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The Business of Banking: Looking to the Future

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INTRODUCTION

The basic framework that governs the powers and permissible activities of national banks was, at last, resolved by the United States Supreme Court's recent decision in *NationsBank v. Variable Annuity Life Insurance Co. (VALIC)*.¹ Ending over 100 years of muddled precedent and conflicting commentary, the unanimous Court held that the "business of banking" is not limited to those activities and powers expressly enumerated in the National Bank Act (Act).² Rather, the Court found that the business of banking is an expansive concept and that the powers enumerated in the Act are merely illustrative. The Court's decision also reaffirmed that courts should accord substantial deference to reasoned decisions by the Comptroller of the Currency (Comptroller) interpreting the powers of national

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1. 115 S. Ct. 810 (1995). For a detailed discussion of the facts and background of the VALIC matter, see Tamar Frankel, *Bank Powers to Sell Annuities*, 49 BUS. LAW. 1691 (1994).

2. The "business of banking" clause comes from § 24(Seventh) of the National Bank Act, which affirmatively grants national banks the power:

To exercise . . . all such incidental powers as shall be necessary to carry on the *business of banking*; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title.

12 U.S.C. § 24(Seventh) (1988 & Supp. V 1993) (emphasis added). The first clause of the section gives banks "all incidental powers . . . to carry on the business of banking." The clause implies that banks have both the power to "carry on the business of banking" as well as all "incidental powers" that are necessary to carry on that business. Where the business of banking ends and the incidental powers begin is not clear. The remaining clauses in § 24(Seventh) refer to more specific powers (e.g., discounting and negotiating promissory notes, etc.). These specific powers are referred to as the "enumerated" or "express" powers.

banks under the National Bank Act.³ Together, these two components of the *VALIC* decision give the Comptroller the ability to allow the business of banking conducted by national banks to evolve and to service developing markets and emerging customer needs. The key issue now is how to identify the activities that fit within the *VALIC* framework. Specifically, a test is needed to determine whether a particular activity is part of or incidental to the business of banking and therefore within the Comptroller's discretion to permit.

The boundaries of the business of banking, and its companion concept of powers incidental to that business,⁴ outline the role national banks may play in the nation's financial system; in particular, what products they may offer and what customers they may serve.⁵ Unfortunately, analysis of these key terms by courts and commentators has been less than clear.

This Article presents an approach to defining the "business of banking" in contemporary contexts, based on the history of the national bank charter and the purpose of the national bank system, and guided by the analytical threads linking the numerous, and seemingly inconsistent, cases addressing the issue. Much of the confusion has been quieted by the *VALIC* decision, where the Court determined that the business of banking is a broad concept, not limited to the powers expressly stated in the National Bank Act. Other cases that preceded *VALIC*, and the legislative history of the National Bank Act, also support the conclusion that the business of banking is an evolving activity and that the national bank charter should be treated as an organic entity whose powers may respond over time, within certain parameters, to developments in the financial marketplace and the needs of banks' customers.

VALIC and prior cases now allow us to articulate the criteria that characterize the business of banking, both today and as it evolves. The focus should be on three questions:

3. *VALIC*, 115 S. Ct. at 810 ("It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of banking laws to an extent that warrants the invocation of this principle with respect to its deliberative conclusions as to the meaning of these laws.") (quoting *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 403-04 (1987); *Investment Co. Instit. v. Camp*, 401 U.S. 617, 626-27 (1971)); see *First Nat'l Bank v. Taylor*, 907 F.2d 775, 777 (8th Cir. 1990) ("Supreme Court has made clear that the Comptroller's interpretation of the National Bank Act must be given 'great weight.'") (citations omitted).

4. This Article focuses on the criteria for defining the "business of banking," rather than the distinct issue of what activities are "incidental" to that business; courts often have confused and conflated these two concepts. See *infra* note 48.

5. To the extent that states have modeled their own bank powers statute on § 24 (Seventh) of the National Bank Act, or have parity statutes that give their state banks the same powers as national banks, the definition of the business of banking and the scope of powers incidental to that business determine or influence the powers available to state-chartered banks as well. See *infra* note 13.

- (i) Is the activity a contemporary functional equivalent or logical outgrowth of a recognized banking function?
- (ii) Does the activity benefit customers and/or strengthen the bank?
- (iii) Are the risks of the activity similar to the type of risks already assumed by banks?

THE MODERN BANKING ENVIRONMENT

The scope of the business of banking is not merely an interesting theoretical issue. As all are aware, the financial services industry is continuing to evolve rapidly.⁶ If banks do not keep up, they will become obsolete. While the present condition of the U.S. banking industry is generally strong, the banking industry has experienced a long-term secular decline in its traditional activities.⁷ In the last twenty-five years, the share of credit market assets held by banks has dropped in half. The decline of U.S. banks in the international markets has been equally dramatic.

Why? When many of the current restrictions on bank activities were put in place, they reflected a compromise of sorts. While banks were restricted in the activities they could conduct and were subject to significant regulation, they also were the preeminent providers of transaction services and lending products commonly associated with banking. The first half of this bargain remains largely intact, but not the latter. As a result of fundamental economic developments, legislative and regulatory changes, and advancements in technology, banks now face competition from nonbanking organizations in almost all of their activities. And because banks face greater restrictions, more intense examinations, higher regulatory costs, and broader obligations in connection with their lending and deposit-taking activities, nonbank organizations frequently have the competitive upper hand.

