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National Bank Operating Subsidiaries: How Far Has the OCC Opened the Door to Nonbanking Activities?

I. INTRODUCTION

In the early part of 1997, NationsBank, N.A., one of the largest banks in the United States, fired a resounding shot throughout the banking world when it applied to establish an operating subsidiary to develop residential condominiums on land where the bank operated a local branch.¹ The bank fired a second shot on that same day by applying to use a subsidiary to engage in certain real estate lease financing transactions.² The proposal to engage in real estate activities roused the banking community, with Federal Reserve Chairman Alan Greenspan warning that approval of the applications "would take national banks down a road that Congress has historically barred."³ Soon thereafter, Zions First National Bank applied for permission for its subsidiary to underwrite, deal in, and invest in municipal revenue bonds, an activity equally controversial

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³ Fed Strongly Opposes NationsBank Real Estate Development Proposal, BANKING POL’Y REP., June 2, 1997, at 5, available in WESTLAW, Bnkpr Library (reporting Greenspan’s observation that similar real estate investments led to the S&L debacle of the 1980s). The applications also galvanized members of Congress, including Senate Banking Committee Chairman Alfonse D’Amato (R-NY), who criticized the NationsBank applications. See, e.g., Pamela Atkins, D’Amato Pledges to Push Roukema Bills, Plans New Financial Services Reform Bill, 68 Banking Rep. (BNA) 833 (May 5, 1997); Pamela Atkins, Treasury Searching for Winning Approach on Thorny Financial Services Reform Issue, 68 Banking Rep. (BNA) 784 (Apr. 28, 1997) (suggesting NationsBank application may lead House Republicans to urge Congress to prevent regulators from upstaging Congressional turf). Real estate professionals also feared that approval of the application could “lead to banks having too much involvement in non-traditional banking activities, such as real estate development, investment, and brokerage.” NAR Has Doubts on NationsBank Application, 68 Banking Rep. (BNA) 706 (Apr. 14, 1997).
because of the traditional prohibition against commercial banks engaging in investment banking.4

These applications were made possible when new regulations5 issued by the Office of the Comptroller of the Currency (OCC), the regulator of national banks, became effective December 31, 1996,6 almost two years after their original introduction in November of 1994.7 The controversial8 new section 5.34 allows

4. Like the NationsBank applications, the Zions application also caused some alarm in Congress. See, e.g., Roukema Objects to Bank's Request to Underwrite Municipal Revenue Bonds, 68 Banking Rep. (BNA) 734 (Apr. 21, 1997) (reporting Representative Marge Roukema's (R-NJ) objection to Zions' application and her suggestion that Congress move quickly on financial services modernization); Fed Opposes Zions Op-Sub Proposals on Revenue Bonds, BANKING POL'Y REP., June 16, 1997, at 2, available in WESTLAW, Bnkr Library (explaining the Federal Reserve's opposition to the use of operating subsidiaries as a means of expanding bank activities); Lawmakers Squirm as OCC Considers Zions' Op-Sub Plan, BANKING POL'Y REP., May 5, 1997, at 4, available in WESTLAW, Bnkr Library (reporting Representative Marge Roukema's (R-NJ) introduction of a bill prohibiting banks from underwriting municipal revenue bonds through operating subsidiaries). The Office of the Comptroller has approved the application of Zions National Bank, but has yet to act on the NationsBank applications. See infra notes 127-41, 274 and accompanying text.

5. See 12 C.F.R. §§ 5.1-5.70 (1997). The rules under Part 5 govern corporate application and notice procedures for activities such as organizing a bank, establishing branches, and engaging in business combinations. This Comment will focus on the changes specifically made to section 5.34. For further discussion regarding the new part 5 regulations, see James R. Smoot, Bank Operating Subsidiaries: Free at Last or More of Same?, 46 DEPAUt L. REV. 651 (1997).

6. The new rules were announced on November 20, 1996 by OCC Chairman Eugene A. Ludwig. See Olaf de Senerpont Domis, Green Light for Banks to Sidestep Holding Cos., AM. BANKER, Nov. 21, 1996, at 1. Ludwig explained that the rules had been on hold for two years while Congress debated financial modernization, and that the OCC had waited long enough, especially considering that the debate on financial modernization might continue for "a very long time indeed." Id. at 2.

7. See Rules, Policies, and Procedures for Corporate Activities; Proposed Rule, 59 Fed. Reg. 61,034 (1994). Comptroller Ludwig announced on October 5, 1996 that the OCC was ready to "dust off" plans to expand the banking industry's sphere of influence. See Pamela Atkins, OCC Ready to 'Dust Off' Regulations Expanding Powers of National Banks, 67 Banking Rep. (BNA) 620 (Oct. 14, 1996). Ludwig explained to the American Bankers Association (ABA) that "we should assume that the 'business of banking' is sufficiently broad and flexible that a bank can engage in any financial activity or activity incident to financial services that benefits its customers." Id.

8. The regulations were denounced by members of Congress, Federal Reserve Chairman Alan Greenspan, and various trade groups. See generally Niles S. Campbell, OCC Rule Expands Bank Business Lines; Operating Subsidiary Section Draws Fire, 67 Banking Rep. (BNA) 873 (Nov. 25, 1996). Senate Banking Committee Chairman Alfonse D'Amato said the issuance of the new regulations was a bad move which "may subject federally insured banks to excessive risks and exposes bank insurance funds . . . to unnecessary liability" as well as "detract[ing] from the emerging consensus in favor of comprehensive [Congressional] reform [of banking law]." Id. Representative John Dingell (D-MI), ranking minority member on the House Commerce Committee, said OCC Comptroller Ludwig should be removed from office for making bad policy decisions which
operating subsidiaries of national banks to engage in activities prohibited to the parent bank so long as the OCC determines that the activities are "part of or incidental to the business of banking" or otherwise authorized by law and that the limitation applicable to the bank does not apply to the subsidiary. In its preamble announcing the new regulations, the OCC specifically said that it would not necessarily approve the subsidiaries' requests to engage in an activity prohibited to the parent bank, but that it intended to evaluate applications on a case-by-case basis.

This Comment first describes the provisions of the old and new section 5.34, the legal authority behind the changes, and the criticisms to them. Next, it discusses the two applications submitted by NationsBank, N.A. (NationsBank) to engage in real estate developing and real estate lease financing, and the legal arguments submitted for and against approval of the applications. The Comment then describes the application submitted by Zions First National Bank (Zions) to underwrite the sale of municipal revenue bonds, and the analysis applied by the OCC to approve the applications. After describing the applications, the Comment analyzes the legal issues presented by each of them. Lastly, this Comment discusses whether each of the applications should be approved and the impact that the new regulations may have on financial modernization.


9. See 12 C.F.R. §§ 5.34(d), (f) (1997). The language of the regulation is similar to the "incidental" powers clause of section 24 (Seventh), which grants national banks "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. 24 (Seventh) (1994).


11. See infra notes 16-59 and accompanying text.

12. See infra notes 60-121 and accompanying text.

13. See infra notes 122-41 and accompanying text.

14. See infra notes 142-252 and accompanying text.

15. See infra notes 253-75 and accompanying text.
II. PART 5 REGULATIONS

The operating subsidiary rule under the old Part 5 Regulations (Old Part 5) offered a narrow scope of activities in which a subsidiary of a national bank could engage.\textsuperscript{16} A national bank was allowed to use an operating subsidiary to engage only in those activities allowed for the parent bank as "part of or incidental to the business of banking."\textsuperscript{17} In order to qualify for Part 5 treatment, the parent bank was required to own at least eighty percent of the voting stock of the subsidiary.\textsuperscript{18} The Old Part 5 spelled out application procedures which required that a national bank intending to acquire, establish, or perform new activities in an operating subsidiary submit a letter to the Deputy Comptroller.\textsuperscript{19} The Comptroller would then conduct a review of the bank's application to determine if "the proposed activities exceed[ed] those legally permissible for a national bank's operating subsidiary" and to guarantee "prudent banking principles."\textsuperscript{20} Unless it was notified otherwise, a bank could begin operations through the operating subsidiary thirty days after the Comptroller received the bank's letter.\textsuperscript{21}

The new Part 5 Regulations (Regulations) significantly change the scope of permissible activities as well as the application procedures for the establishment and operation of operating subsidiaries.\textsuperscript{22} The Regulations clarify the form which an operating subsidiary may take, providing that a national bank may invest in a corporation, limited liability company, or similar entity.\textsuperscript{23} While the

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{16} See 12 C.F.R. § 5.34(c) (1996); see also Smoot, supra note 5, at 663-64.
\item \textsuperscript{17} See 12 C.F.R. § 5.34(c).
\item \textsuperscript{18} See id.
\item \textsuperscript{19} See id. § 5.34(d)(1)(i).
\item \textsuperscript{20} Id. § 5.34(d)(1)(ii).
\item \textsuperscript{21} See id. § 5.34(d)(1)(iii). The Old Part 5 also provided that banks could establish or acquire an operating subsidiary in less than 30 days if so notified by the OCC. See id.
\item \textsuperscript{22} See id. § 5.34(c) (1997); see also Smoot, supra note 5, at 664-72.
\item \textsuperscript{23} See 12 C.F.R. § 5.34(d)(2). The OCC said that authorizing investments in different types of entities increases the flexibility of national banks to structure their activities. See Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,350 (1996). In a press release, the OCC also noted that general partnerships were another type of activity available to the operating subsidiary which is not available to the parent. See Questions and Answers on Part 5, News Release 96-129, Nov. 20, 1996 (visited Mar. 4, 1998) <http:/www.occ.treas.gov/ftp/release/96%2D129.txt>.
\end{enumerate}
\end{footnotesize}
Old Part 5 required a parent bank to own more than eighty percent of the voting interest in a subsidiary, the Regulations now provide that parent banks must own fifty percent or otherwise control the subsidiary.24

The Regulations also restructure the OCC approval procedures by dividing operating subsidiary proposals into three categories: after-the-fact notice, expedited processing (for financially strong and well-managed banks), and standard processing.25 For certain activities, banks which are “adequately capitalized” or “well capitalized” may acquire or establish operating subsidiaries and simply provide after-the-fact notice to the OCC within ten days of acquiring or establishing the subsidiary.26 Under expedited review, an eligible bank submits an application with the OCC which is deemed approved ten days after the filing, unless notified otherwise.27 Standard processing, which applies when a bank proposes new activities that do not qualify for after-the-fact or expedited review, requires a bank to submit an application and receive approval from the OCC before acquiring or establishing the subsidiary or before commencing the new activity.28

The most controversial change stems from the increased authority of the Comptroller to approve new activities for bank subsidiaries that are prohibited to the parent. The Regulations reiterate that a bank may use a subsidiary to conduct activities that are “part of or incidental to the business of banking, as determined by the Comptroller of the Currency pursuant to 12 U.S.C. § 24.24

See 12 C.F.R. § 5.34(d)(2). Additionally, no other party may control more than 50% of the voting interest of the subsidiary. See id.; see also Smoot, supra note 5, at 686-92.


26. See 12 C.F.R. § 5.34(e)(2). The new rule defines activities which will qualify for after-the-fact notice to include, among other things, holding property in the course of debt collection, providing business services to the bank, and selling money orders. See id. § 5.34(d)(2)(ii)(A)-(M).

27. See id. § 5.34(e)(3). Activities eligible for expedited review include, among other things, providing securities brokerage, underwriting and dealing in securities permissible for national banks under 12 U.S.C. § 24 (Seventh), and data processing. See id. § 5.34(e)(3)(ii)(A)-(G). The new rule also allows banks to establish operating subsidiaries without filing an application or providing notice for certain other activities. See id. § 5.34(e)(4).

