is difficult to prove allegedly forced agreements in the antitrust area. It must be remembered that potential witnesses will still need credit from the held-bank and therefore will be reluctant to commit economic suicide against their source of credit. Consequently, it has been the feeling of the economic experts\textsuperscript{57} that the antitrust laws, even if fully enforced, are inadequate to control the unchecked growth of the one-bank holding company and to prevent the emergence of an American \textit{Zaibatsu System}.

\textit{Problems in Managing the Congenerics}

Managing the huge congeners was extremely difficult. For instance, this growth mandated a larger staff of employees. With this rise in personnel came the need for additional skills and training. While the management of the bank was competent within its own field, it lacked expertise in running travel agencies, insurance agencies, armored car companies, etc. This led to the possibility of instability as the management attempted to master the evergrowing number of

\textsuperscript{55}Id. at 810-11.
\textsuperscript{56}394 U.S. 495 (1969).
\textsuperscript{57}Hearings at 9, 20 (Statements of Professors Berle and Schwartz respectively).
services it was providing. Furthermore, there was the danger that the management in its attempts to make all subsidiaries profitable, might make loans to a subsidiary which it would not have made if the subsidiary of the holding company were just another customer and not involved in the holding company complex. It is conceivable that one of these gargantuan congenerics could have so improvidently extended credit as to result in a total business failure. Failure of a bank this size would surely have wreaked economic chaos on a broad geographical segment of the United States.

The 1970 Amendments

Because of the fear that the economic structure of the country would be changed by the one-bank holding company and that it would lead to "... erosion of the traditional separation of powers between the suppliers of money—the banks—and the users of money—commerce and industry..." it was almost universally believed that the one-bank holding company exemption should be removed. There were many bills proposed in Congress, all of which contained varying methods of dealing with this problem. The bill introduced by Congressman Patman on February 17, 1969, H.R. 6778, was ultimately passed by both the House and Senate Committees in substantially the same form as introduced. Since tracing the legislative history of the rejected bills would be of little or no utility, this section will concentrate on an analysis of H.R. 6778 as amended and discuss its impact on the one-bank holding company.

H.R. 6778, as originally introduced, plugged the existing loophole by redefining the terms "bank holding company" and "control." It also accomplished six other objectives for tightening the 1956 Bank Holding Company Act:

(1) It removed the partnership exemption;
(2) It provided that the Federal Reserve Board could find actual control of a bank by a company even though that company controlled less than 25% of the stock of the bank;
(3) It retained the 1956 definition of what constituted a permissible bank-related activity for bank-holding companies to engage in;
(4) It contained no grandfather clause exemption;
(5) It contained an anti-tie-in provision applying to all in-

60 Ad. News 5563.
sured banks, whether or not it is part of a holding company system;

(6) It removed the exemption in the 1956 Act for bank stock held in trust by a bank.61

As previously noted the Act eliminated the one-bank holding company exemption by simply redefining the term "bank holding company." The 1956 Act covered all companies which owned or controlled 25 percent or more of the voting stock of two or more banks. H.R. 6778, as amended, alters the 1956 Act to cover "... any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this Chapter."62 The authors of the Bill also recognized that it was possible for one-bank holding companies to exercise control over banks without actual ownership. Accordingly, control was defined as (A) the ownership, control or power to vote 25 percent or more of the bank's voting shares; (B) controlling elections of the majority of the Board of Directors; or (C) a Board determination that a controlling influence is exercised over the management policies of the bank.63 The Act has created a presumption that under (C) above, a company is in control of a bank or company unless it, at the time in question, "directly or indirectly owns or controls, or has power to vote less than 5 % or more of any class of voting securities."64 Thus, under these two sections, the one-bank holding company exemption has been completely removed and the possibilities of indirect control over a bank are under much closer Federal Reserve Board scrutiny than ever before.

The most troublesome area concerning the passage of this bill through both the House and Senate was section 1843(c)(8), which deals with bank-related activities. As originally introduced, the bill would have retained the 1956 Act's definition of what constituted a permissible bank-related activity in which bank-holding companies may engage. This was "so closely related to the business of banking . . . as to be a proper incident thereto."65 The House passed H.R. 6778 with a rewritten section 1843(c)(8) test which permitted a bank holding company to engage in any non-banking activity that was "functionally related to banking" and could be reasonably expected to produce public benefits which would outweigh adverse anti-competitive effects. This measure also included six specific activities from which bank holding

61 Id.
63 Id. § 1841(a)(2)(A), (B), (C).
64 Id. § 1841(a)(3).
65 1956 Act § 4(c)(6).
companies were either barred or were permitted to participate in to a limited extent. These six became known as the "laundry list."