Banks have seen, and may continue to see, their market share of commercial and industrial loans erode. The banking industry's most stable and successful corporate customers now turn to the cheaper commercial paper market (which is dominated by investment banks, insurance companies, and other nonbank institutions), Euromarkets, and foreign banks when they need funds. These markets and organizations have no intrinsic advantages over commercial banks. They simply operate under less regulation and hence have more flexibility and generally lower costs. The loss of these high-quality customers to nonbanking organizations affects banks beyond

6. See generally FEDERAL DEPOSIT INSURANCE CORPORATION, DIVISION OF RESEARCH AND STRATEGIC PLANNING, MANDATE FOR CHANGE: RESTRUCTURING THE BANKING INDUSTRY 5-16 (1987).

7. Some recent research suggests that the relative decline of the banking industry has been overstated. See, e.g., George G. Kaufman & Larry R. Mote, *Is Banking a Declining Industry? A Historical Perspective*, Economic Perspectives, Federal Reserve Bank of Chicago 2-21 (May/June 1994).

their bottom lines. It shifts bank lending portfolios into areas of greater risk, ultimately affecting the relative safety and soundness of the industry.

The situation is little better with banks' traditional consumer business. In the past two decades, consumers have invested hundreds of billions of dollars in uninsured nonbank money market accounts and mutual funds, which can offer more attractive returns than deposits. Nonbank firms offer check-writing services through their cash management accounts. Many nonbanking entities (e.g., finance companies, retailers that sell on credit, and mortgage companies) have become major players in the consumer credit market. Once more, the nonbank competition has been inching banks into increasingly more risky business areas. Having lost a substantial share of the secured consumer credit market (e.g., motor vehicle loans and home mortgages), banks have turned increasingly toward the revolving-credit market, where the credit is unsecured. Even in this market, though, the competition with nonbanks is intense, narrowing the returns.

Banks' continuing ability to serve their customers and to play a meaningful role in the national economy hinges on their ability to respond to changing markets and customer needs. Without the ability to retain existing customers and to attract new business, banks will continue to shrink relative to other financial service providers, or take on higher risks within the scope of their permissible activities, or both. The former will diminish access to credit for many borrowers dependant on banks, such as small businesses. The latter could undermine the industry's safety and soundness. From the perspective of both industry viability and the customer benefits that flow from healthy competition, the issue of whether banks can offer a competitive range of products and services is a vital, practical concern.

THE NATURE OF NATIONAL BANK POWERS

COMPETING VIEWS OF BANK POWERS

The applicable statute, section 24(Seventh) (also referred to as the powers clause) of the National Bank Act, provides national banks with the following power:

To exercise . . . *all such incidental powers as shall be necessary to carry on the business of banking*; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title.⁸

The text is amenable to multiple interpretations. Prior to *VALIC*—for over a century—courts and commentators debated the meaning of the powers

8. 12 U.S.C § 24(Seventh) (emphasis added).

clause. The participants in the debate generally fell into one of two camps, either proponents of a narrow, strict constructionist view of section 24(Seventh), or advocates of a broad, flexible view.

The narrow view of section 24(Seventh) read the phrase “business of banking” as mere shorthand for the five enumerated powers immediately following the “business of banking” clause. Thus, a national bank’s “incidental powers” could include only those powers that are “necessary to carry on” the five enumerated powers.⁹

The broad view construed the “business of banking” as a separate grant of power. The enumerated powers that follow were characterized as merely examples of the types of business activities included within the business of banking.¹⁰

Approving bank sales of annuity products, the Supreme Court in *VALIC* explicitly endorsed the broad view: “We expressly hold that the ‘business of banking’ is not limited to the enumerated powers in 24(Seventh) and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.”¹¹ Left largely unsaid was any justification for the Court’s position. In fact, the Court addressed the subject in a footnote.¹² Given the brevity of the Court’s instruction on this critical matter, and to provide better context for its application, the principal arguments for and against the approach adopted by *VALIC* are summarized *infra*. While the relevant statutory text, legislative history, and case law are uneven, in the main, they support the Court’s broad interpretation of section 24(Seventh). They also guide us prospectively in developing a workable test to define the business of banking.

The principal argument in support of the broad view, and the only argument articulated in *VALIC*, comes from the text that accompanies the powers clause. That text indicates Congress did not consider the enumerated powers in section 24(Seventh) to be all inclusive, and assumed that

9. An even more restrictive interpretation of § 24(Seventh) would not distinguish between the business of banking and those activities that are incidental to the business of banking. All bank powers would be considered “incidental powers” and those powers would be strictly limited to what is enumerated in § 24(Seventh). *See, e.g.,* Birdsell Mfg. Co. v. Anderson, 20 F. Supp. 571 (W.D. Ky. 1937), *aff’d* 104 F.2d 340 (6th Cir. 1939).

10. An alternative broad-view interpretation would limit the business of banking to the enumerated powers, but would expand the scope of national banks’ incidental powers to include powers that are not related to the enumerated powers. A further alternative construction of § 24(Seventh) would not distinguish between the business of banking and those activities that are incidental to the business of banking. The legislative history of § 24(Seventh), however, indicates the distinction between the “business of banking” and “powers incidental to the business of banking” is appropriate. *See infra* note 28.