28. See id. § 5.34(c)(1)(i)(A).
In addition, the new section 5.34(f) significantly expands permissible operating subsidiary activities by allowing subsidiaries to engage in "an activity authorized under section 5.34(d) for the subsidiary but different from that permissible for the national bank." 29

The Regulations set out three types of requirements to ensure that new activities are conducted safely and soundly. First, the "notice and comment" requirements provide that if the OCC has not previously approved a proposed activity, a public notice and an opportunity for comment on the application is required. 30 Second, there are "corporate requirements" which mandate that certain corporate formalities be followed in order to ensure that the subsidiary remains separate and distinct from its parent. 31 Lastly, the Regulations establish specific "supervisory safeguards" when the subsidiary participates in new activities. 32 For example, one supervisory safeguard requires that the parent bank qualify as an "eligible bank" before and after commencement of the activity and after taking into account the capital deduction it is required to make for its investment in the subsidiary. 33 In addition, to ensure arms

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29. Id. § 5.34(d). Subsection (d) also permits "other activities permissible for national banks or their subsidiaries under other statutory authority." Id.
30. Id. § 5.34(f).
31. See id. § 5.34(f)(1). Under these procedures, the applications by NationsBank, N.A. and First Zions National Bank were published and comment letters were received. See infra notes 84-103, 118-21, 128 and accompanying text.
32. See 12 C.F.R. § 5.34(f)(2). The new rule lists ten "corporate requirements" which the subsidiary should follow to ensure perception as a separate and distinct entity, adequate capitalization, arms-length dealing between the parent and subsidiary and autonomy of the subsidiary from its parent. See id. § 5.34(f)(2)(i)-(x). Pursuant to these requirements, the subsidiary should be physically separate and distinct from its parent, operate under a name different from the parent's name, maintain separate accounting and corporate records, and have a board of directors with at least one third being from outside of the bank's board. See id.
33. See id. § 5.34(f)(3). The Regulations limit the amount which the parent bank may invest in the subsidiary by requiring the bank to reduce its capital and total assets by the amount of the bank's investment in the subsidiary as well as requiring the bank to reduce its Tier 1 and Tier 2 capital by its investment in the subsidiary. See id. § 5.34(f)(3)(i).
34. Id. § 5.34(f)(3)(iii). Under § 5.3(g) of Part 5, an "eligible bank" means a national bank that:

1. Is well capitalized as defined in 12 C.F.R. [§] 6.4(b)(1);
2. Has a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (CAMEL);
3. Has a Community Reinvestment Act (CRA), 12 U.S.C. [§] 2901 et seq., rating of "Outstanding" or "Satisfactory"; and
length dealing between the parent and the subsidiary, the supervisory requirements apply sections 23A\textsuperscript{35} and 23B\textsuperscript{36} of the Federal Reserve Act to transactions between the parent bank and subsidiary.\textsuperscript{37}

The OCC has said that in reviewing applications involving new activities it will consider: "(1) the form and specificity of the restriction applicable to the parent bank; (2) why the restriction applies to the parent bank; and (3) whether it would frustrate the purpose underlying the restriction on the parent bank to permit a subsidiary of the bank to engage in the particular activity."\textsuperscript{38} In addition, the OCC announced that it will also consider the "safety and soundness implications of the activity," other regulatory safeguards applying to the subsidiary or the activity itself, conditions imposed (by the OCC) in conjunction with application approval, and any additional undertakings by the bank or its operating subsidiary to address these factors.\textsuperscript{39}

Several trade associations ("dissenters") opposed the regulations based on concerns that bank expansion into new lines of business would risk the safety and soundness of the banking

\textsuperscript{35} Federal Reserve Act § 23A, 12 U.S.C. § 371c (1994). Section 23A imposes restrictions on transactions between banking affiliates and banks or their subsidiaries. See id. § 371c(a)(1). The statute limits transactions between affiliates and banks (or their subsidiaries) to ten percent of the capital stock and surplus of the bank, per affiliate, with a total limit of 25% for all affiliates. See id. § 371c(a)(1)(A)-(B). The statute also prohibits the bank from purchasing "low quality assets" from an affiliate unless made pursuant to an independent credit evaluation. See id. § 371c(a)(3). In addition, section 23A requires all transactions be "on terms and conditions that are consistent with safe and sound banking practices." Id. § 371c(a)(4).

\textsuperscript{36} Federal Reserve Act § 23B, 12 U.S.C. § 371c-1. Under section 23B, a member bank and its subsidiaries may engage in transactions with each other only:

(A) On terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or
(B) in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.

Id. § 371c-1(a)(1)(A)-(B).

\textsuperscript{37} See 12 C.F.R. § 5.34(f)(3)(ii).


\textsuperscript{39} Id.
NONBANK SUBSIDIARY ACTIVITIES

The OCC responded to these concerns by reiterating that safeguards are provided in the Regulations and that new activities will only be approved on a case-by-case basis. The OCC further explained that applications for new activities would not be approved unless the bank met certain corporate and supervisory requirements. According to the OCC, banks would benefit from conducting certain activities in a subsidiary, because such organization would allow more effective management and monitoring of the activities, lessen potential conflicts of interest, and facilitate the safe and sound operation of the parent bank.

The dissenters also opposed the Regulations based on the portion of section 24 (Seventh) which states: "except as hereinafter provided or otherwise permitted by law, nothing herein shall authorize the purchase [by the bank] of any shares of stock of any corporation." The dissenters argued that the statute's language prohibits a national bank from owning stock in any corporation, including a subsidiary. The OCC responded by arguing that the clause only relates to "speculative stock purchases" and does not prohibit national banks from owning stock in subsidiaries. The OCC cited support for national bank ownership of subsidiaries in the portion of section 24 (Seventh) that allows national banks to exercise "all such incidental powers as shall be necessary" to carry on the business of banking. According to the OCC, the term "necessary" has been interpreted by the courts to mean "convenient and useful," and use of subsidiaries is a convenient and useful way of conducting the business of banking.

40. See id. at 60,350-51.
41. See id. at 60,351.
42. See id. at 60,354.
43. See id.
44. Id. at 60,351 (quoting 12 U.S.C. § 24 (Seventh) (1994)).
45. See id. (citing 12 U.S.C. § 24 (Seventh)). But see Smoot, supra note 5, at 672-86 (concluding that the practice of banks owning subsidiaries is so well established that any litigation challenging such ownership would most likely fail).
47. Id. (quoting 12 U.S.C. § 24 (Seventh)).
48. See id. (citing Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972)).
49. See id. at 60,351-52. The OCC pointed to the Supreme Court’s holding that permissible bank activities are not limited to powers enumerated in section 24 (Seventh). See id. at 60,351 (citing NationsBank of North Carolina, N.A. v. Variable Annuity Life
Referring to OCC precedent which characterized subsidiaries as "department[s] of the banks," dissenters argued that it was inconsistent to allow operations in a subsidiary that are not permissible in the parent. The OCC explained that its earlier statements were only "policy positions" and did not represent a legal determination that operating subsidiaries should never be allowed to conduct activities different from those of its parent. Furthermore, the OCC stated that it may modify its policies where the change is lawful and enhances flexibility.

Some dissenters pointed to the traditional separation of investment and commercial banking. They suggested that sections 16 and 21 of the Glass-Steagall Act (Glass-Steagall) prevent the conduct of commercial and investment banking functions in the same entity. Additionally, the dissenters argued, while the Comptroller

Insurance Co. (VALIC), 513 U.S. 251 (1995)). The OCC noted that it is the Comptroller who has the "discretion to authorize activities beyond those specifically enumerated (in section 24 (Seventh))." Id. (citing VALIC, 513 U.S. at 258, n.2). In addition, the OCC explained that the 1927 McFadden Act and 1933 Glass-Steagall Act (Glass-Steagall) implicitly accepted the power of national banks to own subsidiaries by placing limitations on subsidiary activities. See id. at 60,352.

50. See id. at 60,352.
51. See id.
52. See id. at 60,352-53 (citing Smiley v. Citibank, 517 U.S. 735 (1996)).
53. Section 16 is now codified in the Banking Act as 12 U.S.C. § 24 (Seventh), which provides:


54. Section 21 is now embodied in 12 U.S.C. § 378, which provides:


has the power to prescribe rules and regulations under section 93a,\textsuperscript{56} he does not have the power to promulgate rules relating to Glass-Steagall.\textsuperscript{57} The OCC responded that it was not necessarily allowing activities that conflict with these rules, but instead was merely establishing a process by which to approve the applications of banks to enter into new areas.\textsuperscript{58} The OCC, furthermore, rejected claims that it was promulgating regulations beyond its authority, noting that the regulations do not diminish or otherwise affect application of Glass-Steagall to national banks.\textsuperscript{59}

III. RECENT APPLICATIONS UNDER THE NEW PART 5 REGULATIONS

Although the new Regulations became effective on December 31, 1996, it was not until April 4, 1997 that the first applications were filed under the new operating subsidiary rule.\textsuperscript{60} On March 26, 1997, NationsBank, N.A. filed two separate applications with the OCC. One requested permission to engage in limited real estate development activities in connection with bank premises through an operating subsidiary.\textsuperscript{61} The other sought OCC approval to establish an operating subsidiary to engage in real estate lease financing.\textsuperscript{62}

A. \textit{NationsBank Application - Real Estate Development}

NationsBank's first application requested permission to engage in real estate development through a newly-established operating subsidiary known as Tryon Development Partners.\textsuperscript{63} The

\textsuperscript{56} 12 U.S.C. § 93a.
\textsuperscript{57} \textit{See} Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. at 60,353. For a more thorough discussion regarding this section 93a argument with regards to the Zions application, see \textit{infra} notes 243-48 and accompanying text.
\textsuperscript{59} \textit{See} id.
\textsuperscript{61} \textit{See} Operating Subsidiary Notice 97-07, 62 Fed. Reg. at 16,213. For more discussion on the application, see \textit{infra} notes 63-103 and accompanying text.
\textsuperscript{62} \textit{See} Operating Subsidiary Notice 97-06, 62 Fed. Reg. at 16,214. For more details of the application, see \textit{infra} notes 104-21 and accompanying text.
\textsuperscript{63} \textit{See} Letter from Richard K. Kim, NationsBank Assistant General Counsel, to Stephen J. Weiss, Deputy Controller, Office of the Comptroller of the Currency 1 (Mar. 26,
application was for a "single specific project" which involved development of approximately forty-five residential condominium units on land which the bank had owned for over twenty-five years and which was presently the site of a NationsBank branch. NationsBank stated that the goals of the project are to make its premises location more economically vibrant and to produce a safer, more pleasant work environment for its employees and customers.

To allay fears concerning future real estate development activities, the bank noted that future projects would be limited in number and would be confined to areas "adjacent or near NationsBank premises." Lastly, to satisfy concerns regarding the organization of the subsidiary, the bank enumerated fourteen safeguards, similar to the corporate and supervisory safeguards stipulated in section 5.34(f), that would be used.

NationsBank argued that the real estate development activities were permissible because they were "part of or incidental to the business of banking" and that approval of the activities would not be "inconsistent with the policies of section 29" of the National Banking Act.


64. See Letter from Richard K. Kim to Stephen J. Weiss, supra note 63, at 2. The bank estimated that the cost of constructing the condominiums would be about $13 million, and that the combined approximate value of the office building and the land would be $56 million. See id.

65. See id. at 1.

66. Id. at 2. NationsBank listed as examples of future projects, construction of an office building, retail space, or residential housing. See id.

67. See id. at 2-4. These safeguards included a self-imposed requirement that all loans, investments, and advances to the subsidiary not exceed two percent of the bank's Tier I capital. See id.

68. 12 U.S.C. § 29 (1994). The provisions of section 29 expressly provide that:

A national banking association may purchase, hold, and convey real estate for the following purposes and for no others:

First. Such as shall be necessary for its accommodation in the transaction of its business.

Second. Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.

Third. Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.

Fourth. Such as shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts due to it.

Id.
Bank Act.\textsuperscript{69} Citing the \textit{NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.}\textsuperscript{70} decision, NationsBank maintained that the OCC has broad authority in determining whether an activity is “part of or incidental to the business of banking.”\textsuperscript{71} NationsBank argued that this determination should be based on whether the activity is functionally equivalent to, or a logical outgrowth of, a recognized banking activity, whether it responds to customer needs or otherwise benefits the bank or its customers, and whether it involves risks similar in nature to those already assumed by banks.\textsuperscript{72}

Applying these factors, NationsBank argued that real estate development activities would be “functionally equivalent” to other recognized banking activities because the development of bank premises is incidental to the conduct of banking.\textsuperscript{73} Because the proposed project would develop areas “ancillary to” and “integrated with” the bank’s premises, NationsBank asserted that the activity itself was also ancillary and incidental to the authority to develop bank premises.\textsuperscript{74} The activity responded to customer needs, NationsBank argued, because the activity would make bank locations safer and more pleasant.\textsuperscript{75} Lastly, NationsBank argued that the activity involved risks similar to those already encountered by the

\textsuperscript{69} Letter from Richard K. Kim to Stephen J. Weiss, \textit{supra} note 63, at 4.
\textsuperscript{70} 513 U.S. 251 (1995); see \textit{infra} notes 233-38 and accompanying text.
\textsuperscript{72} See \textit{id.} at 4-5 (citing Office of the Comptroller of the Currency, Corporate Decision 97-06, at 9 (Jan. 22, 1997) (on file with the OCC) (allowing establishment of an operating subsidiary to reinsure mortgage insurance based on “business of banking” analysis using these criteria)).
\textsuperscript{73} See \textit{id.} at 5. NationsBank cited the OCC’s determination that certain activities “are incidental to the conduct of the banking business, and therefore permissible, even though they are not, substantively, banking activities.” \textit{Id.} (citing Memorandum on the Legal Authority for the Revised Operating Subsidiary Regulation from Julie Williams, Chief Counsel, to Eugene A. Ludwig, Comptroller of the Currency 3 (Nov. 18, 1996)).
\textsuperscript{74} See \textit{id.}
\textsuperscript{75} See \textit{id.} at 6.
banks because of their experience developing, purchasing, and selling bank premises of which they only occupied a portion.\textsuperscript{76}

Although NationsBank recognized that section 29 of the Banking Act expressly prohibits bank ownership of real estate except in limited circumstances,\textsuperscript{77} it focused on the rationale underlying the limitations in that statute.\textsuperscript{78} The bank observed that the Supreme Court had interpreted the purposes of the statute as keeping the capital of the banks flowing through the daily "channels of commerce," preventing banks from engaging in "hazardous real estate speculation," and restraining banks from accumulating large amounts of real estate.\textsuperscript{79}

NationsBank argued that allowing its subsidiary to be involved in real estate development transactions would not frustrate the purposes underlying section 29. NationsBank first noted that the activities would not hinder capital from flowing into the "channels of commerce" because all loans, investments, and advances to the subsidiary would not exceed two percent of the bank's Tier 1 capital.\textsuperscript{80} Furthermore, the bank would plan to sell the condominiums as quickly as possible so that the diversion of capital would be the same as if they had made a loan to a developer for construction.\textsuperscript{81} The "hazardous real estate speculation" risks, explained NationsBank, would also be minimized by the two percent limitation confining such activities to a \textit{de minimis} scale.\textsuperscript{82} Finally, NationsBank argued that it would not accumulate large amounts of real estate because of the \textit{de minimis} limitations.\textsuperscript{83}

The real estate development application from NationsBank drew criticism from many sources, including the Federal Reserve,

\begin{itemize}
\item \textsuperscript{76} See id. The bank also noted that banks bear similar risks when they make real estate secured loans. See id.
\item \textsuperscript{77} See id. (citing 12 U.S.C. § 29 (1994)). For the text of section 29, see \textit{supra} note 68.
\item \textsuperscript{78} See Letter from Richard K. Kim to Stephen J. Weiss, \textit{supra} note 63, at 6.
\item \textsuperscript{79} See id. (citing National Bank v. Matthews, 98 U.S. 621 (1878) (interpreting the reasons which underlie the statutory restrictions against national banks owning and loaning on real estate)).
\item \textsuperscript{80} See id. This limitation was self-imposed by the bank. See id.
\item \textsuperscript{81} See id. at 8.
\item \textsuperscript{82} See id. If the bank ceased to be well-capitalized for two consecutive quarters, it would submit to the OCC an acceptable plan to become well-capitalized or it would divest itself of the real estate activity. See id.
\item \textsuperscript{83} See id. The bank would also deduct its equity investment from the parent bank's capital and total assets. See id.
\end{itemize}
which attacked the proposal by questioning the OCC’s authority to promulgate the rules in an area subject to Congressional control. The Federal Reserve noted that since 1864 “Congress has explicitly prohibited national banks from owning and developing real estate” and saw “no reason to overturn the judgment of Congress on this subject.” The agency questioned whether Congress intended to create a statutory scheme allowing express prohibitions on national banks to be overcome by administrative interpretations of the OCC. Noting the riskiness of real estate ventures, the Federal Reserve argued that approval would undermine the power of the Federal Deposit Insurance Corporation (FDIC) to limit risky activities of state banks.