The Senate version of the bill retained the "functionally related to banking" language and the public benefits test but did not include any prohibited activities. Because this section dealt with the activities bank holding companies would be allowed to be engaged in, this distinction between the two bills became a crucial issue. The joint conference was able to resolve the issue only by inserting substitutional language in both versions of the bill. 66

It is perhaps important here to note that the Patman Bill, H.R. 6778 as enacted, 67 retained the provisions of the 1956 Act which gave the Federal Reserve Board the sole right to decide whether a particular activity was "closely related to banking." A possible explanation for Congressman Patman's reluctance to include the Department of the Treasury and the Comptroller of the Currency in this rule-making group is the liberal attitude taken by the Comptroller of the Currency in recent years in his administration of the National Bank Act. The Federal Reserve Board has traditionally been more conservative in its approach to banking and the Congressman must have believed that the Board would be more inclined to safeguard the intentions of the Congress in its passage of the Act. 68

The 1956 Act in section 4(c) used the following language to describe activities it did not forbid:

Shares of any company all the activities of which are of a financial, fiduciary or insurance nature and which the Board after due notice and hearing, and on the basis of the record made at such hearing, by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of the Act. 69

The language of section 1843(c)(8) under the 1970 amendments reads as follows:

Shares of any company the activities of which the Board after due notice and opportunity for hearing, has determined to be
(by order or regulation) so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. In orders and regulations under this subsection the Board may differentiate between activities commenced de novo and activities commenced by acquisition, in whole or in part, of a going concern.70

A comparison of the two sections reveals that there were some significant changes. The first is that the new section deletes the phrase "of a financial, fiduciary or insurance nature." The statement on the part of the Managers of the House indicates that the rationale behind the elimination of this phrase was to avoid redundancy, i.e., it was believed that the language, "so closely related to Banking . . . as to be a proper incident thereto . . . ," was sufficient to include activities of a financial, fiduciary and insurance nature. Another explanation for the deletion of this phrase is that it was omitted in order to make sure that large one-bank holding companies did not purchase huge insurance company affiliates. Had the insurance language not been omitted, the holding companies could have argued that the provisions of the 1970 Amendments specifically allowed them to hold insurance-company affiliates. The combination of a huge one-bank holding company held-bank and a large insurance company within the same holding company complex would be exactly the type of undue concentration of financial resources that the Amendments were necessary to prevent.71

Another major change in section 1843(c)(8) was the retention of

70 1970 Amendments § 1843(c)(8).
71 By early 1969, Congressman Patman, Chairman of the House Committee on Banking and Currency, initiated hearings concerning the unchecked growth of one-bank holding companies; at the time four of the largest banks in New York City were considering acquisition of major insurance companies by way of their holding companies. The negotiations were finally suspended pending outcome of the Bill. Congressman Patman commented on these proposed acquisitions as follows:

The half dozen largest banks in New York could acquire the six largest insurance corporations and through fractional reserves could have enough money to then buy up almost all the profitable manufacturing and industrial corporations in America.

Shapiro, The Profit Motive and the Public Interest: Wright Patman vs. The Bankers, RAMPARTS, Mar. 1971, at 18, 20, col. 1. This method of concentrating economic power would be the quickest method imaginable of establishing an American Zaibatsu System. Contra, AD. NEWS 5565.
the term "closely related" as it appeared in the 1956 Act. Both the House and the Senate had passed the Bill with the language "functionally related to banking" inserted instead of "closely related." The Federal Reserve Board had requested the "functionally related" language.72 Those who advocated the "functionally related" language believed it was more liberal than the "closely related" criteria. They opined that it would grant greater discretion to the Federal Reserve Board in its rulings on proposed new activities. Proponents of this phrase felt that it would allow bank holding companies to engage in new activities which would not have been permitted under the 1956 language. It was the general opinion of those desiring this change that the phrase "so closely related" was too restrictive and did not give the Federal Reserve Board sufficient discretion to keep pace with the development of new banking services. The joint conference, however, rejected the "functionally related" test and retained the "closely related" language. This must be construed to mean that Congress did not intend to liberalize the test as passed in 1956. The proposed acquisition, in order to be approved by the Federal Reserve Board, must bear a direct and significant connection between the business of banking, as it is now carried on, and the activities of the new acquisition.

The new section 1843(c)(8) is actually a harsher standard than the old one, because it now contains the "public benefits" test which was not in the 1956 Act. Under this test, the applicant must not only prove that the proposed activity is closely related to banking, but it also has the burden of proving that the activity to be performed by an affiliate can be reasonably expected to produce benefits to the public. These benefits must outweigh possible adverse effects, "such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."73 Possible public benefits would include "greater convenience, increased competition and gains

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72 Ad. News 5566 (Federal Reserve Board Chairman William McChesney Martin was the first to suggest and support the language).
73 1970 Amendments § 1843(c)(8). With regard to anti-competitive effects some of the factors the Federal Reserve Board would consider are:
(a) Intimidation of customers to cause them to refrain from buying a competitor's products;
(b) commercial espionage with the purpose of procuring confidential information that could be used unfairly in competing with a non-bank competitor. (This is particularly applicable to banking institutions since they deal to a very great extent with confidential information obtained from customers);
(c) inducing breach of contract;
(d) enticing away competitor's employees in order to cripple his business;
(e) price discrimination;
(f) selling a service below cost or offering a service for no cost in order to obtain a business for another subsidiary;
(g) harrassing practices such as intimidating customers and/or competitors. Ad. News 5569-70 [House Managers Statement].
in efficiency." The Board must consider whether the proposed new activity will come about through acquisition or de novo entry into a field. De novo entry should be encouraged as it increases competition. On the other hand, the acquisition of going concerns should be weighed heavily against public benefits. Acquisition reduces competition—acquisition of a going concern in a field where the holding company is already involved should not be allowed, but if it is, it should serve as an extremely important negative factor in the Federal Reserve Board's determination. It is entirely possible that a proposed new activity will pass the "closely related to banking" test and fail the "public benefits" test. In this event, section 1843(c)(8) mandates that the Federal Reserve Board deny the application.