11. *NationsBank v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

12. *Id.* at 814 n.2.

banks had powers beyond those listed in section 24(Seventh).¹³ In specific, the McFadden Act of 1927, which added a provision to section 24(Seventh) to *limit* bank securities activities, recognized the power to deal in securities as preexisting. The legislation provided that “[t]he business of buying and selling investment securities shall *hereafter* be limited.”¹⁴ The use of the term “hereafter” reveals that the McFadden Act presupposed that buying and selling investment securities was already part of the business of banking.¹⁵ Because that power does not fall within any of the enumerated powers, it must have originated in the general “business of banking” clause.¹⁶ As the *VALIC* Court noted: “Congress’ insertion of the limitation

13. The texts of certain state banking statutes imply that legislatures in a number of states also had adopted a broad view of § 24(Seventh). At least ten states modeled their respective bank powers clauses on the “business of banking” clause in § 24(Seventh). In several of these states, the text was modified to clarify that the business of banking was a separate grant of power, with the enumerated powers mere examples of that power. *See, e.g.,* W. VA. CODE § 31A-4-13 (Supp. 1994) (“Any state-chartered banking institution shall have and exercise all of the powers necessary for, or incidental to, the business of banking, *and without limiting or restricting such general powers*, it shall have the right to buy or discount promissory notes and bonds, negotiate drafts, bills of exchange. . . .”) (emphasis added); S.D. CODIFIED LAWS ANN. § 51A-4-1 (1990) (“In addition to powers otherwise conferred . . . a bank may exercise all such powers as are usual in carrying on the business of banking, *including*, the buying, discounting, and negotiating promissory notes. . . .”) (emphasis added).

14. Act of Feb. 25, 1927, ch. 191, § 2(b), 44 Stat. 1226 (emphasis added) [hereinafter *McFadden Act*].

15. Banks had been dealing in securities many years prior to the McFadden Act. *See* Clarke v. Securities Indus. Ass’n, 479 U.S. 388, 407-08 & nn. 20-22 (1987); *see also* H.R. REP. NO. 83, 69th Cong., 1st Sess. 2 (1926) (“It is a matter of common knowledge that national banks have been engaged in the investment securities business . . . for a number of years. In this they have proceeded under their incidental corporate powers to conduct the banking business”); *accord* CONG. REC. 2828 (1926); *Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 1782 and H.R. 2*, 69th Cong., 1st Sess. 22 (1926) (statement of Rep. McFadden); S. REP. NO. 473, 69th Cong., 1st Sess. 7 (1926); Edwin J. Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 *BANKING L.J.* 483, 492, 494 & n.26 (1971).

16. Similarly, the enumerated powers in § 24(Seventh) did not give banks the authority to engage in the safe-deposit business. Yet a further provision added to § 24(Seventh) by the McFadden Act states:

Provided, that in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of [15 percent of the bank’s capital].

See McFadden Act, § 2(b). Like the McFadden Act’s investment-securities restriction, this revision did not create a new power. Rather, it recognized that some national banks had been engaging in the safe-deposit business and placed upon such banks a capital-based limitation. The authority to carry on a safe-deposit business came elsewhere—the only place being the § 24(Seventh) powers clause. The legislative history of the McFadden Act further clarifies that the Act’s safe-deposit limitation cannot be reconciled with a narrow view of the business of banking. *See infra* note 17.

In addition, § 14 of the Banking Act of 1933, 48 Stat. 184 (1933), added a new § 24A to

[on securities dealing] decades after the National Bank Act's initial adoption makes sense only if banks already *had* authority to deal in securities, authority presumably encompassed within the 'business of banking' language which dates from 1863."¹⁷

Proponents of the broad view have also made other, generally less persuasive arguments. Some have pointed to the semicolons in section 24(Seventh) to support a broad construction.¹⁸ One commentator has contended that many financial services can be broken down into constituent components, where each of the components falls within one of the enumerated powers in section 24(Seventh), leading to a broad-view result.¹⁹ Still

the Federal Reserve Act to limit the amount of a national bank's stock and other investments in, and loans to, a corporation that owns a bank's premises. The new § 24A required approval by the Comptroller if the bank's aggregated equity and debt investments in, and loans to, such corporation exceeded 100% of the bank's capital. 12 U.S.C. § 371d (1988). Like the safe-deposit and investment securities provisions that were added in 1927, § 24A did not grant any additional powers. To the contrary, it assumed such investments in bank premises were lawful and merely tried to regulate them. Again, the source for such power must have come from the § 24(Seventh) powers clause. Similarly, §§ 13 and 20 of the Banking Act of 1933 contained regulatory features that presupposed the authority of national banks to invest in subsidiaries under § 24(Seventh).

17. *NationsBank v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 814 (1995) (emphasis added). The legislative history of the McFadden Act affirms this point. The final report accompanying the legislation noted that the bill's provisions regarding the investment-securities business (as well as the safe-deposit business) had been changed in the final version of the bill:

[I]nstead of appearing in the bill as new grants of power (as they appeared in [the prior bill]) they now appear as a *confirmation and regulation of an existing banking service or business*. It is a matter of common knowledge that national banks have been engaged in the investment-securities business and the safe-deposit business for a number of years. In this they have proceeded under their incidental corporate powers to conduct the banking business. Section 2(b) recognizes this situation but declares a public policy with reference thereto and thereby regulates these activities.

H. REP. NO. 83, 69th Cong., 1st Sess. 2 (1926) (emphasis added).

18. The first clause of § 24(Seventh), "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking," is separated by a semicolon from the subsequent clause, and the further subsequent clauses are separated by semicolons from one another. In Ralph F. Huck, *What is the Banking Business?*, 21 *BUS. LAW.* 537-44 (1966), the author argues that standard rules of construction require that each of the clauses separated by semicolons be read independently of the others. Accordingly, the phrase "the business of banking" should not be modified or limited by the subsequent independent clauses which specify less general powers.