The National Association of Realtors (NAR) also raised several objections to the NationsBank application for real estate development. NAR argued that banks were unskilled in the real estate industry. NAR also complained that inadequate firewalls existed to prevent banks from misusing information they gathered in their role as lender. Furthermore, NAR worried that once one application for a new activity was approved, it would serve as precedent for other banks to engage in that activity without specific authorization.

85. Id. at 1.
86. See id. at 3.
87. See id. The Federal Deposit Insurance Corporation (FDIC) was neutral regarding the applications but cautioned that real estate development activities are risky to the deposit insurance funds. See Letter from Ricki Heifer, Chairman, FDIC, to Eugene Ludwig, Comptroller of the Currency 3 (May 30, 1997) (on file with the OCC). The letter cited as statutory authority 12 U.S.C. § 1831a (1994), which allows state-chartered insured banks to invest in equity investments of the same type and amount as allowed for national banks. See id. at 1. The FDIC urged caution in allowing real estate development activities, noting that the S&L crisis stemmed from risky real estate investments. See id. at 2. The letter also outlined the FDIC’s own experience and criteria used in approving applications to engage in real estate activities. See id. at 3.
88. See Letter from Stephen D. Driesler, Senior Vice President/Chief Lobbyist, National Association of Realtors (NAR), to the OCC 3 (May 5, 1997) (on file with the OCC). The OCC received 144 comment letters regarding the application, most of which were received from real estate agents. See OCC, Docket 97-07, NationsBank Operating Subsidiary Notice (1997) (on file with the OCC).
89. See Letter from Stephen D. Driesler to the OCC, supra note 88, at 3.
90. See id. at 4.
91. See id.
The Consumer's Union (CU) joined the dissenters and questioned whether there was any statutory authority for banks' entrance into real estate development activities. CU argued that under section 29 of the National Bank Act, a bank may only buy, own, and sell real estate for specific purposes "and no others." CU criticized NationsBank's attempt to characterize the project as proper under section 29 for the "accommodation of its business," arguing that condominiums have little relation to a bank's transaction of its business. CU also pointed out that other banking legislation, such as the Bank Holding Company Act, permits real estate leasing activity but does not authorize real estate development activities. Finally, CU challenged the characterization of real estate development as "incidental" to the "business of banking" under section 24 (Seventh).

CU also expressed safety and soundness concerns by referencing the immense losses the savings and loan organizations (S&Ls) suffered from real estate investments. Specifically, CU

92. See Letter from Mary Griffin, Consumer's Union Insurance Counsel, to the OCC 1-2 (May 5, 1997) (on file with the OCC). Consumer's Union (CU) describes itself as a nonprofit educational membership organization which provides "consumers with information, education, and counsel about goods, services, health, and personal finance" and which "initiate(s) and cooperate(s) with individual and group efforts to maintain and enhance the quality of life for consumers." Id. at 1 n.1. The organization's income is solely derived from the sale of the magazine Consumer Reports. See id.


94. See id. at 2. The term "bank premises purpose" of section 29 should be interpreted narrowly, CU argued. See id. Approving the application, it maintained, would serve as an incentive for banks to purchase large parcels of land for their bank premises, and develop areas "adjacent or near" these parcels into retail malls, senior retirement communities, or other large-scale development properties. See id.

95. See id. The organization noted that attempts by the Federal Reserve in 1987 to allow bank holding companies to create subsidiaries to engage in direct real estate investment were quashed by Congress. See id. The Bank Holding Company Act is codified at 12 U.S.C. §§1841-1844, 1846-1850.

96. See id. CU argued that "financing" real estate involves a much different risk than the development of real estate. See id. The organization argued that "development" is a commercial activity because it involves the end-use of credit whereas "financing" involves an extension of credit and is therefore a banking function. See id. at 3. The National Association of Home Builders (NAHB) also submitted a letter objecting to the proposal, arguing that real estate development involves the acquisition of land, preparation of the infrastructure, and the actual construction of a building which are not "incidental" to a banks role of deposit taking and lending. See Letter from Kent W. Colton, NAHB Executive Vice President, to the OCC 2-3 (May 5, 1997) (on file with the OCC).

97. See Letter from Mary Griffin to the OCC, supra note 92, at 3. CU noted that one of the activities which played a role in the S&L failures was the lending of money to buyers...
noted that the S&Ls which had engaged in real estate investment activities experienced a higher failure rate than those not involved in such investments. CU argued that any losses incurred by an operating subsidiary would negatively impact the parent bank and leave the parent in a weakened financial condition.

Notwithstanding the above criticisms, several banks and banking trade associations argued in favor of the NationsBank application. One banking trade association, for example, stated that the activities should be allowed because federal savings associations are allowed to invest in real estate. Another group asserted that banks have been involved in real estate development for their own use for decades without undue safety and soundness concerns. A third supporter argued that banks understand the risks involved with real estate and that those risks are adequately addressed by the safeguards incorporated by section 5.34(f).

B. NationsBank Application - Real Estate Lease Financing

NationsBank’s application to engage in real estate lease financing (RELF) transactions caused less of a stir. The bank proposed engaging in RELF through a newly-created subsidiary which would offer the leases on a “nonoperating,” “full payout” who purchased land from the thrifts’ real estate affiliates at inflated prices. See id. at 4 (citation omitted). CU also questioned whether the OCC had the expertise to effectively regulate real estate activities. See id. at 5. Instead of operating subsidiaries, “affiliates” would provide a safer means of conducting nonbank business because negative impacts of any subsidiary losses would not be directly felt by the parent bank, CU argued. See id.

See, e.g., Letter from Steven A. Bennett, Senior Vice President and General Counsel, Banc One Corporation, to the OCC (May 14, 1997) (on file with the OCC); Letter from Robert R. Davis, Director of Government Relations, America’s Community Bankers, to the OCC (May 5, 1997) (on file with the OCC); Letter from Julius L. Loeser, Vice President and Senior Counsel, Wells Fargo, to the OCC (Apr. 29, 1997) (on file with the OCC); Letter from James D. McLaughlin, Director of Agency Relations, American Bankers Association, to the OCC (May 5, 1997) (on file with the OCC); Letter from James C. Sivon, Support Group for Modern Banking, to the OCC (May 23, 1997) (on file with the OCC).

A “nonoperating”, or “net” lease is a lease in which the lessor of the property is not obligated to provide any specialized services in connection with the lease, such as repairs, maintenance, or insurance. See Leasing, 61 Fed. Reg. 66,554 (1996).

The “full-payout” requirement means that the bank must expect to recover the full
basis for initial terms of at least ninety days. Because the estimated residual value of the leased property would not exceed twenty-five percent of its acquisition cost, each lease would qualify as a "full payout" lease functionally equivalent to a mortgage loan. According to the application, the bank would acquire real property only in connection with the proposed leasing transactions and would not acquire real property in anticipation of leasing it at a later date.

NationsBank argued that RELF was "part of or incidental to the business of banking" because the OCC had allowed national banks to own real estate for the purpose of engaging in lease financing transactions in other circumstances. For example, explained NationsBank, banks have been allowed to lease facilities to municipalities, if the municipality agreed to acquire the facility at the termination of the lease. NationsBank also noted that the OCC recently stated that in some cases it would permit a national bank to

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108. See id. NationsBank would be the sole shareholder of the proposed subsidiary, and would take measures to ensure compliance with the corporate and supervisory safeguards of section 5.34(f). See id. at 2-4.


110. See Letter from Gerald P. Hurst to Stephen J. Weiss, supra note 106, at 4. Section 7.1000(d) of the new regulations provides:

A national bank may purchase or construct a municipal building, school building, or other similar public facility and, as holder of legal title, lease the facility to a municipality or other public authority having resources sufficient to make all rental payments as they become due. The lease agreement must provide that the lessee will become the owner of the building or facility upon the expiration of the lease.

acquire and lease real property where it is a component of a personal property lease financing transaction.111

According to NationsBank, even if RELF is prohibited to parent national banks based on the general prohibitions on real estate ownership under section 29 of the National Bank Act, such transactions should be allowed within operating subsidiaries.112 The bank asserted that allowing RELF would not frustrate the purposes underlying the restrictions in section 29113 because long-term financing agreements are more akin to lending money, which, under section 371114 of the Federal Reserve Act, is a permissible activity for banks.115 Risk would be minimized because the investment would be voluntarily limited to five percent of the bank’s Tier 1 capital.116 NationsBank would not accumulate large amounts of real estate, it said, because the subsidiary would buy real estate only in connection with proposed RELF transactions.117

The application regarding RELF received fewer comment letters than the application to engage in real estate development.118 NAR took a more conciliatory tone than it did in response to NationsBank’s other application; the group recognized that “NationsBank does have extensive experience in other aspects of

111. See Letter from Gerald P. Hurst to Stephen J. Weiss, supra note 106, at 4-5 (citing Leasing, 61 Fed. Reg. at 66,554 (revising rules governing personal property lease financing transactions of national banks)).

112. See id. at 5. The bank analyzed the application of section 29 to RELF based on the same criteria applied to the real estate development application. See id. at 6.

113. See supra note 68; see also infra note 148.

114. 12 U.S.C. § 371 (1994). Section 371 allows a national bank to “make, arrange, purchase, or sell loans or extensions of credit secured by liens on interests in real estate.” Id. § 371(a).

115. See Letter from Gerald P. Hurst to Stephen J. Weiss, supra note 106, at 7. (citing M&M Leasing Corp. v. Seattle First Nat’l Bank, 563 F.2d 1377 (9th Cir. 1977) (holding that personal property leases on a net full payout basis are the functional equivalent of secured lending and therefore permissible for national banks)). The bank did not attempt to argue that the activity was permissible under the National Bank Act, which permits banks to “loan[] money on personal security.” 12 U.S.C. § 24 (Seventh).


117. See id.

118. The OCC received a total of 142 comment letters regarding the application, most coming from the same realtors who opposed the application to develop real estate. See OCC, Docket 97-06, NationsBank Operating Subsidiary Notice (1997) (on file with the OCC). The OCC also received several letters from the same trade associations and banks which expressed their support of the real estate development application. See id; see also supra notes 84-103 and accompanying text. The application was not formally opposed by Consumer’s Union.
leasing and lease financing." In addition, the Federal Reserve did not directly oppose the RELF application. Banking trade associations supported the application.

C. Zions Application – Municipal Revenue Bonds

The dust had barely settled before Zions First National Bank (Zions) filed an application in April of 1997, requesting permission to underwrite, deal in, and invest in municipal revenue bonds (revenue bonds) through an operating subsidiary. The application

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119. Letter from Stephen D. Driesler to the OCC, supra note 88, at 6. NAR also noted that “[o]n the face [the application] is not an outrageous proposal” but urged “extreme caution in evaluating the application.” Id.

120. See Letter from William W. Wiles to Eugene Ludwig, supra note 84, at 3-4. The letter observed that the activity “appeared to be permissible under the Bank Service Company Act because real estate leasing activities have been found to be closely related to banking.” Id. Most likely, the Federal Reserve did not object to the RELF application because that same activity is permissible for bank holding companies under its Regulation Y issued in February of 1997. See infra notes 202, 260, 268 and accompanying text.