Section 4(a)(2) is the divestiture section and it has been substantially amended by section 1843(a)(2). The main thrust of this section is that a bank holding company may not retain ownership or control of any company which is not a bank. The 1956 Act read:

engage in any business other than that of banking or managing or controlling banks or of furnishing services to or performing services for any bank of which it owns or controls 25% or more of the voting shares.

The 1970 Amendments change this to:

engage in any activities other than (A) those of banking or of managing or controlling banks and other subsidiaries authorized under this Chapter or of furnishing services to or performing services for its subsidiaries, and (B) those permitted under paragraph (8) of subsection (c).

The major change brought about by the amendment with regard to this section is that now the holding company is permitted to provide services for any subsidiary and not just its bank subsidiary. While it is possible that this providing of services to all subsidiaries could lead to abuse, the Federal Reserve Board will probably enforce this section in such a way as to comply with the intention of Congress in its passage of the Act.

The effect of the divestiture requirement established in section

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74 1970 Amendments § 1843(c)(8).
75 Ad. News 5573.
76 1956 Act § 4(a)(2).
77 1970 Amendments § 1843(a)(2).
1843(a)(2) depends upon the particular class to which the holding company belongs. The Act divides holding companies into four classes:

1) Companies which were bank holding companies under the 1956 Act.
2) Bank holding companies formed after the effective date of the 1970 Amendments.
3) Existing bank holding companies which were formed after June 30, 1968.
4) Existing holding companies which were formed prior to July 1, 1968.

Bank holding companies falling into classes (1) and (2) must divest themselves within two years of all subsidiaries which do not meet the requirements of the Act. The Federal Reserve Board may grant yearly extensions of this divestiture requirement, but in no event may a holding company be granted more than three such extensions.

Holding companies falling into classes (3) and (4) have until December 31, 1980, to dispose of subsidiaries which are required to be divested. The difference between class (3) and class (4) is that if the holding company falls into class (3), it may legally continue its unauthorized operations until December 31, 1980. On the other hand, class (4) holding companies have been given a potential extension of the December 31, 1980 divestiture requirement with regard to activities that the holding company's subsidiaries were legally engaged in since June 30, 1968. These subsidiaries need not be divested unless the Board provides an opportunity for a hearing, and at that time, determines that the continuation of these non-banking activities would be in violation of the Act. If the Board does make such a decision, the holding company is required to divest itself of this subsidiary within ten years of the date of such decision. In the case of holding companies with assets of over $60 million, the Federal Reserve Board must make this determination within two years of the effective date of the Act.

The Senate version of H.R. 6778 would have exempted all one-bank holding companies, which became such prior to July 1, 1968, from the coverage of the 1970 Amendments. The House Bill would have exempted all which were formed prior to May 9, 1956, had banking assets of less than 30 million and possessed non-banking

70 1970 Amendments § 1843(a)(2).
80 Id.
81 Id.
assets of less than 10 million. These proposed exemptions became known as the "grandfather clauses." It is significant to note that under the Senate version, 82 percent of the bank holding companies would have escaped the coverage of the 1970 Amendments. The joint conference rejected these "grandfather clauses" and substituted a new provision. This brings all bank holding companies under the coverage of the Act. It does not matter when they were formed or what their size is. Under the new provision, a company which became covered by the Bank Holding Company Act of 1956, due to the 1970 Amendments, is permitted to engage in all activities which were permitted on June 30, 1968 (or on a later date, if as of June 30, 1968, the company had a written contract to purchase another involved in some different activity). To be eligible for this exemption, the holding company must have been continuously active in this field since June 30, 1968 or a later date if it were under control as of June 30, 1968. Fortunately, the right to remain in these activities is not an absolute one, as it was in the version adopted by the Senate. The Act requires the Federal Reserve Board to determine, within two years, whether each affected holding company should be allowed to continue to enjoy the benefits of the exemption. This only applies to companies which have assets in excess of 60 million dollars. The Board must withdraw the benefits unless the holding company proves that there would not be an "undue concentration of resources, decreased or unfair competition, conflict of interest or unsound banking practices" if the exemption were to remain in force. The reason for the "assets over 60 million" figure is that the exemption was primarily intended to protect the traditional small town bank holding company, which the conferees believed provided special services to small communities and was not a major factor in the American economy. However, the House Managers were careful to point out that this 60 million figure is not a cut-off point and that the Board is free to remove the exemption from those holding companies with assets of less than 60 million if it deems the removal to be for the public benefit. The main reason Congress passed the Act with this 60 million figure was to establish a set of priorities for the Board. As holding companies with assets in excess of 60 million are potentially more dangerous to the economy, it was