19. Henry Harfield, *Sermon on Genesis 17:20, Exodus 1:10 (A Proposal for Testing the Propriety of Expanding Services)*, 85 *BANKING L.J.* 565 (1965). In his article, Mr. Harfield gave the following example: A bank creates a Merchandise Mart, sending merchandise catalogues from third-party manufacturers to its own banking customers. The customers contract with the bank to purchase articles in return for the bank debiting their accounts for the catalogue price. The bank then contracts with the manufacturer to have the manufacturer deliver the ordered merchandise to bank customer homes in exchange for a commission. Taken in their entirety, these acts can be characterized as the business of merchandizing and well outside

others have argued that Congress implicitly recognized the flexible nature of bank powers in connection with its authorization of bank trust powers by tying national bank trust powers to state law.²⁰

The principal argument supporting the narrow view is expressed by the maxim *expressio unius est exclusio alterius*, a principle of statutory interpretation meaning the expression of one thing implies the exclusion of others.²¹ More plainly, national banks should be prohibited from engaging in activities other than those expressly granted by Congress. Because the phrase "the business of banking" arguably grants no specific powers, it cannot be a source of authority for banks. Advocates of the narrow view therefore read section 24(Seventh) to grant national banks "all such incidental powers as shall be necessary to carry on" the described enumerated powers.

Even if one concedes the validity of *expressio unius est exclusio alterius*,²² however, its application in this instance is inappropriate. Nothing prohibits

the business of banking. But looked at separately, each of the bank's acts are perfectly within the bank's express powers under § 24(Seventh)—namely, the power to enter into contracts. No court, however, has taken this approach. Presumably it would fail on the proposition that a whole can constitute more than just the sum of its parts.

20. Under 12 U.S.C. § 92a (1988), a national bank is authorized (with the Comptroller's approval) to engage in whatever fiduciary activities state banks or other corporations that compete with national banks can perform under the laws of the state where the national bank is located. *Id.* § 92a(a), (b). Thus, national bank fiduciary powers are referenced to state law, and as a result, subject to change. A similar state parity provision with respect to general banking powers had been included in a draft of the original Banking Act of 1933. *See* H.R. 5611, 73d Cong., 1st Sess. (1933) (draft of 1933 Act legislation, as introduced by Mr. Steagall and committed to the Committee of the Whole, proposed to revise § 24(Seventh) by adding an additional clause after the enumerated powers. The pertinent portions of the revised § 24(Seventh) would have read as follows:

To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking . . . and generally by engaging in all forms of banking business and undertaking all types of banking transactions that may, by laws of the State in which such bank is situated, be permitted to banks of deposit and discount organized and incorporated under the laws of such State, except insofar as they may be forbidden by the provisions of any Act of Congress.

(proposed revisions in italics)).

21. *See* *Burgin v. Forbes*, 169 S.W.2d 321, 325 (Ky. 1943); *Newblock v. Bowles*, 40 P.2d 1097, 1100 (Okla. 1935); *see also* *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010, 1013-14 (5th Cir. 1968).

22. The logic of *expressio unius est exclusio alterius* is particularly suspect in this instance, where it is being applied to an organic act (the National Bank Act), the nature of which demands that only the general outlines of the law be marked and its important objects designated. The National Bank Act is over 130 years old. It has never been read to contain all of the accurate details of how banks should be run and operated. The situation is not dissimilar to the debate over the "necessary and proper" clause in the Constitution, as set forth in *McCulloch v. Maryland*, 4 Wheat. 316, 4 L. Ed. 415 (1819). There, the Supreme Court found that Congress had the power to charter the Second National Bank of the United States, even though the power to establish banks was not among the enumerated powers in the Constitution. Although the Tenth Amendment declares the powers "not delegated to the

reading the enumerated powers as mere examples of the “business of banking.”²³ Moreover, as discussed previously,²⁴ Congress has affirmed the existence of bank powers not included in the enumerated powers, such as brokering investment securities and providing safe deposit services.²⁵

United States, nor prohibited to the States, are reserved to the States or to the people,” U.S. CONST. amend. X, the Court found that the power to establish banks was implied from the enumerated powers. *McCulloch*, 4 Wheat. at 409. The Court further rejected the argument that the “necessary and proper” clause significantly limited the implied powers. *Id.* at 411-25. The term “necessity” can mean “convenient or useful.” *Id.*; see also *Legal Tender Case*, 110 U.S. 421, 440 (1884); cf. *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972); *M&M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978). The Court argued that it would have been wholly impracticable to have created a constitution with “immutable rules, for exigencies which, if foreseen at all, must have been seen dimly, and which can be best provided for as they occur.” *McCulloch*, 4 Wheat. at 415. After all, “we must never forget that it is a constitution we are expounding.” *Id.* But in *Arnold Tours*, 472 F.2d at 431, the First Circuit rejected a bank powers argument based on *McCulloch* on the grounds that the “identical” argument was “rejected or ignored” by the Supreme Court in *Texas & Pac. Ry. Co. v. Pottorff*, 291 U.S. 245 (1934). The *Pottorff* opinion, however, did not “reject” the *McCulloch* argument, it simply failed to address it. Moreover, the Supreme Court has declined to follow the *Pottorff* reasoning. As discussed below, while the holding was appropriate, the Court’s reasoning was not. The opinion was an over-reaction to what the Court perceived to be an unsound banking practice. See *infra* notes 121-126 and accompanying text. Today, the *Pottorff* decision may best stand for the proposition that bad facts make bad law. Cf. *Northern Sec. Co. v. United States*, 193 U.S. 197, 400 (1904) (“Great cases like hard cases make bad law.”) (Holmes, J., dissenting).

23. An alternative construction of § 24(Seventh) would construe the enumerated powers as neither grants of power, nor examples of the business of banking. Rather, the enumerated powers would be examples of incidental powers. The punctuation in § 24(Seventh), however, complicates this reading, and the interpretation does not comport with general understanding of 19th or 20th century banking practices.