121. A letter from Support Group for Modern Banking argued the application should be allowed because RELF is similar to activities currently permissible to federal savings associations and bank holding companies. See Letter from James C. Sivon to the OCC, supra note 100, at 3 (citing 12 C.F.R. § 560.41(b),(c) (1997) (federal savings associations) and 12 C.F.R. § 225.28(b)(3) (1997) (bank holding companies)). The ABA supported the application. The ABA argued that a new lease agreement could be entered at the end of the lease term if the lessee didn’t own the property at the end of the lease, that the provisions of the RELF agreement were consistent with those under Part 23 regarding leasing transactions structured so as to be equivalent to a loan, and that the OCC had not yet addressed whether RELF was permissible under the revised Part 7 rules. See Letter from James D. McLaughlin, Director of Agency Relations, American Bankers Association, to the OCC (May 5, 1997) (on file with the OCC).

122. Zions First National Bank was chartered in 1873 and has its headquarters in Salt Lake City, Utah. See Fed. Banking L. Rep. (CCH) No. 1734 (Dec. 19, 1997). The bank operates in the states of Utah, Arizona, Nevada, Colorado, California, and Idaho, and currently has approximately $5 billion in assets. See id. The bank is one of the largest dealers in U.S. securities between Chicago and California. See id. The OCC received only twelve comment letters, primarily from municipalities, banks, and trade associations. See OCC, Docket 97-10, First Zions Operating Subsidiary Notice (1997) (on file with the OCC).

123. See Letter from W. David Hemingway, Executive Vice President, Zions First National Bank, to the OCC (Apr. 8, 1997) (on file with the OCC); see also Operating Subsidiary Notice 97-10, 62 Fed. Reg. 19,171, (1997), also available on the Internet at Proposals Out for Comment (visited Mar. 4, 1998) <http://www.occ.treas.gov/propregs.htm>. Banks are generally prohibited by the National Bank Act from underwriting, dealing in, or investing in certain securities, including revenue bonds. See 12 U.S.C. § 24 (Seventh) (1994). A provision was added to section 24 (Seventh) as a result of Glass-Steagall to prevent the fusion of commercial and investment banking within the same entity. See infra notes 220-30 and accompanying text. While section 24 (Seventh) does not
proposed offering revenue bonds through an existing subsidiary which was already providing brokerage and investment advisory services.\textsuperscript{124} Zions itself would offer the same services as proposed in the application with respect to general obligation securities.\textsuperscript{125} In addition, the parent would continue to broker and provide investment advice regarding securities such as revenue bonds to its institutional customers, but the bank would fully disclose that it was acting only as an agent and would advise that the revenue bonds were actually being underwritten by the subsidiary.\textsuperscript{126}

On December 11, 1997, the OCC approved Zions' application in a thirty-two page decision which announced that bank operating subsidiaries may underwrite and deal in securities such as revenue bonds, subject to the revenue limits for bank-ineligible activities set forth by the Federal Reserve Board for member bank affiliates under section 20 of Glass-Steagall.\textsuperscript{127} The OCC explained allow banks to underwrite revenue bonds, it does authorize them to underwrite a host of other types of investment securities, such as obligations of the United States, general obligations of states and municipalities, and obligations issued under the authority of the Federal Home Loan Bank, to name a few. See 12 U.S.C. § 24 (Seventh); see also infra notes 136-37 and accompanying text.

\textsuperscript{124} See Letter from W. David Hemingway to the OCC, supra note 123, at 2. Zions was already engaged in underwriting, dealing in, and investing in general obligation securities which it marketed to institutional clients. See id. at 3. Under the terms of the proposal, Zions said it would continue to underwrite and deal in general obligation bonds while the subsidiary would provide similar services with respect to revenue bonds. See id.

\textsuperscript{125} See id. The primary difference between general obligation bonds and revenue bonds is that the full faith, credit, and taxing power of municipalities back general obligation bonds, while revenue bonds are only backed by the revenue stream from a proposed municipal project. See Olaf de Senerpont Domis, OCC Seen Giving Zions Unit Authority on Revenue Bonds, AM. BANKER, Oct. 16, 1997, at 2.

\textsuperscript{126} See Letter from W. David Hemingway to the OCC, supra note 123, at 4.

\textsuperscript{127} See Decision of the Comptroller of the Currency on the Application by Zions First National Bank, Salt Lake City, Utah to Commence New Activities in an Operating Subsidiary, Conditional Approval No. 262, at 5 (Dec. 11, 1997) (on file with the OCC and also available on the internet at Interpretations and Actions – Dec. 1997 (visited Mar. 4, 1998) \<http:llwww.occ.treas.gov/interp/dec97/intdec97.htm>\) [hereinafter Decision of the Comptroller]. The opinion was written by OCC Chief Counsel Julie L. Williams. See id. In a press release announcing OCC approval of the application, Chairman Ludwig stated "what impressed me most [about the Zions application] were comments of officials from the small towns of Utah who feel that their bond issues are too small to be of much interest to Wall Street." See OCC Approves Zions Application to Underwrite Municipal Revenue Bonds, NR 97-110 (Dec. 11, 1997) (on file with the OCC and available at OCC Approves Zions Application to Underwrite Municipal Revenue Bonds (visited Mar. 4, 1998) \<http:llwww.occ.treas.gov/ftp/release/97-110.txt>\). The press release also noted that approval of the Zions application was more conservative than current financial modernization legislation pending in the House Banking Committee which would permit national bank subsidiaries to conduct underwriting of corporate debt and equity with fewer
that although banks themselves are limited in their direct involvement with securities by section 16 of Glass-Steagall, bank "affiliates," such as nonbanking subsidiaries of bank holding companies and operating subsidiaries of national banks, are subject to the less severe restrictions of section 20.128 Under section 20 of Glass-Steagall, an "affiliate" of a member bank may conduct investment banking activities involving securities of all types, including bank-ineligible securities, so long as it is not "engaged principally" in underwriting and dealing in these bank-ineligible securities, the OCC stated.129 An operating subsidiary of a bank qualifies as an affiliate because it is a company that is more than fifty

limitations than those imposed on the Zions subsidiary. See id. Because the decision was authored by Williams, it is unclear whether Chairman Eugene A. Ludwig recused himself from deciding the Zions application. Ludwig has currently recused himself from consideration of the NationsBank applications in response to controversy stemming from his meeting with Hugh McColl, NationsBank's Chief Executive Officer, at a White House fund-raiser. See Atkins, supra note 8, at 690.

128. See Decision of the Comptroller, supra note 127, at 5. In its application, Zions noted that the prohibitions on securities activities conducted directly by banks were deliberately not applied to the subsidiaries, as evidenced by the fact that a different set of rules (sections 20 and 32 of Glass-Steagall) were applied to subsidiaries and affiliates of national and state banks. See Memorandum in Support of the Application of Zions First National Bank to Commence New Activities Through an Operating Subsidiary 14 (Apr. 8, 1997) (on file with the OCC and also available on the internet at Proposals Out for Comment (visited Mar. 4, 1998) <http://www.occ.treas.gov/propregs.htm>) [hereinafter Zions Memorandum]. A district court decision supported the proposition that restrictions applying to the banks themselves should not apply to subsidiaries, Zions argued. See id. at 16 (citing Investment Co. Inst. v. Federal Deposit Ins. Corp., 606 F. Supp. 683, 686 (D.D.C. 1985) (upholding an interpretation of Glass-Steagall by the FDIC that permitted state banks to own affiliated subsidiaries engaged in the securities business)).

The application to engage in revenue bond activities was strongly opposed by the Securities Industry Association (SIA). See Letter from Marc E. Lackritz, President, the Securities Industry Association, to the OCC (May 19, 1997) (on file with the OCC) [hereinafter SIA Memorandum]. SIA represents the interests of investment banks, broker dealers, specialists, and mutual fund companies. See id. at 1 n.1. The SIA argued that revenue bond activities were prohibited by Glass-Steagall, which was meant to separate commercial and investment banking activities. See id. at 12-13 (citing Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys. (Becker), 468 U.S. 137, 147 (1984)). The SIA said it was irrelevant that the proposed activities would take place in a separate operating subsidiary because of past OCC interpretations characterizing subsidiaries as "departments" of the banks. See id. at 13-14. The SIA acknowledged, however, that there was no legal precedent addressing whether the OCC may permit national banks to conduct ineligible securities activities by means of an operating subsidiary. See id. at 16.

129. Decision of the Comptroller, supra note 127, at 5 (quoting Glass-Steagall). The term "affiliate" is defined to include a corporation of which a bank directly or indirectly owns or controls either a majority of the voting shares or more than 50% of the voting shares. See 12 U.S.C. § 221a(b) (1994).
percent owned or controlled by a bank, the OCC said. The OCC further explained that because the Zions subsidiary had committed itself to limiting revenues derived from underwriting and dealing in revenue bonds to no more than twenty-five percent of its total revenues, it would comply with the Federal Reserve’s “Revenue Test,” which is used to determine if an affiliate is “principally engaged” in securities activities under section 20. Based on this rationale, the OCC determined that since the Zions subsidiary would not be “engaged principally” in selling bank ineligible securities, it would not frustrate the purposes of Glass-Steagall to conduct the activity in a bank operating subsidiary.

The OCC further ruled that underwriting and dealing in revenue bonds is within a national bank’s express statutory authority to “discount and negotiate evidences of debt.” According to the OCC’s decision, “evidence of debt” includes a debt security such as a revenue bond, and the terms “to discount and negotiate” include the power to buy and sell as principal.

The OCC emphasized that Zions’ involvement in municipal revenue bonds would entail little added risk for the bank but would provide substantial benefits for both banks and municipalities. The OCC noted that banks have significant experience investing in and analyzing revenue bonds and other securities. Furthermore,
explained the OCC, the risks presented by underwriting and dealing in municipal revenue bonds are not a new risk because banks are already authorized under section 16 of Glass-Steagall to issue other types of revenue bonds, such as housing, university, or dormitory bonds. The OCC also said that allowing Zions to underwrite and deal in revenue bonds would benefit municipalities by providing greater access to funds and would benefit the bank by allowing it to diversify its activities and generate new sources of income.

The OCC stated that its oversight of Zions would ensure the “safe and sound operation” of the bank and would guarantee that Zions complies with all applicable regulatory and supervisory restrictions. Furthermore, explained the OCC, the Zions subsidiary would be subject to regulation by the Securities and Exchange Commission; the subsidiary would therefore have to comply with numerous financial reporting, anti-fraud, and financial responsibility rules. In addition, the OCC noted that the subsidiary would also be

137. See id. (citing 12 U.S.C. § 24 (Seventh) (1994)). The OCC also observed that the Federal Reserve has determined that the underwriting and dealing in municipal revenue bonds is a “natural extension of activities currently conducted by banks, involving little additional risk . . . and potentially yielding significant public benefits in the form of increased competition and convenience at lower cost.” Id. at 11 n.23 (quoting Citicorp, J.P. Morgan & Co. and Bankers Trust N.Y. Corp., 73 Fed. Res. Bull. 473, 487 (1987), aff’d sub nom, Securities Indus. Ass’n v. Board of Governors of Fed. Reserve Sys., 839 F.2d 47 (2d Cir. 1988)).

138. See id. at 12. Zions noted in its memorandum that there had been a significant decrease in investment banks offering municipal financing services, and argued that the lack of competition had resulted in higher interest charges being paid by municipalities. See Zions Memorandum, supra note 128, at 10. The bank explained that a congressional study found in 1988 that permitting banks to underwrite municipal revenue bonds could have saved state and local governments as much as $480 million per year. See id. (citing Senate Comm. on Banking, Housing and Urban Affairs, Financial Modernization Act of 1988, S. Rep. No. 100-15 (1988)). The bank argued that additional competition was needed since several brokerage firms, such as CS First Boston; Donaldson, Lufkin & Jenrette; Lazard Freres and Chemical Securities had eliminated their municipal finance businesses since 1995. See id. at 19. As a result, the bank argued, smaller communities were less able to obtain financing because brokerage firms were unwilling to underwrite or deal the relatively small amount of securities these municipalities wished to offer. See id.

139. See Decision of the Comptroller, supra note 127, at 26-27. The OCC added that it has a great deal of experience overseeing banks which participate in the underwriting, dealing, and investing in government securities. See id. at 27.

140. See id. When the OCC originally proposed revising the operating subsidiary rule, it received a letter from the Securities and Exchange Commission (SEC) requesting confirmation that if the regulations were approved: “(1) securities activities conducted in operating subsidiaries would be subject to federal securities laws, and (2) the OCC’s regulation would not allow activities previously not permitted for a bank itself to be shifted from an operating subsidiary to the bank.” Id. at 27 n.73 (citing Rules, Policies, and
subject to the rules and regulations of the National Association of Securities Dealers and the Municipal Securities Rulemaking Board, each of which would serve as additional safeguards against financial losses.\textsuperscript{141}

IV. ANALYSIS

This section evaluates each of the applications based on the three primary criteria\textsuperscript{142} which the OCC has stated it will consider in approving the applications, focusing primarily on the rationale underlying the restriction on the parent bank.\textsuperscript{143} First, this section analyzes the restrictions section 29 of the National Bank Act imposes on a national bank's ability to engage in real estate activities as proposed by NationsBank, and discusses possible arguments for why these restrictions should be given less weight, especially when applied to a bank subsidiary.\textsuperscript{144} It then analyzes the OCC's rationale for approving Zions' application and considers the arguments that commercial and investment banking should be completely separated under section 16 of Glass-Steagall.\textsuperscript{145}

A. NationsBank Application - Real Estate Development

NationsBank applied to engage in real estate development activities through an operating subsidiary.\textsuperscript{146} The restrictions on such activities by a parent bank are found in section 29 of the National Bank Act, which specifically declares that a bank may "purchase, hold, and convey" real estate in four particular circumstances and "no others."\textsuperscript{147} One circumstance in which a bank may purchase real
estate is when it "shall be necessary for its accommodation in the transaction of its business," as in the case of bank premises. OCC regulations provide limitations on the amount which a bank may invest in bank premises. Because the limitations in section 29 and accompanying OCC regulations are rather specific, the purpose underlying the restriction is important. According to the Supreme Court in National Bank v. Matthews, the underlying purposes for the section 29 restrictions are threefold: (a) to allow the banks to provide a steady flow of capital, (b) to deter them from engaging in the hazards of real estate investment, and (c) to prevent the accumulation of large amounts of real estate.