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83 1970 Amendments § 1843(a)(2).
84 Id.
85 Id.
86 Id.
87 AD. News 5578.
determined that the Board should look into their exemptions first.88
The Board may take away the exemption despite an initial decision to allow it to remain. The Board is free to order termination of all nonbanking activities, some nonbanking activities or specified areas of one nonbanking activity.89

The conferees also agreed to exempt the following types of holding companies from the Act:
1) Labor unions and agricultural and horticultural organizations were exempted from section 4.
2) A company 85 percent or more of whose stock was owned by the same family as of June 30, 1968 and continuously thereafter, was exempted from section 4.
3) Any federally insured trust company or mutual savings banks which own one bank, if it owned it on the date of enactment and such ownership is authorized by state law.
4) A bank which is chartered as a bank but does not make commercial loans.
5) The Federal Reserve Board may approve one exemption for any company controlling a bank operated for the purpose of facilitating transactions in foreign commerce if the Board determines that such control would not be at substantial variance with the purposes of the Act and would be in the public interest.
6) Exemption from section 4 of the Act for (a) any company the greater part of whose business is conducted outside the United States and (b) any company doing no business in the United States. In both (a) and (b) the Federal Reserve Board must find that the exemption would not be substantially at variance with the Act and would be in the public interest.
7) Any bank controlled through a company wholly owned by thrift institutions; if the bank restricts itself to the acceptance of deposits from thrift institutions, deposits in connection with the corporate business of its owners, and deposits of public monies.90

However, all of the above exemptions may be removed by the Federal Reserve Board if it decides that they are not in the public interest.

The final type of exemption which the Federal Reserve Board has been authorized to grant applies to one-bank holding companies which were formed prior to July 1, 1968. This exemption would not be at

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88 Id. 5577-78.
89 Id. 5579.
90 Id. 5573-74.
variance with the purposes of the Act and is justifiable on one of the following conditions:

1) Where the forced sale of either the held-bank or a subsidiary would disrupt “business relationships that have existed over a long period of years without adversely affecting the banks or the communities they serve.”

2) Where there is a “possibility that if the holding company were forced to sell the bank it could not find a local buyer.”

3) Where it is quite evident that because of the small size of the held-bank it “could not be used in any meaningful way to advance the interests of other affiliated companies.”

All of these exemptions are justifiable and the Board has the power to take them away if the holding company begins to abuse the privilege.

The Act contains an anti-tie-in section which prohibits the held-bank from providing any credit, property or service to a customer on condition that he obtain from the bank some additional credit, property or service other than “loan, discount, deposit, or trust service” or that he provide to the bank some additional credit, property or service. It also prohibits any held-bank from supplying a customer with credit, property or service on the condition that he must obtain from, or provide to, the holding company or any other subsidiary thereof some additional credit, property, or service. Moreover, it forbids any forced agreement that the customer of the held-bank not obtain other credit, property, or service from a competitor of the bank, the holding company or a subsidiary. Still, the bank may make a reasonable requirement along these lines to ensure soundness of credit. Exempted from these sections are tie-in agreements involving traditional bank services, i.e., loans, deposits, discounts, and trust services. A held-bank is free to tie-in these four traditional activities but if it ties any of them to another service offered by either the bank, the holding company or a subsidiary, the exemption does not apply.

Finally, the Act gives standing to any present or potential competitor to join as a party in interest before the Board and in the courts where the Board has rendered a decision against the competitor. The Act speaks of three instances wherein the competitor or potential com-

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91 Id. 5574-75.
92 1970 Amendments § 1972(1), (3).
93 Id. § 1972(2), (4).
94 Id. § 1972(5).
95 Id. § 1972(4).
96 Ad. News 5579.
petitionor has standing. These are (1) where an applicant seeks authority to acquire a subsidiary which is a bank under section 1842 of this title; (2) where an applicant seeks authority to engage in a nonbanking activity under section 1843; and (3) where the holding company is seeking to engage in a business practice which is prohibited by the tie-in provision. The House Managers were careful to stress that these three instances should not be construed as the only times competitors and potential competitors have standing with regard to the 1970 Amendments. The Managers believed that the "broadest possible forum" should be available for adversary proceedings to take place in order that all issues be aired completely.

**Recent Developments**

On Monday, December 21, 1970, the Act as passed by Congress, was sent to President Nixon for approval. The President signed the bill into law on December 31, 1970, the last day of the 1970 legislative session. Reactions by bankers and competitors of bank holding companies were predictably diverse. The bankers have intimated a belief that the new amendments give the Federal Reserve Board more flexibility in allowing the holding companies to expand their investments while the competitors are convinced the amendments have not so liberalized the Act. It has been predicted that this dispute will ultimately be tested in the courts. It does appear, however, that at least one member of the Federal Reserve Board firmly believes that the amendments are to be implemented by the Board in such a way as to ensure that there is a clearcut distinction between banking and commerce.