24. See *supra* notes 13-17 and accompanying text.

25. Others have made additional textual arguments in support of the narrow view. A 1966 legal opinion by the Legislative Reference Service of the Library of Congress contended that the specific, enumerated powers take precedence over a more general statement of power (e.g., the power to engage in the business of banking). *To Prohibit Banks From Performing Certain Nonbanking Services: Hearings on H.R. 112, H.R. 117, and H.R. 10529, Before the Subcomm. on Banking Supervision and Insurance of the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 11 (1966) (Legal Opinion Prepared by the Legislative Reference Service of the Library of Congress Concerning the Assertions in the Preceding Article by Ralph F. Huck) [hereinafter *Legal Opinion*]. The *Legal Opinion* relied on the following passage from Sutherland’s treatise on statutory construction:

Where general words follow specific words in an enumeration describing the legal subject, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words. . . . If the general words are given their full and natural meaning, that is, the meaning they would receive in the abstract, they would include the objects designated by the specific words, making the latter superfluous. . . . Had the legislature intended the general words to be used in their unrestricted sense, it would have made no mention of the particular words, but would have used “only one compendious” expression.

JABEZ G. SUTHERLAND, *STATUTES AND STATUTORY CONSTRUCTION* II 395, 398, 399, 401-02 (3d ed. 1943). But the Sutherland principle need not be challenged in order to support a

As between the arguments based on subsequent legislation presupposing non-enumerated powers and the arguments based on the principle of *expressio unius est exclusio alterius*, the former holds sway.²⁶ The *VALIC* Court had reasonable grounds, from textual arguments alone, to conclude that the “business of banking” was an express grant of power.

HISTORICAL PERSPECTIVE ON THE BUSINESS OF BANKING

The legislative history of section 24(Seventh) also sustains the *VALIC* broad view. More important, it explains *why* the broad interpretation is most appropriate and provides guidance for future interpretations of the scope of the business of banking.²⁷

The present section 24(Seventh) originated as section 11 of the National Currency Act of 1863.²⁸ The National Currency Act (renamed the National

broad interpretation of § 24(Seventh). The principle was simply misapplied in the *Legal Opinion*. In § 24(Seventh), the specific words *follow* the general words—the very opposite of the situation addressed by the Sutherland passage. At minimum, logic does not dictate that latter words always qualify preceding words just because the latter words are considered more “specific.”

The *Legal Opinion*'s reliance on another statutory treatise was similarly misplaced. The opinion quotes Earl Crawford's *The Construction of Statutes*:

General and special provisions . . . in the same statute should also be harmonized, if possible, but in the event they are in irreconcilable conflict, the specific provision will control, unless the statute, considered in its entirety, indicates a contrary intention upon the part of the legislature. . . .

EARL T. CRAWFORD, *THE CONSTRUCTION OF STATUTES* §§ 167, 230 (1940). The Crawford principle excludes the instant case by its terms. The provisions in § 24(Seventh) can be harmonized by reading the specific provisions as examples of the business of banking. There is no “irreconcilable conflict.” The prescription of having the specific provisions control is unnecessary and unwarranted.

26. The familiar rule of construction that requires statutes to be construed so as to give meaning to all of their words, is used by proponents of both perspectives. Supporters of the narrow view argue that if the “business of banking” clause is an express grant of power, the enumerated powers are meaningless. Proponents of the broad view contend the opposite, if the business of banking clause has no meaning beyond what is specifically enumerated in the same sentence, it would be superfluous. Both sides also offer counterarguments. Narrow view supporters argue the business of banking is merely a convenient way to refer to the more complex, enumerated powers. Broad view proponents contend the enumerated powers are mere examples. In the end, neither side of this particular argument persuades.

27. For further detail concerning the history of the “business of banking” clause, see Edward L. Symons, Jr., *The “Business of Banking” in Historical Perspective*, 51 *GEO. WASH. L. REV.* 767 (1983).

28. Section 11 provided:

Every association formed pursuant to the provisions of this act . . . shall have power to carry on the business of banking by obtaining and issuing circulating notes in accordance with the provision of this act; by discounting bills, notes, and other evidences of debt; by receiving deposits; by buying and selling gold and silver bullion, foreign coins, and

Bank Act in 1864) was modeled on the New York Free Banking Act of 1838 (New York Act). In fact, the powers clause in section 11 was copied almost word for word from the New York Act.²⁹ Banks chartered under the New York Act were to have the same powers as banks that had been individually chartered by New York in previous years, so the text of the New York Act's powers clause mimicked the language that had been used in individual New York bank charters.³⁰ According to the New York Court of Appeals in *Curtis v. Leavitt*,³¹ the purpose of the powers clause in the individual bank charters had been to exclude banks from statutes designed to prevent nonbanking institutions from exercising banking powers. Thus, the court explained that the specifications in the subsequent New York Act "were . . . intended not to restrict the appropriate business of banking, but as a mere legislative definition of that business; a definition not indispensable, perhaps, but eminently useful, because it left nothing to construction or in doubt."³² The court further stated "it would be difficult

bills of exchange; by loaning money on real and personal security, in the manner specified in their articles of association, for the purposes authorized by this act, *and by exercising such incidental powers as shall be necessary to carry on such business.*

Act of Feb. 25, 1863, ch. 58, § 11, 12 Stat. 665, 558 (emphasis added). The incidental powers clause in section 11 was separate and distinct from the initial clause giving banks the "power to carry on the business of banking." At minimum, this separation implies that the "incidental powers" were not limited to the enumerated powers. The separation also casts doubt on the validity of alternative constructions of § 24(Seventh) which do not distinguish the two terms. See *supra* note 10. Although the powers clause was reorganized in 1864 into a format more closely representing the present § 24(Seventh), this implication would remain. There was no indication in the legislative history pertaining to the 1864 amendment that Congress sought to change the meaning of the powers clause.