The NationsBank application raises concerns about providing a steady flow of capital to bank customers, as well as a larger concern over whether banks might be led to compete with their customers over real estate development projects. NationsBank attempts to address the flow of capital concern by including a self-

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148. 12 U.S.C. § 29. OCC regulations define real estate permissible for the “transaction of its business” to include:

(i) Premises that are owned and occupied (or to be occupied, if under construction) by the bank, its branches, or its consolidated subsidiaries;
(ii) Real estate acquired and intended, in good faith, for use in future expansion;
(iii) Parking facilities that are used by customers or employees of the bank, its branches, and its consolidated subsidiaries; and
(iv) Residential property for the use of bank officers or employees [in remote areas or foreign countries].

149. See 12 C.F.R. § 7.1000(c)(1)-(2). Specifically, the regulations provide that 12 U.S.C. § 371d governs when OCC approval is required for a national bank to invest in bank premises. See id. § 7.1000(c)(1). Section 371d states that a bank may not invest in bank premises unless either the bank receives prior approval by the Comptroller of the Currency, the aggregate amount of all investments and loans for bank premises is less than or equal to the amount of the capital stock of the bank, or the aggregate of investments and loans is less than or equal to 150% of the capital of the bank and the bank meets certain CAMEL, capitalization, and notification requirements. See 12 U.S.C. § 371d(a)(1)-(3) (1994).

150. See supra note 38 and accompanying text.

151. 98 U.S. 621 (1878).

152. See id. at 626. Other courts have also construed the reasoning behind the prohibitions imposed by section 29. See, e.g., Central Nat'l Bank v. Fleetwood Realty Corp., 441 N.E.2d 1244 (Ill. App. Ct. 1982) (stating that the purpose is "to protect bank depositors and stockholders from risky investments"); Exchange Bank of Commerce v. Meadors, 184 P.2d 458, 463 (Okla. 1947) (stating that purpose is to prevent speculation in real estate). For further discussion of the history of the restrictions on banks owning real estate, see John A. DeAngelis, Note, Riches Do Not Last Forever: Real Estate Investment by National Banks, 1991 U. ILL. L. REV. 777, 779-84.
imposed limitation on its investment in real estate development activities to two percent of Tier 1 capital.153 In addition, the bank said it would sell any real estate which it develops as quickly as possible.154 However, some commenters expressed fear that bank participation in real estate development would affect banks' lending judgment with respect to real estate development projects.155 These commenters noted that there might be inadequate firewalls to prevent banks from forwarding insider information regarding promising real estate to its real estate development subsidiaries and that banks might be tempted to compete with customers on real estate projects.156 NationsBank answered these concerns by promising that all contracts between the parent and subsidiary would be on terms and conditions "substantially comparable" to those with outside parties.157 Because it would apply sections 23A and 23B of the Federal Reserve Act, NationsBank argued, all deals would be conducted at arms length.158

Perhaps the greatest concern surrounding the proposed activity is that banks might engage in "hazardous real estate speculation." The Federal Reserve noted that "the nation's recent experience with allowing federally insured thrifts to engage in real estate development through subsidiaries serves to confirm the imprudence of mixing banking and real estate."159 NationsBank argued that the Tier 1 limitation of two percent adequately addressed concerns that it might be exposing too many assets to real estate development.160 The bank also stated that the risks would be mitigated by its plans to become well-capitalized or to terminate the real estate activities if the bank fails to be well-capitalized for two

153. See Letter from Richard K. Kim to Steven J. Weiss, supra note 63, at 7.
154. See id. at 8.
155. See, e.g., Letter from Kent W. Colton to the OCC, supra note 96, at 4.
156. See id.
157. See Letter from Richard K. Kim to Steven J. Weiss, supra note 63, at 3.
158. See id. For a description of sections 23A and 23B, see supra notes 35-36.
159. Letter from William W. Wiles to Eugene Ludwig, supra note 84, at 1. The Federal Reserve also argued that banks might end up devoting a greater percentage of their resources to real estate activities, thereby exposing them to greater potential losses. See id. at 2.
160. See Letter from Richard K. Kim to Steven J. Weiss, supra note 63, at 8. The bank also said it would deduct its equity investment in the subsidiary from its capital and total assets which would reduce risk by requiring the bank to maintain minimum capital requirements without including the subsidiaries capital. See id. This falls within one of the supervisory requirements of the new Part 5 rules. See 12 C.F.R. § 5.34(3)(1) (1997).
successive quarters. While critics point to the losses suffered by the S&Ls during the 1980s as a result of their real estate investments, the limitations proposed by NationsBank are consistent with similar protections under the Federal Deposit Insurance Corporation Act. That act allows an insured state bank to invest in a “qualified housing project” up to two percent of the total assets of the bank. A “qualified housing project” is defined as “residential real estate that is intended to primarily benefit lower income people throughout the period of the investment.”

NationsBank’s argument assumes that real estate risks will be limited by its plans to divest itself of any unprofitable real estate and by limitations imposed on the parent’s investment in the subsidiary. The Federal Reserve pointed out the flaws in this assumption by noting the difficulty of recognizing “bad real estate investments” because of the “cyclical and speculative nature of real estate.” The NAR also noted that banks and thrifts traditionally have not performed well in the real estate arena when they venture beyond lending. While NationsBank argued that it had “substantial experience in developing both commercial and residential real

161. See Letter from Richard K. Kim to Steven J. Weiss, supra note 63, at 8.
162. 12 U.S.C. § 1831a (1994). That Act prohibits state banks from engaging as a principal in “any type of activity that is not permissible for a national bank.” Id. § 1831a(a)(1). However, the act provides exceptions if the FDIC determines both that the activity “pose[s] no significant risk to the appropriate deposit insurance fund” and that the state bank continues to meet capital requirements. Id.
163. See id. § 1831a(e)(3)(B).
164. See id. § 1831a(e)(3)(C)(i). For information on newly-proposed FDIC rules, see infra note 185.
165. Letter from William W. Wiles to Eugene Ludwig, supra note 84, at 2. They argued that NationsBank’s plans to divest of poor real estate investments were overly optimistic because investors rarely know when they are making “bad real estate investments.” Id. The FDIC echoed this concern, stating that real estate investment activity is risky partly because of a long gestation period for projects, resulting in changed supply and demand conditions when the projects finally come to market. See Letter from Ricki Helper to Eugene Ludwig, supra note 87, at 2.
Consumer's Union distinguished banks' experience in financing from their experience in development. While financing consists of the extension of credit, CU explained, development includes planning and construction.

Another assumption underlying NationsBank's argument is that certain steps taken by the bank will minimize losses which might result from bad real estate investments. NationsBank argued that the two percent investment limitation and deduction of the equity investment from the parent's capital and total assets would restrict any potential losses to a de minimis amount. In comparison, state banks may invest up to two percent of their total assets in qualified housing projects. In addition, federal savings associations are permitted to invest, through service corporations, up to three percent of their assets in real estate activities.

Although the NationsBank application seems to fall within the percentage limitations of these parallel regulations, the proposed development is slightly different from that which is allowed by the

167. Letter from Richard K. Kim to Steven J. Weiss, supra note 63, at 8. The bank argued that commercial and residential real estate development bore similar risks to those involved in developing, purchasing, and selling bank premises. See id. at 6. For example, NationsBank often develops property for bank premises and then only occupies a portion of the property while leasing or selling the remainder. See id. The bank also argued that it is exposed to similar risks when it makes real estate secured loans. See id.

168. See Letter from Mary Griffin to the OCC, supra note 92, at 3 (noting that financing involves the extension of credit, a banking activity, while development involves the end-use of credit, which is a function of commerce). The FDIC pointed out other differences in development when compared to financing: variability or uncertainty of returns on invested funds as compared with other equity investments, lack of security, inadequate financial information, illiquid markets, and the highly leveraged character of most commercial real estate investments. See Letter from Ricki Helffer to Eugene Ludwig, supra note 87, at 2.

169. See Letter from Mary Griffin to the OCC, supra note 92, at 3.

170. See Letter from Richard K. Kim to Steven J. Weiss, supra note 63, at 8.

171. See supra notes 163-64 and accompanying text.

172. A "service corporation" is a corporation organized under the laws of the state in which the federal savings association's home office is located and whose entire capital stock is available for purchase only by savings associations of that state and by federal associations having their home offices in that state. See 12 U.S.C. § 1464(c)(4)(B) (1994). Under the regulations, a service corporation may acquire real estate for development, rental, resale, remodeling, renovation, offices, management activities, or real estate brokerage. See 12 C.F.R. § 559.4(e) (1997).

173. See 12 C.F.R. § 559.5(a). Investments must "serve primarily community, inner city, or community development purposes." Id. § 559.5(a). The regulations on state banks seem to allow additional investment if an activity poses no significant risk to deposit insurance funds and the state bank has complied with applicable credit standards. See 12 U.S.C. § 1831a(1)(A)-(B).
other regulations. As earlier noted, the application proposes to develop forty-five residential condominiums at a cost of $13 million.\textsuperscript{174} Assuming the units were sold at cost, each unit would retail for approximately $300,000 and would not qualify as a “qualified housing project”\textsuperscript{175} under the regulations applicable to state banks. Furthermore, when the real estate development is combined with the proposed RELF activities,\textsuperscript{176} NationsBank could have up to seven percent of its Tier 1 capital committed to real estate-related projects. This amount might be considered risky.

In response to the concern in Matthews that banks would accumulate large amounts of real estate, NationsBank argued that its \textit{de minimis} investment amounts combined with its plans to quickly sell any developed real estate would help to prevent such accumulations.\textsuperscript{177} The OCC must consider, however, that banks have already poked several holes in section 29 through extensive development of bank premises under the statutory phrase of “necessary for its accommodation in the transaction of its business.”\textsuperscript{178} While an investment of two percent might seem insignificant, the amount could be substantial for a bank the size of NationsBank, whose consolidated balance sheet for the year ended December 31, 1997, shows $3.2 billion in “premises and equipment.”\textsuperscript{179}

An additional risk not contemplated in the Matthews decision is the potential for real estate losses to translate into losses to the federal deposit insurance fund which did not exist in 1878 when the case was decided.\textsuperscript{180} In response to the application, the FDIC

\begin{enumerate}
\item[174.] See Letter from Richard K. Kim to Steven J. Weiss, \textit{supra} note 63, at 2.
\item[175.] See \textit{supra} notes 163-64 and accompanying text. While the term “lower income people” is not defined in the statute, given their high price, the term probably would not include purchasers of the condominiums.
\item[176.] According to NationsBank, the RELF activities would be capped at five percent. See \textit{supra} note 116 and accompanying text.
\item[177.] See Letter from Richard K. Kim to Steven J. Weiss, \textit{supra} note 63, at 8-9.
\item[178.] 12 U.S.C. § 29(First) (1994). As noted by NationsBank in its application, the real estate projects proposed by the subsidiary would be “a fraction of the real estate currently owned and occupied by NationsBank as premises.” Letter from Richard K. Kim to Steven J. Weiss, \textit{supra} note 63, at 8.
\item[180.] Federal Deposit Insurance was created under the Banking Act of 1933 in response to the bank panic of 1933 and is available to qualifying members of the Federal Reserve System. See \textit{JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW AND
cautioned that any real estate investment activity should be approached cautiously and with limitations to “protect the banks and the deposit insurance funds from losses.” The FDIC argued that such activities should be permitted only “where there is a clear legal separation from the insured bank, stringent firewalls and limited exposure of the capital of the consolidated organization.” Although the FDIC responded to the application with some concern, the FDIC apparently determined that real estate development may be permissible given certain safeguards. However, allowing real estate development by national bank subsidiaries would likely mean that state-chartered banks could engage in such activity. In that case, the risk that the federal deposit insurance fund could suffer losses would increase.

REGULATION 21-22 (2d ed. 1997). The insurance is administered by the Federal Deposit Insurance Corporation (FDIC), an independent agency which is overseen by a five-person board of directors. See id. at 67. The FDIC provides federal deposit insurance to all national banks and most state-chartered banks. See id.

181. Letter from Ricki Helfer to Eugene Ludwig, supra note 87, at 1. The Federal Reserve claimed that bank subsidiaries have a competitive advantage over companies not owned by a bank because federal deposit insurance acts as a subsidy, reducing the cost of capital to the subsidiaries. See Pamela Atkins, New Bank Businesses Should be in Holding Company, Greenspan Insists, 68 Banking Rep. (BNA) 348 (Feb. 24, 1997). In response, the OCC claimed that no evidence exists of banks acting as though there is such a subsidy, or of banks favoring one type of organizational structure over another. See id.

182. Letter from Ricki Helfer to Eugene Ludwig, supra note 87, at 3.

183. See id. (“It is my view that real estate development activities . . . should be permitted for bank subsidiaries only where there is a clear legal separation from the insured bank, stringent firewalls and limited exposure of the capital of the consolidated organization.”).