On January 25, 1971, the Federal Reserve Board proposed a list of ten activities to be regarded under the new law as closely related to banking or managing or controlling banks, and thus regarded as permissible areas for bank holding companies' participation. These proposed activities included:

a. [a]ny bank holding company may apply to the Board by filing an application with its Federal Reserve Bank, for permission to retain or acquire an interest in a company that engages solely in one or more of the following activities:

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97 Id. For tie-in provisions, see generally id. §§ 1971-78.
98 AD. NEWS 5580-81.
99 Nixon Signs Holding Company Measure, Closing Loophole to One-Bank Institutions, AMERICAN BANKER (Jan. 4, 1971).
100 Id.
101 See note 78 supra.
1. Making, for its own account or for the account of others, loans such as would be made, for example, by a mortgage, finance, or factoring company;
2. Operating as an industrial bank;
3. Servicing loans;
4. Acting as fiduciary;
5. Acting as investment or financial adviser, including for a mortgage investment trust or a real estate investment trust;
6. Leasing personal property, where the initial lease provides for payment of rentals that will reimburse the lessor for the full purchase price of the property;
7. Acting as insurance agent or broker principally in connection with extensions of credit by the holding company or any of its subsidiaries;
8. Acting as insurer for the holding company and its subsidiaries or with respect to insurance sold by the holding company or any of its subsidiaries as agent or broker;
9. Providing bookkeeping or data processing services for (i) the holding company and its subsidiaries, (ii) other financial institutions, or (iii) others, Provided That the value of services performed by the company for such persons is not a principal portion of the total value of all such services performed; or
10. Making equity investments in community rehabilitation and development corporations engaged in providing better housing and employment opportunities for low-income and moderate income populations.\(^\text{103}\)

As previously mentioned, the Board received its authority to propose these regulations under amended section 1843(c)(8) in conjunction with section 1844(b) of the Act.

All interested parties were given an opportunity to comment\(^\text{104}\) on these regulations.\(^\text{105}\) In view of the tremendous volume of comments received and requests for hearings, the Federal Reserve Board on March 22, 1971,\(^\text{106}\) scheduled three separate sessions in April and May to discuss its regulatory proposals.

The proposed regulations of January 26th also included a spelling out of the procedures the Board would use in implementing amended section 1843(c)(12) of the Act, which deals with divestitures and acquisitions before January 1, 1981. The regulations would have allowed a holding company which had filed an irrevocable declaration of its intent to cease to be a bank holding company by January 1, 1981, to

\(^{103}\) Id. (emphasis added).
\(^{104}\) Id. at 1431.
\(^{105}\) Id.
enter into new activities without further action by the Board unless the Board suspended the authority to do so. The procedure established was simple. The company need only notify the Board of its proposed acquisition within 45 days of the actual transaction. If the Board did not reject the proposed acquisition within this time, it was deemed to have approved it. The purpose of this regulation was to allow large conglomerates holding only one bank to continue in their nonfinancial activities, with the understanding that they would divest themselves of the bank. This ensures an orderly transition and does not force the seventy or so conglomerates, such as J.C. Penney Co., Sperry and Hutchinson, and Kinney National Services, Inc., to immediately sell their banks at substantial losses. The Board stated that if no such declaration is filed, no acquisitions could be made or activity commenced under section 1843(c)(12) without prior Board approval. This consent would only be granted where the company demonstrates that the activities sought are necessary to enable the more efficient marketing of assets subject to divestiture.

In the January 26, 1971 proposed regulations, the Federal Reserve Board also announced that a holding company would be allowed to enter into the above listed activities de novo if it notified the Federal Reserve Board of its intention to do so and the Board does not reject such a plan. On the other hand, where the holding company proposes to engage in one of the ten activities through acquisition of a going concern, the board has established more stringent procedures. The application to the Board for such an acquisition must be published in the Federal Register, and a competitor is to be given the opportunity for a hearing wherein the applicant would be required to prove to the satisfaction of the Board that the activities of the proposed application would not create an undue concentration of economic resources or decrease competition and that they would be beneficial to the public. Thus, de novo entry into these fields would be given almost automatic approval while entry through acquisition would be put to a severe test.

The Board also proposed regulations to implement section 1843(c)(5) of the Act. It decided to limit lending and fiduciary activities under 1843(c)(5) to those commenced de novo unless the shares involved are of the kinds and amounts explicitly eligible for invest-

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108 Note 106 supra.
ment by a national bank under federal law. This proposed regulation would not affect the scope of activities permitted to a banking subsidiary but could affect acquisitions of a nonbanking company by the bank, since an acquisition by the held-bank would actually be an indirect acquisition by the holding company. In this manner, the holding companies could not acquire nonbanking firms indirectly.