29. The equivalent clause in the New York Act provided:

Such associations shall have power to carry on the business of banking by discounting bills, notes, and other evidences of debt; by receiving deposits; by buying and selling the gold and silver bullion, foreign coins and bills of exchange, in the manner specified in their articles of association for the purposes authorized by this act; by loaning money on real and personal security; and by exercising such incidental powers as shall be necessary to carry on such business.

1838 N.Y. Laws 245, 249.

30. The charter of the Commercial Bank of Albany in 1825, for example, gave the bank:

all incidental and necessary powers to carry on the business of banking by discounting bills, notes, and other evidences of debt; by receiving deposits; by buying gold and silver bullion and foreign coins; by buying and selling bills of exchange; and by issuing bills, notes and other evidences of debt [and] no other powers whatsoever.

Symons, *supra* note 27, at 690. Bank charters issued by New York prior to 1825 did not include an enumeration of banking powers. *Id.*

31. 15 N.Y. 9 (1857).

32. *Id.* at 58. Other New York laws designed to restrain the banking business at that time collaborate this view. Those laws prohibited corporations that were not expressly incorporated for banking purposes from exercising banking powers. *Id.*

to conceive of a greater absurdity than [to find restrictions on banking activities] in a statute intended merely to restrain unauthorized banking."³³

In sum, the present section 24(Seventh) was more the result of historical accident than any grand design. It was patterned on the New York Act, which was modeled on language contained in individual New York bank charters that, in turn, was drafted for purposes of excluding banks from certain restraining statutes. The language in the charters was "[not intended] to restrict the appropriate business of banking," therefore neither should the similar language contained in section 24(Seventh).³⁴

Although *VALIC* established the propriety of the broad construction of section 24(Seventh)—both for the reasons stated in the opinion and for the additional reasons discussed previously—the past century of judicial debate concerning the broad and narrow interpretations remains useful. Not only does the debate bolster the *VALIC* conclusion that the business of banking is a broad concept, but more important, it makes clear that the term is also an evolving concept. It can change, and has changed, over time to keep pace with developments in business practices, customer needs, and new technologies.

The evolving nature of the business of banking was first acknowledged by the New York Court of Appeals in *Curtis v. Leavitt*.³⁵ The *Curtis* court determined that the New York Act's powers clause, which was later incorporated into the National Bank Act, did not restrict the appropriate business of banking. In a separate, concurring opinion, Judge Brown said it best:

The implied powers [of a bank] exist by virtue of the grant [to do the banking business], and are not enumerated and defined, because no human sagacity can foresee what implied powers may, in the progress of time, the discovery and perfection of better methods of business and the ever-varying attitude of human relations, be required to give effect to the express powers. They are, therefore, left to implication.³⁶

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.* at 157 (Brown, J., concurring). The *Curtis* court also compared the banking law with the general law of corporations. While corporations must act pursuant to the laws that created them, a law that authorizes a corporation to do specific acts does not restrict the corporation from performing other activities, provided such other activities are within the nature of the corporation's business. *Id.* at 157-59; see Richard S. Beatty, *What Are the Legal Limits to the Expansion of National Bank Services?*, 86 *BANKING L.J.* 3, 15 (1969). Similarly, the *Curtis* court reasoned banks are free to engage in activities that are within the nature of their business and not otherwise restricted. *Curtis*, 15 N.Y. at 58-65. The court expounded at length on the legislative history of the New York Act, emphasizing it had "no doubt the [New York] Legislature intended to leave the [banking] business essentially free . . . it conferred the most ample banking powers, without a single restriction in the use of those powers." *Id.* at 60. *But see* *Nassau Bank v. Jones*, 95 N.Y. 115 (1884) ("The language employed in the [New York Act] defines [a bank's] power and duties, and excludes by necessary implication

Just as the demands of the market change with time, so too may the business of banking, allowing banks to adapt and serve an evolving economy and changing customer needs.³⁷

Much later, the United States Court of Appeals for the Ninth Circuit in *M&M Leasing Corp. v. Seattle First National Bank*³⁸ affirmed that the business of banking is an evolving concept, saying it drew comfort from the following fact:

commentators uniformly have recognized that the National Bank Act did not freeze the practices of national banks in their nineteenth century forms. Indeed, many contend that the powers of national banks are “not confined to the powers specified in the National Bank Act and those necessary to carry out those specific powers.” . . . [W]e believe the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking.³⁹

The court narrated the repercussions of an early eighteenth century decision by Chief Justice Holt in *Clerke v. Martin*.⁴⁰ In that case, the Chief Justice’s strict construction of bank powers had to be overruled by statute several years after the decision.⁴¹ “Chief Justice Holt’s mistake was to believe that ‘the most correct technical reasoning could stop the devel-

a capacity to carry on any other business than that of banking, and the adoption of any other methods for the prosecution of such business than those specially pointed out by the statute.”).

37. See also *Bank of Cal. v. Portland*, 69 P.2d 273, 279, (Or.) cert. denied, 302 U.S. 765 (1937) (while approving safe deposit business, court indicates business of banking may change, stating: “[t]ime was, perhaps, when the safe deposit business would not be considered an integral part of the banking business, but in this day and age . . . the modern bank is not complete without safe deposit facilities”); cf. *Franklin Nat’l Bank v. New York*, 347 U.S. 373, 377 (1954) (emphasizing the evolving nature of bank powers by noting that the federal government has frequently expanded the functions and authority of national banks. With respect to the Federal Reserve Act, the Court stated that the Act “should [not] be construed to freeze individual banks or those located within any state to the customs and practices preceding the statute.”).