185. The CU feared that allowing the national bank subsidiaries to engage in real estate development might be used to support the same activities by state banks. See Letter from Mary Griffin to the OCC, supra note 92, at 3. Oddly enough, that is exactly what the FDIC has proposed, issuing a proposed rule on August 26, 1997 which would make it easier for healthy state-chartered banks to engage in real estate and securities activities. See FDIC Issues Proposal Easing Requirements for Real Estate Investment by State Banks, 69 Banking Rep. (BNA) 347-48 (Sept. 8, 1997). The proposed rule gives state banks the authority to engage in real estate activities through a majority-owned subsidiary. See Activities of Insured State Banks and Insured Savings Associations, 62 Fed. Reg. 47,969, 48,016 (1997) (to be codified at 12 C.F.R. pt. 362). The proposed rule would allow banks with investments exceeding two percent of their Tier 1 capital to engage in real estate activities, so long as certain safeguards are satisfied. See id. at 48,017 (to be codified at 12 C.F.R. § 362.4(b)(5)(i)). If a bank’s investment in the subsidiary does not exceed two percent of its Tier 1 capital, it would not be subject to these restrictions. See id.
B. NationsBank Application - Real Estate Lease Financing

NationsBank's application to engage in RELF falls within an area in which the OCC has been more permissive, indicating that subsidiaries may conduct certain leasing activities subject to the agency's review. In its application to engage in the RELF activities, NationsBank proposed limitations on leases which seem designed to comply with prior precedent from the OCC and the courts. The proposed leases would be restricted to "nonoperating," "full payout" leases, for initial terms of at least ninety days. Because the leases will involve real estate, and not personal property, the relevant section appears to be section 29 of the National Bank Act.

Whether section 29 is applicable is somewhat unclear because the terms of the lease have several characteristics of a financing transaction. In M&M Leasing Corp. v. Seattle First Natl. Bank, the United States Court of Appeals for the Ninth Circuit distinguished leasing from financing, holding that "in light of all the relevant circumstances," certain leasing of motor vehicles constitutes a loan of money secured by vehicles and is allowable as part of the "business of banking." The court emphasized that the lessor bank must look primarily to the creditworthiness of the lessee and not to the market value of the leased property. In contrast, the court noted that a loan which must be repeated or extended in order for the

187. See Letter from Gerald P. Hurst to Steven J. Weiss, supra note 106, at 1.
188. See id. at 1-2. The definitions and significance of these restrictions are discussed supra notes 104-08 and accompanying text.
189. See 12 U.S.C. §29 (1994). Banks are allowed to lease personal property under section 24 (Seventh), which allows banks to loan money "on personal security." Id. § 24 (Seventh). Banks are also authorized to "invest in tangible personal property, including without limitation, vehicles, manufactured homes, machinery, equipment, or furniture, for lease financing transactions on a net lease basis, but such investment may not exceed 10 percent of the assets of the association." Id. § 24 (Tenth).
190. 563 F.2d 1377 (9th Cir. 1977).
191. Id. at 1380. The court noted, however, that a lease ceases to be a secured loan when the lessor bank assumes material burdens other than those of a lender which subjects it to risks not ordinarily incident to a secured loan. See id. The court determined that banks may use "new ways of conducting the very old business of banking." Id. at 1382.
192. See id. at 1383-84.
bank to recover its advances and profits was akin to a rental business and would not qualify as a loan. Although perhaps useful by analogy, the rationale of *M&M Leasing* has to date only been applied by the courts to personal property.

The OCC, meanwhile, has announced its position that certain real property leases may be offered by banks. While not expressly authorized by section 29 of the National Bank Act, the OCC has allowed lease financing of public facilities to municipalities or public authorities having sufficient resources to make all payments, if the lease agreement requires that the lessee become the owner at the expiration of the lease. The OCC has also stated that under certain circumstances real estate leasing may be an incidental component of a personal property leasing transaction. Although the OCC has not previously allowed RELF transactions, NationsBank argued that in creating these two exceptions, the OCC recognized that RELF is the functional equivalent of lending and qualifies as an activity "incidental" to banking under section 24 (Seventh).

The NationsBank application includes several restrictive provisions on its proposed RELF transactions in a clear effort to make the transactions mirror a loan of money secured by property.

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193. *See id.* at 1384.
194. Search of WESTLAW; Allfeds Library (Mar. 1, 1998) (search for records containing "M&M Leasing" and "real property" or "real estate").
195. *See* 12 C.F.R. § 7.1000 (1997). Under Subpart A of Part 7 enumerating bank powers, banks may purchase certain public facilities to lease with some restrictions. *See id.* § 7.1000(d)(1). The Part 7 regulations were revised in 1996. *See* Interpretive Rulings, 61 Fed. Reg. 4849 (1996). The OCC refused to expand section 7.1000, which permits banks to purchase and then lease certain public facilities, to allow leases to non-public entities; the OCC said it would "not address this issue at this time." *Id.*
196. *See* 12 C.F.R § 7.1000(d)(1); *see supra* note 110 and accompanying text.
197. *See* Leasing, 61 Fed. Reg. 66,654 (1996). The OCC said it would decide, on a case-by-case basis, the permissibility based upon the facts of a given lease financing transaction. *See id.* at 66,656. The OCC regulations provide that a bank may "acquire personal property for the purpose of, or in connection with leasing that property, and may engage in activities incidental thereto, if the lease qualifies as a full-payout lease and a net lease." 12 C.F.R. § 23.3 (1997).
198. *See* Letter from Gerald P. Hurst to Steven J. Weiss, *supra* note 106, at 5. The bank argued that because long-term RELF is the functional equivalent of real estate lending, it is an activity permissible for a national bank and its operating subsidiary. *See id.* at 7. A national bank may "make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate" as the OCC prescribes by regulation or order. 12 U.S.C. § 371 (1994).
199. *See* M&M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377, 1382 (9th Cir. 1977).
Regulations issued by the OCC allow a bank to lease personal property if the lease "qualifies as a full-payout lease and a net lease." Because NationsBank said it would only offer leases on a "nonoperating" (i.e. a "net lease") and "full payout" basis and that any estimated residual value of the leased property would not exceed twenty-five percent of the acquisition cost, the proposed activity seems to fall within the criteria specified by the OCC for other types of acceptable leases.

If the OCC determines that RELF is already permissible for the parent bank as an activity "incidental" to the "business of banking" because of its similarity to loans, RELF is clearly permissible in operating subsidiaries. Although the OCC has yet to determine that the leasing of real estate to non-public entities is a permitted activity under Part 7 and 23 of the regulations, the NationsBank application gives the OCC an opportunity to finally resolve the issue.

If the OCC determines that section 29 is in fact applicable to RELF, the OCC would again look to Matthews to determine the

200. 12 C.F.R. § 23.3(a) (1997); supra notes 104-05. Similar restrictions apply to federal savings associations, which are permitted to become the "legal or beneficial owner of tangible personal property or real property for the purpose of leasing such property." 12 C.F.R. § 560.41(a). To qualify as the functional equivalent of a loan, the lease by the federal savings associations must be a "net, full payout lease representing a non-cancelable obligation of the lessee." Id. § 560.41(c)(2).

201. See Letter from Gerald P. Hurst to Steven J. Weiss, supra note 106, at 1. The application states that it expects the leases will yield a return that will compensate the subsidiary an amount at least as much as the subsidiary’s full investment in the real property plus the estimated total cost of financing the property over the term of the lease from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial term. See id. at 2.

202. See id. The 25% residual value requirement follows the requirement for personal leases which mandates that “any unguaranteed amount must not exceed 25% of the original cost of the property to the bank.” 12 C.F.R § 23.21(a)(2). The limitations also follow those imposed by the Federal Reserve on nonbanks under its new Regulation Y provisions relating to real estate leasing regulations. See Bank Holding Companies and Change in Bank Control (Regulation Y), 62 Fed. Reg. 9290 (1997) (to be codified at 12 C.F.R. pt. 225). The new Part Y regulations permit the leasing of real and personal property. See id. at 9335. For personal property leases, the lease must be on a nonoperating basis for an initial term of at least 90 days. See id. For real estate leases, there are the additional requirements that the lessor recover at least its full investment in the property and that the estimated residual value of the property not exceed 25% of the lessor’s acquisition cost. See id.

203. See supra note 196-98 and accompanying text.
purpose of the restrictions.204 As discussed earlier, the Supreme Court announced that the purpose of section 29 is to allow banks to provide a steady flow of capital, to deter them from engaging in the dangers of real estate investment, and to prevent them from accumulating large amounts of real estate.205

In its application, NationsBank gave reasons why allowing RELF in the bank's operating subsidiary would not undermine the underlying purposes of section 29. Regarding the "flow of capital," NationsBank noted that it would voluntarily limit its interest in real estate transactions to five percent of the parent's Tier 1 capital.206 The five percent limitation would also act as a safeguard against "hazardous real estate speculation" by preventing the bank from exposing itself to excessive risk.207 In addition, the "full payout" requirements and the twenty-five percent limit on the residual value at the end of the lease term would limit potential losses upon the termination or expiration of a lease.208 Accumulation of excess real estate would not be a problem because the bank would only acquire property in connection with a proposed RELF transaction.209 If the lessee did not acquire the property at the termination of the lease, the subsidiary would either enter into a new lease agreement with the lessee or a third party, or reclassify the property as "other real estate owned"210 and dispose of the property in accordance with the OCC guidelines.211

204. See 98 U.S. 621 (1878); see also supra notes 151-52 and accompanying text.
205. See Matthews, 98 U.S. at 626.
206. See Letter from Gerald P. Hurst to Steven J. Weiss, supra note 106, at 7.
207. See id. at 8.
208. See id.
209. See id. The bank noted that the subsidiary would own only legal title, while the lessee would have all possessory rights to the property. See id.
210. "Other Real Estate Owned" (OREO) generally consists of all real estate a national bank acquires which is not currently in use or contemplated for use within the near future as bank premises. See Other Real Estate Owned, 12 C.F.R. §§ 34.81-34.87 (1997). Banks are permitted to own OREO by virtue of section 29 of the National Bank Act, which provides that banks may own real estate under mortgage or to secure debts due to it for up to five years. See 12 U.S.C. § 29 (1994). Banks may own real estate for up to an additional five years if it has made a good faith attempt to liquidate the OREO within the initial five-year period or if disposal of the property within the five-year period would be harmful to the organization. See id.
While the OCC has previously allowed RELF only with respect to municipal facilities, it has never ruled out the possibility that it might allow similar transactions with private entities. Whether the OCC ultimately approves the application will depend, in part, upon whether it determines that the five percent limitation provides adequate protection against losses from real estate investment. It is unclear whether the OCC will consider the two applications in the aggregate, which together could potentially result in up to seven percent of the bank’s capital being devoted to real estate-type activities.

C. Zions Application – Municipal Revenue Bonds

Downplaying the possibility that section 16 of Glass-Steagall might prohibit national banks from underwriting and dealing in municipal revenue bonds, the OCC approved the Zions application by determining that the activity was allowed under the express powers language of section 24 (Seventh) of the National Bank Act, which authorizes national banks to “discount and negotiate evidences of debt.” The OCC determined that the term “evidence of debt” includes a debt security such as a revenue bond and that the phrase “to negotiate and discount” includes the power to buy and sell bonds as principal.

212. See supra note 195 and accompanying text.
214. Decision of the Comptroller, supra note 127, at 6 (quoting 12 U.S.C. § 24 (Seventh) (1994)). Section 24 (Seventh) was passed in 1863 as part of the National Bank Act. See MACEY & MILLER, supra note 180, at 11. Glass-Steagall, otherwise known as the Banking Act of 1933, was passed as part of major banking reform in response to bank panics in 1933 which ultimately resulted in President Franklin D. Roosevelt declaring a nationwide banking holiday on March 6, 1933. See id. at 21-22. In addition to separating commercial and investment banking, Glass-Steagall also established a program of federal deposit insurance. See id. at 22-23.
215. Decision of the Comptroller, supra note 127, at 9 (quoting 12 U.S.C. § 24 (Seventh). Citing a decision of the Supreme Court in 1881, the OCC determined that the term “discount” includes the purchases of notes and other evidences of debt. See id. (citing National Bank v. Johnson, 104 U.S. 271 (1881)). The OCC also said that a “negotiation” includes a transfer, disposition, or sale. See id. (citing BLACK’S LAW DICTIONARY 934 (5th
Despite its broad interpretation of the terms of section 24 (Seventh), the OCC interpreted the prohibitions of Glass-Steagall narrowly, stating that the Act prohibited only "certain types of securities" from being sold directly by a bank and did not entirely exclude investment banking from the business of banking.\textsuperscript{216} The OCC pointed to section 24 (Seventh) as the legal basis which allowed banks to engage in investment banking activities before the passage of Glass-Steagall.\textsuperscript{217} The effect of that act, according to the OCC, was to keep banks from engaging in investment activities with respect to "certain types of securities;" the act did not, however, alter "the basic concept of the business of banking," including banks' ability "to discount and negotiate promissory notes and other evidences of debt."\textsuperscript{218} Thus, explained the OCC, banks are allowed to continue these activities, to a limited extent, through a subsidiary or other bank-related entity.\textsuperscript{219}

Though the OCC interpreted Glass-Steagall as allowing banks to engage in investment banking activities in some circumstances, the Supreme Court has generally expressed in dicta a disdain for mixing commercial and investment banking. In \textit{Investment Company Institute v. Camp},\textsuperscript{220} the Court held that banks

\textsuperscript{216} See Decision of the Comptroller, \textit{supra} note 127, at 6. In fact, said the OCC, the Act expressly recognized investment banking as a part of the business of banking. See \textit{id}. Support for the OCC's position that the restrictions apply only to "certain types of securities" is found in other portions of section 24 (Seventh). Specifically, section 24 (Seventh) allows banks to sell certain types of securities, providing that "the limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply" to obligations of the United States, general obligations of states and their political subdivisions, and other agencies of the federal government. See 12 U.S.C. § 24 (Seventh) (1994).