At one of the three hearings which was scheduled for April 16, 1971, concerning data processing and bookkeeping services, interested parties were invited to submit their comments on the following questions:

1. What, if any, limitations should apply to a holding company performing (itself or through a nonbank subsidiary) payroll, accounts receivable and billing services?
2. To what extent, if any, and by what measure should the holding company be limited in the other data processing services that it may perform for persons other than itself, its subsidiaries, and other financial institutions?

The arguments presented at the hearings were predictable. The banks wanted all ten proposed activities to be approved and to be significantly expanded. The competitors desired that some of the proposed activities be either deleted or severely restricted.

One supposedly minor change desired by the banks was the deletion of the word “solely” from subparagraph (a) of the proposed regulations. By deleting this one word, the entire meaning of the regulations would be changed and the purposes of the act would be frustrated. Without limiting the proposed regulations to “solely” the specified ten activities, the regulations would, in effect, be providing that a holding company could acquire or create de novo any corporation in any field as long as it was also active in one of the ten enumerated activities.

The banks also wished to significantly expand upon the ten activities. For example, the first activity proposed in paragraph a(1) would allow the holding company to participate in “making for its own account or for the account of others, loans such as would be made, for example, by a mortgage, finance, or factoring company.”

The banks submitted comments suggesting that this paragraph would

111 Note 106 supra.
allow all sorts of activities which were probably not envisioned by the Federal Reserve Board.\textsuperscript{114}

\textsuperscript{114} On Feb. 26, 1971, the Wachovia Corporation submitted its comments to the Board of Governors concerning the proposed regulations which the Board had issued. With regard to the proposed regulation which would allow one-bank holding companies to “make for its own account or for the account of others, loans such as would be made, for example, by a mortgage, finance or factoring company,” the Wachovia Corporation suggested that this proposal should be interpreted broadly enough to include:

A. Mortgage Company

1. Guidelines of permissible activities
   a. Originate or purchase for own account or for others, in whole or through participations, the following types of real estate loans:
      (1) Permanent loans
      (2) Land and land development loans
      (3) Construction loans
      (4) Interim loans
      (5) Loans secured by junior liens or mortgages on real property
      (6) Other loans either unsecured or secured by collateral other than liens on real property
   b. Take or otherwise acquire an equity position, either individually or as a partner in a joint venture, in any type of real estate project.
   c. Service loans (as indicated in Subparagraph (a)(5)) for own account or for others.
   d. Act as insurance agent, broker or underwriter in connection with mortgage banking activities for all types of coverage including casualty, title and credit risk insurance.
   e. Act as manager or advisor to a mortgage investment trust, a real estate investment trust, or to a closed end real estate or mortgage investment fund as indicated in Subparagraph (a)(5).
   f. Warehouse loans
   g. Provide the following services generally associated with mortgage banking services:
      (1) Buy and sell real estate for own account or others
      (2) Act as manager for all types of real estate
      (3) Act as leasing agent, consultant and provide other real estate advisory services
      (4) Act as builder-developer for own account or for others
      (5) Act as syndicator for real estate including both development and sales
      (6) Provide consulting services
   h. Conduct such other activities that may now or hereafter be or become an accepted activity for the mortgage banking industry so as to competitively provide a complete mortgage banking service.

2. To compete effectively in its industry, a mortgage company associated with a bank holding company must be able to provide financing and financial services on the same basis as any other mortgage banking firm or related company, including Commercial Banks, Savings and Loan Associations, Insurance Companies, and other integrated real estate financing and development companies. Greater convenience to the public and more efficient operations can only be achieved by vigorous competition with such non-regulated companies.

3. The proposed publication of notice and 45-day minimum waiting period applied to the mere move of an office location within the same geographic area, the de novo expansion into a new geographic area, or the acquisition of an established business would unduly restrict a mortgage banking subsidiary’s ability to compete with non-regulated companies and should not be required except for economically significant merger activity.

B. Finance and Factoring Companies

1. Guidelines of permissible activities
   a. Sales Finance Operations, consisting of:
      (1) Discounting installment notes receivable issued to dealers by purchasers and secured by title-retaining instruments on automobiles
The banks went through all ten of the proposed activities in a similar manner, expanding on them to include almost every conceivable activity which could fit under the enumerated category. The justification consistently given was that the affiliate of a bank holding company must be allowed to operate on a basis substantially identical to its direct competitors in order for the public to obtain maximum benefits from such a company. It would seem that the banks overlooked the fact that before the 1970 Amendments, the held-affiliates were allowed to operate on such a basis and as a result, unfair competitive advantage was available to the held-affiliates through the financial resources of the held-bank.

The competitors of bank holding companies obviously wanted all ten activities, if deemed permissible, to be as limited as possible. Data processing companies and insurance agencies were against holding company entry into these two fields no matter how limited.