38. 563 F.2d 1377 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978).

39. *Id.* at 1382 (quoting Rufus J. Trimble, *The Implied Power of National Banks to Issue Letters of Credit and Accept Bills*, 58 YALE L.J. 713, 721 (1949) (citing Huck, *supra* note 18, at 541)); Note, *Diversification by National Banks*, 21 STAN. L. REV. 650, 651-53 (1969); see Henry Harfield, *The National Bank Act and Foreign Trade Practices*, 61 HARV. L. REV. 782 (1948) (“The tenets of construction must be long-range standards. The [National Bank Act] must be construed in terms of objectives and not in terms of mechanisms; it is an architect’s drawings and not a set of specifications.”). *But see* *California Bank v. Kennedy*, 167 U.S. 362, 366 (1897) (“It is settled that the United States statutes relative to national banks constitute the measure of the authority of such corporations, and that they cannot rightfully exercise any powers except those expressly granted, or which are incidental to carrying on the business for which they are established.”) (citing *Logan County Nat’l Bank v. Townsend*, 139 U.S. 67, 73 (1891)).

40. 2 Ld. Raym. 757 (1702).

41. *M&M Leasing*, 563 F.2d at 1382.

opment of the new machinery rendered necessary by the new needs of an expanding trade.' ”⁴² The *M&M Leasing* court “did not wish . . . to repeat Chief Justice Holt’s mistake.”⁴³

In 1994, 137 years after *Curtis*, the New York Court of Appeals again addressed the evolutionary nature of the business of banking in *New York State Ass’n of Life Underwriters v. New York State Banking Department*.⁴⁴ While affirming the right of New York banks to broker annuities, the court declared that the business of banking must continue to evolve.⁴⁵ The business “is not static but rather must adjust to meet the needs of the customers to whom banking organizations provide a valuable service.”⁴⁶ The court expounded on the necessity of adopting a flexible construction of the business of banking:

Care should be exercised not to cripple [banking organizations] and break down their usefulness by a narrow construction of the statutes which will result in unwisely limiting their usefulness in the transaction of business under modern conditions. . . . [T]he transactions of banking . . . are not to be clogged, and their pace slackened, by overburdensome restrictions.⁴⁷

The *VALIC* Court did not note the evolving nature of the business of banking specifically. Nonetheless, its holding and approach implicitly acknowledged the evolution of that business. The holding approved a further bank power not previously recognized. The Court’s broad-view approach will allow the Comptroller to approve, and banks to conduct, additional new activities in the future. The question now turns to the limits of the Comptroller’s discretion. How broad is the business of banking?

42. *Id.* (quoting WILLIAM SEARLE HOLDSWORTH, *HISTORY OF THE ENGLISH LAW* VIII 175-76 (1926)).

43. *Id.*

44. 632 N.E.2d 876 (N.Y. 1994).

45. *Id.* at 880; see Harfield, *supra* note 39, at 790 (“The business of banking, then, is at any time coextensive with the businesses and range of businesses conducted by the society in which it operates.”)

46. *New York State Ass’n*, 632 N.E.2d at 880-81 (“the [business of banking] clause must be construed as an independent, express grant of power, intended to reflect the ever-changing demands of the banking business”); see also *Farmers’ & Merchants’ State Bank v. Consolidated Sch. Dist.*, 219 N.W. 164 (Minn. 1928) (“Commercial banks have become institutions of deposits, discount, exchange and . . . circulation. Originally they were for deposit only. . . . Money and commercial paper have evolved them from that primitive form into what they now are.”).

47. *New York State Ass’n*, 632 N.E.2d at 880 (quoting *Dyer v. Broadway Cent. Bank*, 169 N.E. 635 (N.Y. 1930); *Block v. Pennsylvania Exch. Bank*, 170 N.E. 900 (N.Y. 1929)); see *New York State Ass’n v. New York State Banking Dep’t*, 598 N.Y.S.2d 824 (N.Y. App. Div. 1993), *aff’d*, 632 N.E.2d 876 (N.Y. 1994) (powers clause was intended to permit banks to expand their banking services over time consistent with evolving business practices and their customers’ needs).

DEFINING THE BUSINESS OF BANKING

While *VALIC* confirmed that the business of banking is a broad, evolving concept, it did relatively little to flesh out how far that business might extend. The many cases preceding *VALIC*, on the other hand, while they often had difficulty interpreting the powers clause,⁴⁸ articulated useful

48. Many cases were muddled for one or both of two reasons. First, courts frequently confused or combined the concepts of the "business of banking" and "powers incidental to the business of banking." Before *VALIC* affirmatively settled the issue of whether the business of banking could extend beyond the enumerated powers, all non-enumerated powers were termed "incidental powers" by most courts so as to avoid the complex matters finally settled by *VALIC*. This practice allowed courts to approve new bank activities regardless of the result of the *VALIC* debate. Thus, even if an activity clearly fell within the business of banking, courts would apply a so-called "incidental powers test." Because *VALIC* confirmed that new activities can fall within the business of banking, it now will be easier for courts to distinguish the two concepts.