\textsuperscript{217} See Decision of the Comptroller, \textit{supra} note 127, at 9. The OCC also cited historical precedent to support its position, stating that underwriting and dealing was already a part of the business of banking at the time the national banking system was created by President Abraham Lincoln. See \textit{id} at 6. When the National Bank Act was enacted in 1863 (originally named the National Currency Act), banks entered investment banking by selling war bonds for the Civil War and continued to buy and sell government securities after 1865, the OCC said. See \textit{id} at 7. In addition, the OCC cited the House Report on the McFadden Act limiting banks' investment banking activities which stated, "it is a matter of common knowledge that national banks have been engaged in the investment securities business . . . for a number of years." See \textit{id} (citing H.R. REP. NO. 69-83, at 2 (1926); CONG. REC. 2828 (1926)).

\textsuperscript{218} \textit{id}. at 9.

\textsuperscript{219} \textit{See id}.

\textsuperscript{220} 401 U.S. 617 (1970).
may not participate in mutual investment funds because they are securities and thus cannot be underwritten by banks without violating Glass-Steagall sections 16 and 21.\textsuperscript{221} The case involved OCC regulations that authorized banks to establish and operate collective investment funds.\textsuperscript{222} The Court explained that Congress, in passing Glass-Steagall, intended to enact a strict separation between commercial and investment banking, in order to prevent the conflicts of interest banks might experience if they had both promotional and pecuniary interests in particular investment opportunities.\textsuperscript{223} The Court stated that “[e]ven before the passage of the [Glass-Steagall] Act, it was generally believed that it was improper for a commercial bank to engage in investment banking directly.”\textsuperscript{224} Although banks had attempted to circumvent the prohibitions in Glass-Steagall by establishing securities affiliates, the Court observed in dicta that Glass-Steagall “confirmed that national banks could not engage in

\textsuperscript{221} See id. at 639.
\textsuperscript{222} See id. at 619 (citing 12 C.F.R. pt. 9 (1970)). The plan operated by having a bank customer tender between $10,000 to $500,000 to the bank with an authorization which made the bank the customer’s managing agent. See id. The investment was added to the fund, and the bank issued a written evidence of participation, which represented the customer’s proportionate interest in fund assets. See id. The actual custody and investment of the fund assets was handled by the bank in its role as an investment advisor pursuant to a management agreement. See id. at 623.
\textsuperscript{223} See id. at 629. The Supreme Court determined that Glass-Steagall responded to concerns by Congress that banks had been hurt by stock market declines stemming from their “direct and indirect involvement in the trading and ownership of speculative securities.” Id. at 630 (citing S. REP. NO. 73-77, at 6, 8, 10). Congress was concerned that public confidence in banks might decline if banks experienced losses through their securities practices. See id. at 631. In addition, Congress worried that banks might make unsound loans to its securities affiliates to compensate for these losses. See id. (citing Hearings Pursuant to S. Res. 71 before a Subcommittee on the Senate Committee on Banking and Currency, 71st Cong., 3d Sess., 20, 237, 1063 (1931)) [hereinafter 1931 Hearings]. The Court also cited to congressional fears that bank customers might suffer losses on investments they purchased due to their trust in the bank. See id. (citing 77 CONG. REC. 4028 (remarks of Rep. Fish).

The Supreme Court expressed concern over whether securities activities by banks might affect their judgment. The Court determined that Glass-Steagall reflected Congress’ concern that banks might make unsound loans to companies in whose stock or securities the securities affiliate had invested. See id. (citing 1931 Hearings, supra, at 1064). The Court also stated that the banks would be unable to make disinterested investment advice to customers where they had a “promotional interest” as an investment banker. See id. at 633.
\textsuperscript{224} Id. at 629 (citing 1931 Hearings, supra note 223, at 40; 1920 Report of the Comptroller of the Currency).
investment banking directly, and in addition made affiliation with an organization so engaged illegal.\textsuperscript{225}

In 1984, the Supreme Court again discussed the necessity of separating commercial and investment banking in \textit{Securities Industry Association v. Board of Governors of the Federal Reserve System}.\textsuperscript{226} In that case, the dispute arose from an interpretation of Glass-Steagall by the Federal Reserve which allowed banks to market third party commercial paper.\textsuperscript{227} Reaffirming its decision in \textit{Camp}, the Court stated that Congress enacted Glass-Steagall to isolate commercial from investment banking.\textsuperscript{228} The Court explained that Glass-Steagall reflected Congress' determination that "certain investment banking activities conflicted in fundamental ways with the institutional role of commercial banks."\textsuperscript{229} Therefore, the Court held that banks may not sell commercial paper because it is a "security" subject to the prohibitions of section 16 and 21.\textsuperscript{230}

Notwithstanding the Supreme Court decisions in \textit{Camp} and \textit{SIA}, it may still be argued that banks may conduct the activity under the "incidental powers" language of section 24 (Seventh).\textsuperscript{231} Even if underwriting revenue bonds is not included in the power of banks to

\textsuperscript{225} See id. The Court noted that one effect of Glass-Steagall was to abolish the security affiliates of commercial banks. See \textit{id.} (citing H.R. Doc. No. 76-70, pt.2, at 59 (1939)).


\textsuperscript{228} See \textit{SIA}, 468 U.S. at 144-47. The Court noted that through flat prohibitions Glass-Steagall sought to "separat[e] as completely as possible commercial from investment banking." See \textit{id.} at 147-48 (citing Board of Governors of Federal Reserve System v. Investment Co. Inst., 450 U.S. 46, 70 (1981)). The Court determined that Congress specifically had two concerns in mind when it enacted the Act: the inherent risk associated with the securities business and the effect of losses on consumer confidence in the banking system. See \textit{id.} at 145. The Court noted that it was this "crisis of confidence" that contributed to the runs on bank in the 1920s which ultimately hampered these banks' solvency. See \textit{id.}

\textsuperscript{229} \textit{Id.} at 145. Congress recognized that various conflicts of interest exist when a bank represents clients both as a commercial and investment bank. See \textit{id.} Because customers look to banks as a source of investment advice, it might be difficult for banks to give impartial advice about securities which they might be underwriting. See \textit{id.} at 145-46. Conflicts might also arise because banks must incur substantial start up costs to build and maintain a securities distribution system, the Court noted. See \textit{id.} at 146.

\textsuperscript{230} See \textit{id.} at 160; see also \textit{supra} notes 53-54.

\textsuperscript{231} See \textit{supra} note 9.
“discount and negotiate other evidences of debt,” section 24 (Seventh) could still be interpreted to allow the underwriting of revenue bonds as an incidental power which is “necessary to carry on the business of banking.” The Supreme Court’s decision in *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co. (VALIC)* gives banks greater power to expand into other areas deemed to be “incidental” to the business of banking, perhaps even investment banking. In *VALIC*, the Court held that the Comptroller has discretion to authorize activities not expressly enumerated under section 24 (Seventh) of the National Bank Act. The Court cautioned, however, that the OCC does not have unlimited power and emphasized that if the intent of Congress was clear regarding a statute, it was “the end of the matter.” Alternatively, explained the Court, “if the statute is silent or ambiguous with respect to the specific issues,” the OCC’s interpretation will stand if it “is based on a permissible construction of the statute.” Ultimately in *VALIC*, the Court upheld the Comptroller’s determination that banks may sell annuities because they are

232. 12 U.S.C. § 24 (Seventh) (1994). The courts have determined that “necessary” bank powers include those which are “convenient and useful.” See *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972) (holding that operation of a travel agency did not qualify as a “convenient and useful” activity). The OCC likewise looked to the “convenient and useful” standard to justify the use of operating subsidiaries. See *Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60,341, 60,353 (1996)*.


234. The Court noted that banks had the authority to deal in securities well before enactment of Glass-Steagall, and that the insertion of the section limitations made sense “only if banks already had authority to deal in securities, authority presumably encompassed within the ‘business of banking’ language which dates from 1863.” *Id.* at 258. The Court noted that both the Glass-Steagall and the McFadden Acts served only to limit activities already part of the business of banking. See *id.* (citing Act of Feb. 25, 1927, § 2(b), 44 Stat. 1226; *Clarke v. Securities Indus. Ass’n*, 479 U.S. 388, 407-08 (1987) (noting that banks conducted securities activities on a widespread basis before 1927); 2 F. REDLICH, THE MOLDING OF AMERICAN BANKING: MEN AND IDEAS, 389-93 (1951) (detailing the involvement of early national banks in securities transactions)).

235. *Id.* at 258 n. 2 (1995). *VALIC* gave the OCC more power to define permissible activities than an earlier circuit court decision allowing banks to engage in activities “convenient and useful” to the conduct of the business of banking. See *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972).

236. *VALIC*, 513 U.S. at 257 (quoting *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984)). It also said the OCC’s judgment should be given “controlling weight” if it “fills a gap or defines a term in a way that is reasonable in light of the legislature’s revealed design” *Id.* (citing *Chevron*, 467 U.S. at 844).

237. *Id.* (quoting *Chevron*, 467 U.S. at 843).
essentially financial investment instruments which congressional authorization permits them to broker.\textsuperscript{238}

Even if section 16 does prohibit banks from directly selling municipal revenue bonds themselves, it does not apply to an operating subsidiary, according to the OCC.\textsuperscript{239} Although the Supreme Court has not addressed whether the section 16 restrictions should apply to operating subsidiaries of banks, it has decided a similar issue regarding whether section 16 applies to a nonbank subsidiary of a bank holding company.\textsuperscript{240} In 1981, the Supreme Court upheld a determination by the Federal Reserve that a nonbank subsidiary of a bank holding company could act as an investment adviser.\textsuperscript{241} In so holding, the Court explained that section 16 applies only to banks and not to bank holding companies.\textsuperscript{242} Whether such reasoning would also apply to operating subsidiaries of national banks is not clear.

In addition to the confusion regarding whether restrictions on banks also apply to operating subsidiaries, is the uncertainty as to whether the OCC has the power to permit any securities activities at all. As the SIA argued in its comment letter, permitting bank subsidiaries to engage in ineligible securities activities through an operating subsidiary might be construed as beyond the power granted

\begin{itemize}
\item \textsuperscript{238} See id. at 260.
\item \textsuperscript{239} See Decision of the Comptroller, \textit{supra} note 127, at 21. Zions had argued the restrictions of Glass-Steagall should not apply to bank subsidiaries because they were not mentioned in the statutes. See Zions Memorandum, \textit{supra} note 128, at 14. Zions said the "plain meaning [of the statutes] must be honored absent compelling evidence of a different Congressional intent." See id. (citing \textit{Chevron}, 467 U.S. at 842 (1984)).
\item \textsuperscript{240} See Board of Governors of the Federal Reserve v. Investment Co. Inst., 450 U.S. 46 (1981). The lawsuit stemmed from the determination by the Federal Reserve under Regulation Y that bank holding companies and their nonbanking subsidiaries were permitted to serve as investment advisors because the activity was "closely related to banking." See id. at 48-49. The Court rejected arguments presented by the Investment Company Institute, a trade association of investment companies, that the regulation violated sections 16 and 21 of Glass-Steagall. See id. at 53-55.
\item \textsuperscript{241} See id. at 55.
\item \textsuperscript{242} See id. at 58 n.24. The Court rejected the argument that a bank and its bank holding company should be treated as one entity when applying section 16. See id. Even though section 16 serves as an outright prohibition against banks engaging in underwriting activities, the Court noted that the section should not be applied to organizations affiliated with banks because they are dealt with in other sections of Glass-Steagall. See id. The Court applied logic that might also be helpful to operating subsidiaries, holding that bank affiliates may be authorized to engage in some activities which banks may not engage in themselves. See id. at 60. The Court explained that a less stringent standard should be applied to bank holding companies than to banks. See id. at 60 n.26.
\end{itemize}
to the OCC under section 93a of the Bank Act. Section 93a grants the Comptroller of the Currency the power to "prescribe rules and regulations to carry out the responsibilities of the office," but does not allow him to issue regulations relating to the McFadden Act or Glass-Steagall. The OCC avoided the issue of section 93a's applicability by arguing that the approval did "not confer authority on national banks (or their operating subsidiaries) that they do not have under existing law." The OCC said that because the proposed activity is part of the business of banking under section 24 (Seventh), section 93a was "simply inapplicable." Even if section 93a were applicable, it has yet to be used to restrict the OCC's regulating powers in any significant way. In addition, any narrow reading of the OCC's power is difficult to square with the Supreme Court's holding in \textit{VALIC} that an OCC interpretation should have "controlling weight" when it defines a term that is reasonable in light of the legislature's revealed intent.