The main points of contention brought up by the competitors were: (1) de novo entry has nothing to do with whether an activity is permissible and, therefore, should not be looked upon so favorably by the Board; and (2) the banks' proposal to delete the term "solely" from (A)(1) should not be permitted, as Congress intended to forbid all unauthorized activities, no matter how minor.115

With regard to the de novo entry concept, the competitors saw it as an artificial distinction. They pointed out that it plays an extremely limited role in the antitrust field and should be given no more con-

Entry whether de novo or through acquisition should be denied if the activity is not permissible. The competitors' complaint was that the Board's proposed rules did not set down any hearing requirement wherein competitors could attempt to prove that the activity was not "closely related to banking." De novo entry can lead to tie-ins, tying effects, subsidized pricing practices and other forms of unfair competitive practices just as easily as can entry by acquisition.

The competitors were also strongly against deleting the word "solely" from paragraph (A) of the proposed regulations. This, they concluded, would frustrate the intention of Congress by allowing banks to participate in activities not "closely related to banking" as long as the subsidiary engaged in such was also participating in one of the ten proposed activities.

As a result of the hearings held on these activities (not including data processing and insurance), the Federal Reserve Board, on May 20, 1971, announced that the following amendments to section 224(a), (b) and (c) of Regulation Y would go into effect on June 13, 1971:

This is part of Permissible activities:

- Any bank holding company may engage, or retain or acquire an interest in a company that engages, solely in one or more of the activities specified below . . . :
  1. Making or acquiring, for its own account or for the account of others, loans and other extensions of credit (including issuing letters of credit and accepting drafts), such as would be made, for example, by a mortgage, finance, credit card, or factoring company.
  2. Operating as an industrial bank, Morris Plan bank or industrial loan company, in the manner authorized by State law so long as the institution does not both accept demand deposits and make commercial loans.
  3. Servicing loans and other extensions of credit for any person.
  4. Performing and carrying on any one or more of the functions or activities that may be performed or carried on by a trust company (including activities of a fiduciary, agency, or custodial nature) in the manner authorized by state law so long as the institution does not both accept demand deposits and make commercial loans.
  5. Acting as investment or financial adviser, including (i) serving as the advisory company for a mortgage or a real estate investment trust and (ii) furnishing economic or financial information.

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110 Id. at 4.
117 Id. at 5-6.
118 Id. at 4.
119 Id. at 13-14.
6. Leasing personal property and equipment, or acting as agent, broker, or adviser in leasing such property, where at the inception of the initial lease the expectation is that the effect of the transaction and reasonably anticipated future transactions with the same lessee as to the same property will be to compensate the lessor for not less than the lessor's full investment in the property.

7. Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas.¹²⁰

Comparison of those regulations proposed to those finally passed indicates that the holding companies were successful, to a limited extent, in expanding the scope of permissible activities.

The regulation dealing with de novo entry was significantly changed in that competitors are now given an opportunity to have a hearing regarding de novo entry as well as for the question of entry through acquisition. The new procedure set up for this is that the holding company must publish notification of the proposed activity in a newspaper of general circulation in the area to be served. A competitor may then submit adverse comments to its Federal Reserve Bank, which will take the comments into consideration. If the bank holds against the competitor, he has a right of direct appeal to the Federal Reserve Board.

On August 24, 1971, the Board changed the requirement of publication of notice concerning the bank holding companies' entrance into the activity of insurance agencies. Now, the only time the holding company need publish notice is when it must demonstrate that there are inadequate insurance agency facilities in the community in which it wishes to sell insurance. This modification went into effect on September 1, 1971.¹²¹ It is probable that the insurance agency competitors of the holding companies will challenge the authority of the Federal Reserve Board to promulgate such a regulation.

On May 14, 1971, the Board announced a regulatory amendment specifying the kinds of activities subsidiaries of bank holding companies could engage in on the basis of section 1843(c)(5) of the 1970 Amendments.¹²² This became effective July 1, 1971. Section 1843(c)(5) covers the acquisition by a holding company of shares eligible for investment by a national bank. The amendment allows bank holding

companies to acquire shares that are explicitly eligible for investment by a national bank under federal statutes. It does not so restrict held-banks; the national held-banks may acquire shares in accordance with the rules of the Comptroller of the Currency. This amendment is viewed unfavorably by the competitors of one-bank holding companies, for it marks a significant change from the Board’s proposed regulations of January 26, 1971. The Board, on January 26, 1971, had issued a proposed regulation which would have restricted section 1843(c)(5) acquisitions to those expressly allowed national banks under federal statutes. The new regulation permits national held-banks to escape this prohibition and to be restricted instead by the Comptroller of the Currency, who is generally regarded to be more liberal in this area.

On June 10, 1971, the Board of Governors issued an order pertaining to data processing activities of one-bank holding companies. Under the proposed regulation, one-bank holding companies were permitted to engage directly or through a subsidiary in “providing bookkeeping or data processing services for (i) the holding company and its subsidiaries, (ii) other financial institutions, or (iii) others: Provided, That the value of services performed by the company for such persons is not a principal portion of the total value of all such services performed.” As a result of the hearings and the written comments the Board received, it decided to use a qualitative description of services to be performed rather than a quantitative one. Thus, the regulation allows one-bank holding companies to “(i) provide bookkeeping or data processing services for the internal operations of the holding company and its subsidiaries, and (ii) storing and processing other banking, financial, or related economic data, such as performing payroll, accounts receivable or payable, or billing services.” The Board did require that all record-keeping and data processing services be financially oriented. This should serve to limit one-bank holding companies to the financial area and protect the independent data processing centers, as they otherwise would have been stripped of any competitive position had the Federal Reserve Board given the congenerics carte blanche in this area. One problem could arise from the last statement of the Board’s interpretation of proper data processing activities. It allows one-bank holding companies to furnish data processing ser-

126 Id.
127 Id. at 11806.
vices upon request to customers if the service is not otherwise available in the relevant market. Still, it remains to be seen how far the Board will allow the one-bank holding companies to go under this particular section.

On August 5, 1971, the Board of Governors released its rulings on the subject of permissible insurance activities for one-bank holding companies. A hearing had been held on May 12, 1971 to decide whether to implement the Board’s proposed regulation with regard to insurance activities. The proposed regulation read “acting as insurance agent or broker principally in connection with extensions of credit by the holding company and its subsidiaries...” The one-bank holding companies were able to significantly expand this permissible activity. Not only were they granted the right to act as insurance agent with respect to insurance directly related to an extension of credit by a bank or bank-related firm, but they were also permitted to act as insurance agent for any insurance that is otherwise sold as a matter of convenience to the purchaser. The only limitation on this is that the aggregate premium income from these sales cannot constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold. In all likelihood, the Federal Reserve Board will have to set up a certain percentage cut-off point in deciding what is a significant portion of the aggregate insurance premium income. Once the one-bank holding companies know what this percentage figure will be, it would seem, if their conduct should continue, that they will begin an aggressive campaign to sell their financially-related insurance. In this matter, they can sell more non-financial insurance and cause an ever increasing harm to independent insurance agents. The one-bank holding companies also have been given the right to act as insurance agents for any insurance which would be sold in communities with a population of under 5,000 or in communities where the holding company can prove inadequate insurance agency facilities exist. It will be interesting to see how the Federal Reserve Board decides cases where the holding company attempts to prove that the involved community has inadequate insurance agency facilities.

On September 7, 1971 the Board of Governors proposed to permit bank holding companies to perform property management services. This would include farm management, managing office buildings and other industrial properties, managing residences, be they single-family

130 Id.
131 Id.
dwellings or high-rise apartment buildings, plus the management of air rights and oil and mineral rights.\textsuperscript{132} However, it would not include the buying and selling of property or the development of real estate.\textsuperscript{133} All interested parties were invited to comment on this proposed amendment to Regulation Y by October 8, 1971. It is noteworthy that each and every time the Board proposes one of these new activities, it seems to have already deemed that particular field of endeavor as “closely related to banking” and is having hearings solely to decide the “public benefits” issue. One is curious as to the Board’s reasoning behind this particular proposal—managing of oil wells is “so closely related to banking” as to be a proper incident thereto.

\section*{Conclusion}

Whether the 1970 Bank Holding Company Amendments will be completely successful in preventing the Zaibatsu System from arising in the United States remains to be seen. The bank holding companies are pressuring the Federal Reserve Board to consider many activities, aside from those already named, as “closely related to banking.”\textsuperscript{134} It would appear that if the Board were to sanction these activities, the holding companies would be nearly as free to enter non-banking vicinages as they were prior to the 1970 legislation. The success or failure of these recent amendments depends upon the interpretation given them by the Federal Reserve Board. Competitors of bank holding companies have already expressed the fear that the

\begin{itemize}
\item \textsuperscript{133} Id.
\item \textsuperscript{134} Letter from Donald L. Rogers, Executive Director of the Association of Registered Bank Holding Companies to the Secretary of the Board of Governors of the Federal Reserve System, April 1, 1971. In this letter, Mr. Rogers proposed thirteen additional activities for the Board’s consideration. Thus, the Association of Registered Bank Holding Companies has taken the position that the following activities are “so closely related to banking . . . as to be a proper incident thereto.”
\begin{enumerate}
\item Providing investment management services on either a commingled or non-commingled basis for agency accounts;
\item Operating as an issuer of travelers checks, or travelers insurance, or as a travel agent;
\item Operating as a savings and loan association;
\item Providing armored cars and messenger services;
\item Operating as a credit bureau or providing other credit reporting services;
\item Providing property management services;
\item Acting as a custom house broker and freight forwarder;
\item Providing industrial and urban development services;
\item Providing business and farm management consulting services;
\item Operating as an agency for financial advertising or financial public relations;
\item Operating as an agency for the training or employment of financial personnel;
\item Providing tax return preparation services;
\item Providing economic or financial consulting services.
\end{enumerate}
\end{itemize}
Board is rubber-stamping approval of every holding company application.\textsuperscript{135} Should this apprehension be realized, the 1970 Amendments will merely serve to postpone but not to preclude the American Zaibatsu System.

\textsuperscript{135} Missouri Bankers Open Drive, J. Comm., Sept. 8, 1971, at 3, col. 6.