The OCC's approval of Zions' application to engage in revenue bond underwriting can be justified by the agency's

\begin{footnotesize}
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\item[243.] See SIA Memorandum, \textit{supra} note 128, at 4; see also \textit{supra} notes 56-59 and accompanying text.
\item[245.] Decision of the Comptroller, \textit{supra} note 127, at 29 n.77.
\item[246.] \textit{Id}.
\item[247.] Since its enactment, there have been only two cases interpreting the OCC's power under the provision. See Conference of State Bank Supervisors v. Conover, 710 F.2d 878 (D.C. Cir. 1983) (upholding the authority of the OCC to promulgate regulations establishing the terms by which national banks may offer or purchase adjustable-rate mortgages which preempted conflicting state laws); Conference of State Bank Supervisors v. Lord, 532 F. Supp. 694 (D. Co. 1982) (holding section 93a restricts the Comptroller's power to issue regulations in certain areas, but the power is otherwise broad in scope).
\item[248.] See \textit{supra} notes 233-38 and accompanying text.
\end{enumerate}
\end{footnotesize}
determination that section 24 (Seventh) permits banks to directly “discount and negotiate” such instruments.\textsuperscript{249} If the OCC had determined instead that the proposed activity was not part of, but only “incidental” to the business of banking, support for the OCC’s decision could be found in the Supreme Court’s \textit{VALIC} decision.\textsuperscript{250} However, given strong wording in Supreme Court dicta against the mixture of commercial and investment banking in the same entity, the OCC determination could be challenged as going beyond the powers of the Comptroller.\textsuperscript{251} All these issues are also clouded somewhat by the lack of any clear ruling as to whether the prohibitions of section 16 apply to a subsidiary.\textsuperscript{252} 

V. CONCLUSION

The OCC made the correct decision regarding the ability of banks to underwrite municipal revenue bonds. Section 24 (Seventh) already permits banks to underwrite a wide variety of bonds, including general municipal bonds.\textsuperscript{253} There is little basis to distinguish revenue bonds from other government bonds that banks themselves may already directly underwrite. But the OCC’s determination that the proposed activity falls squarely within a bank’s power to “discount and negotiate evidences of debt” is somewhat troubling because such a determination makes the specific authorizations provided later in the statute superfluous.\textsuperscript{254} However,

\begin{itemize}
  \item \textsuperscript{249} See supra notes 133-34, 214-15 and accompanying text.
  \item \textsuperscript{250} See supra notes 233-38 and accompanying text.
  \item \textsuperscript{251} See supra notes 220-30, 243-48 and accompanying text.
  \item \textsuperscript{252} See supra notes 239-42 and accompanying text.
  \item \textsuperscript{253} See supra notes 137, 216 and accompanying text.
  \item \textsuperscript{254} See supra notes 133-34, 214-15 and accompanying text. The OCC’s decision makes it somewhat unclear which activities impermissible to a national bank are permissible to its subsidiary. Based on the language of section 24 (Seventh), a national bank almost certainly would not be allowed to underwrite the sale of municipal revenue bonds because it does not fall within one of the express categories of bonds enumerated in the statute. However, because the proposed activity is to be conducted through a subsidiary, the OCC seems to have applied a laxer standard by including revenue bonds within the definition of “evidences of debt” which banks may underwrite. Perhaps the OCC is attempting to apply the Federal Reserve’s “closely related to banking” standard instead of its own “business of banking” standard. See 12 U.S.C. §§ 1843(c)(8), 24 (Seventh) (1994). In fact, the OCC approved the Zions application, in part, because the activity complied with certain Federal Reserve requirements. See supra note 131 and accompanying text.
\end{itemize}
allowing banks to underwrite these bonds will add much needed competition to the municipal revenue bond market and thus reduce municipal borrowing costs. The activity has the support of the Comptroller, who has greater power to authorize new activities for national banks after VALIC. Supreme Court warnings against the danger of mixing commercial and investment banking have less resonance in the case of government obligations then with corporate investments.

Authority exists to support approval of NationsBank's application to engage in RELF, but the bank's self-imposed limitation of five percent of its Tier 1 capital is too high. The NationsBank application might result in a subsidiary owning real estate at the end of the lease term worth only twenty-five percent of the acquisition cost, which it might then have to release or sell at a significant loss. The potential magnitude of such a loss is substantial because five percent of the Tier 1 capital of a bank the size of NationsBank could be several hundred million dollars. Although NationsBank argued that the "flow of capital" will not be disturbed, the bank has failed to account for the fact that fewer funds will be available to consumers during the period properties to be leased are constructed. Despite these concerns, the OCC will likely approve the application so that operating subsidiaries may conduct the same activities as are now allowed to subsidiaries of bank holding companies under the revised Regulation Y.

255. See supra note 138 and accompanying text.
256. See supra notes 233-38 and accompanying text.
257. See supra notes 220-30 and accompanying text.
258. See supra notes 107, 202 and accompanying text.
259. For the years ended December 31, 1995 and 1996, NationsBank, N.A. had Tier 1 capital of $4.623 and $5.137 billion respectively. See NATIONS BANK CORP., 1996 ANNUAL REPORT (1997). The Tier 1 capital amounts may increase even further, as large banks, such as NationsBank, consolidate their interstate subsidiary banks pursuant to recent changes in federal banking law. See Rick Brooks, NationsBank is Challenged by Texas in Bid to Halt Combination of 2 Units, WALL ST. J., Nov. 28, 1997, at B13. NationsBank is currently facing litigation over its plans to consolidate its Texas banks into its largest banking unit, which is located in Charlotte. See id.; see also Haley M. Brady & Mark V. Purpura, The Riegle-Neal Amendments Act of 1997: The Impact of Interstate Branching on the Dual Banking System, 2 N.C. BANKING INST. 230 (1998).
260. See supra note 202. This would finally allow real estate lease financing to the same extent as has been allowed for the leasing of personal property, including leases to non-public entities. See supra note 195. In its application, NationsBank acknowledged that while the Federal Reserve has not determined that real estate development is a permissible
If it approves the application by NationsBank to engage in real estate development, the OCC will puncture the largest-ever hole in the section 29 wall prohibiting real estate investments by banks. Banks already own large amounts of real estate,261 and much of it is in the form of “bank premises.”262 Allowing the purchase of real estate through operating subsidiaries will provide a way for banks to increase their real estate holdings far beyond simply “premises.” However, the S&L crisis should serve as a reminder of the potential pitfalls stemming from excessive real estate investment by financial institutions. In addition, allowing real estate development by banks without sufficient safeguards could lead to an unfair competitive advantage for banks over nonbanking entities263 and to a subsequent accumulation of even more massive economic power in banks.

For now, it remains unclear how much the new Regulations will enable national banks to engage in new activities through their subsidiaries. For example, if the OCC approves NationsBank’s real estate development and RELF applications, the OCC will certainly encounter a deluge of applications from other banks seeking to expand into new real estate ventures.264 The OCC will also encounter resistance from Congress, which covets its role in effecting financial
services reform and is increasingly belligerent towards attempts by the OCC to weaken some of the banking industry's current barriers to other commercial activities.\textsuperscript{265}

The OCC's issuance of new Part 5 Regulations has resulted in jockeying for position among the various banking regulatory agencies.\textsuperscript{266} The Federal Reserve expressed its intention to apply the limitations of sections 23A and 23B to the activities of bank operating subsidiaries.\textsuperscript{267} The Federal Reserve also approved

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\item \textsuperscript{265} Senate Banking Committee Chairman Alfonse M. D'Amato, who has criticized the Part 5 Regulations, confronted Comptroller Ludwig during a hearing and charged that the OCC has been "undermining the dual banking system, threatening the primacy of state insurance regulation, and usurping the prerogatives of Congress." \textit{OCC's Op-Sub Rule Comes Under Increasing Attack from Greenspan, D'Amato, BANKING POL'Y REP., May 19, 1997, at 6, available in WESTLAW, Bnkpr Library.} Senator D'Amato called Ludwig "the czar of czars" and said the operating subsidiary rule is one way that Ludwig has shown a "clear disregard" of his authority to interpret the National Bank Act. \textit{Id.} In contrast, House Banking Committee Chairman James Leach was supportive, and described the Part 5 Regulations as "a step toward bank modernization." John R. Wilke, \textit{Comptroller Plans to Let Many Banks Enter a Wide Range of New Businesses, WALL ST. J., Nov. 20, 1996, at A2.}

\item \textsuperscript{266} The competition to ease banking regulations has led to an intense rivalry between the OCC and the Federal Reserve to attract banks to one agency over the other. See John R. Wilke, \textit{supra note 265}, at A2. Banks which are organized as holding companies are regulated by the Federal Reserve, while national banks are regulated by the OCC. See \textit{id.} By opening up the possibility of the "universal bank" which also conducts insurance and securities underwriting activities through operating subsidiaries, the Part 5 Regulations threaten the need for bank holding companies. See \textit{Note, The New American Universal Bank, 110 HARV. L. REV. 1310, 1327 (1997)} (concluding that Part 5 promotes efficiency within the banking industry by breaking the regulatory monopoly which the Federal Reserve once had over activities deemed "closely related to banking"); Melanie L. Fein, \textit{OCC's Op-Sub Rule Could Spark Changes in Banking Structure, BANKING POL'Y REP., Jan. 6, 1997, at 6, available in WESTLAW, Bnkpr Library} (arguing that many banks may question the need to retain a bank holding company in light of recent changes allowing banks to engage in more activities). The Federal Reserve continues to argue that new activities should be conducted through a bank holding company instead of an operating subsidiary. See Atkins, \textit{supra note 181}, at 348. Chairman Greenspan testified to the House Banking Financial Institutions Subcommittee that allowing banks to enter new lines of business through bank subsidiaries instead of bank holding companies would effectively extend the subsidy of federal deposit insurance to these subsidiaries, and thus give the subsidiaries a competitive advantage over non-bank-owned companies in the same line of business. See \textit{id.} Testifying as part of a later panel, Comptroller Ludwig disagreed, disputing that there was any net subsidy enjoyed after taking into effect the cost of regulations imposed on banks. See \textit{id.} The moves by the OCC could also result in lawsuits from industry trade associations which have expressed strong opposition to the banks moving into their practice areas.

\item \textsuperscript{267} \textit{See Fed Expected to Seek Curbs on Subsidiaries in Challenge to OCC, AM. BANKER, June 30, 1997, at 2.} The proposal would apply sections 23A and 23B of the Federal Reserve Act to any bank subsidiary which engages in activities impermissible to the bank itself. See \textit{id.} Some observers questioned the need for the Federal Reserve rule since the Part 5 Regulations already require operating subsidiaries to abide by these rules. See \textit{id.}
changes to Regulation Y that allow expanded activities within bank holding companies.\textsuperscript{268} The FDIC moved to permit greater powers for state banks, especially in the areas of real estate development.\textsuperscript{269}

Several questions remain unanswered about the application process itself. The Federal Reserve has provided a laundry list of activities it has determined are appropriate for the subsidiaries of bank holding companies.\textsuperscript{270} The OCC, however, has refused to indicate which activities not permitted for national banks are considered appropriate for their subsidiaries.\textsuperscript{271} Furthermore, although the OCC said that it will review applications on a "case-by-case" basis, it has not explained whether and to what extent approval of one application establishes precedent for future applications.\textsuperscript{272} In addition, the relative weight given to each factor by the OCC in considering an application is unclear. Although the OCC announced three main criteria, it also suggested several additional factors it will consider.\textsuperscript{273} Moreover, the OCC has yet to provide a fixed timetable regarding when applications will be approved. Although it received the two NationsBank applications a few months before the Zions application, the OCC has not announced a decision on the NationsBank requests.\textsuperscript{274}

The regulations proposed by the Federal Reserve drew an unusually negative response, but are expected to be issued by the Federal Reserve nonetheless. See Olaf de Senerpont Domis, Industry, Regulators Blast Fed Plan for Subsidiaries, AM. BANKER, Oct. 7, 1997, at 2. The proposed regulations were opposed by, among others, the FDIC, the OCC, and the OTS. See id.


\textsuperscript{269} See supra note 185.

\textsuperscript{270} See supra notes 202, 260, 268 and accompanying text.

\textsuperscript{271} See 12 C.F.R. § 225.22 (1997). Comptroller Ludwig has refused to identify which activities the OCC might approve, saying that "a laundry list is a terrible mistake." Olaf de Senerpont Domis, supra note 6, at 2.

\textsuperscript{272} The NAR argued that approval of one application made by a bank might serve as sufficient precedent for the bank to establish other subsidiaries to participate in the activity. See Letter from Stephen D. Driesler to the OCC, supra note 88, at 5. The Federal Reserve opposed the NationsBank applications because of the "precedent its approval would set." Letter from William W. Wiles to Eugene Ludwig, supra note 84, at 1.

\textsuperscript{273} See supra notes 38-39 and accompanying text.

\textsuperscript{274} The NationsBank applications had yet to be ruled on by the end of February, 1998, but are expected to be acted upon within the first half of 1998. See Regulatory Roundup: Action Expected Soon, AM. BANKER, Jan. 8, 1998, at 4.
Perhaps the new Regulations will prod Congress into finally taking measures that allow banks to participate in a broader scope of real estate and financial activities. But some people have suggested just the opposite; they contend that Congress might instead pass legislation restricting the ability of banks to offer products or services outside of traditional banking areas. Whatever the eventual outcome of the various operating subsidiary applications, one thing is certain: the OCC has established itself as a major force in shaping the future of banking law.

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275. See, e.g., Atkins, supra note 3, at 784 (asserting that OCC approval of the NationsBank and Zions applications could result in congressional action that limits the scope of bank powers).

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