This Article does distinguish the concepts, outlining the key considerations for determining whether an activity falls within the business of banking. Additional activities, that fall outside the scope of the business of banking, will be and have been approved by the Comptroller if they are "incidental" to the business of banking. In determining whether an activity is incidental to the business of banking, the courts and regulators should consider the second and third factors discussed *infra* (i.e., whether the activity benefits bank customers and/or is convenient or useful to banks, and whether the activity exposes the bank to risks that are similar to the type of risks already assumed by banks). The first factor—whether the activity is functionally equivalent to or a logical outgrowth of a recognized bank power—is not necessarily pertinent in determining the scope of those powers incidental to the business of banking.

Second, many pre-*VALIC* decisions appear somewhat contradictory. In fact, many of the early bank powers cases were more results oriented rather than based on any coherent bank powers theory. This was not without reason. Unlike many modern bank powers cases, where the parties often are trade associations from different industries protesting a general grant of a new power, early cases often concerned very fact-specific matters, generally between a bank and an individual. Compare *American Ins. Ass'n v. Clarke*, 656 F. Supp. 404 (D.D.C. 1987) (insurance association challenged banks' power to offer municipal bond insurance), *aff'd*, 865 F.2d 278 (2d Cir. 1988); *American Soc. of Travel Agents, Inc. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 385 F. Supp. 1084 (N.D. Cal. 1974) (association of travel agents opposed bank's power to operate travel club); *American Land Title Ass'n v. Clarke*, 772 F. Supp. 1353, 1356, 1359 (S.D.N.Y. 1991) (land title associations challenged banks' authority to engage in title insurance agency business), *rev'd*, 968 F.2d 150, 157 (2d Cir. 1992), *cert. denied sub nom. Chase Manhattan Bank, N.A. v. American Land Title Ass'n*, 113 S. Ct. 2959 (1993); *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968) (insurance agents association challenged banks' power to operate general insurance agencies); *New York State Ass'n of Life Underwriters v. New York State Banking Dep't*, 632 N.E.2d 876 (N.Y. 1994) (insurance association opposed bank sales of annuities) *with* *Logan County Nat'l Bank v. Townsend*, 139 U.S. 67, 73 (1891) (defendant bank claimed contract exceeded its powers to avoid liability on contract); *Union Nat'l Bank v. Matthews*, 98 U.S. 621 (1879) (borrower estopped from asserting that lender bank lacked authority to lend money on security of real estate); *Block v. Pennsylvania Exch. Bank*, 170 N.E. 900 (N.Y. 1929) (bank claimed its actions were *ultra vires* to avoid liability on contract). In many of these latter instances, one of the parties would raise the bank powers issue as a defense to its liability. For appropriate reasons, courts were reluctant to let parties escape responsibility for their actions by arguing after-the-fact that the contracts in question were *ultra vires*. See *Matthews*, 98 U.S. at 629.

considerations relevant to the question of whether a new activity falls within the business of banking. The essential reasoning of these courts (as well as the bank regulators)⁴⁹ over the past century can be synthesized to three key factors, namely (i) whether the activity in question is functionally equivalent to, or a logical outgrowth of, a recognized bank power; (ii) whether the activity benefits bank customers and/or is convenient or useful to banks; and (iii) whether the activity presents risks of a type similar to those already assumed by banks. Each of these considerations is addressed in turn.

ACTIVITIES THAT ARE FUNCTIONALLY EQUIVALENT TO, OR LOGICAL OUTGROWTHS OF, RECOGNIZED BANKING FUNCTIONS

Activities traditionally performed by banks, as well as activities functionally equivalent to, or logical outgrowths of, recognized bank functions generally fall within the business of banking. These include activities similar to the enumerated powers as well as activities similar to other recognized, yet unenumerated, powers.

Courts have allowed banks to engage in non-enumerated activities if the activities traditionally had been performed by banking institutions. For example, in *Bank of California v. Portland*,⁵⁰ the Oregon Supreme Court used industry practice—past and present—to determine that the safe deposit business fell within the business of banking: “To ascertain what is legitimately within the scope of the business of banking, it is proper to refer to the history of banking. . . . [C]ourts judicially notice the universal custom of bankers.”⁵¹ The court supported its conclusion with a discussion of the safe depository practices of Ancient Greece and Rome, as well as the banking practices of the Bank of Venice (the earliest bank), the old Bank of Amsterdam, the Goldsmiths of London, and the Bank of England.⁵²

Relying on recognized bank functions cuts both ways. For example, in *First National Bank v. Missouri*,⁵³ a bank lost its challenge to a Missouri law prohibiting branch banking. The bank had argued that the establishment of a branch bank was incidental to the business of banking.⁵⁴ Because the

49. See, e.g., Interpretative Letter No. 494 (Dec. 20, 1989), reprinted in Fed. Banking L. Rep. (CCH) ¶ 83,083; Interpretative Letter No. 499 (Feb. 12, 1990); Interpretative Letter No. 632 (June 30, 1990); Conditional Approval No. 139 (May 4, 1994).

50. 69 P.2d 273 (Or.), cert. denied, 302 U.S. 765 (1937).

51. *Id.* at 276.

52. *Id.* at 276-77; see *Inland Waterways Corp. v. Young*, 309 U.S. 517, 525 (1940) (confirming that national banks can pledge assets to secure deposits by governmental agencies, Court notes “[e]ven constitutional power, when the text is doubtful, may be established by usage”) (citing *United States v. Midwest Oil Co.*, 236 U.S. 459, 473 (1915)).

53. 263 U.S. 640 (1924).

54. *Id.* at 659.

United States Supreme Court found national banks had survived for more than fifty years without branches, however, branch banking could not be an incidental power.⁵⁵ In other words, the Court looked to customary banking practices to determine whether branch banking was part of the business of banking. Finding that branching at that time was not an established activity, nor was it similar to any other approved activity, the Court ruled against the bank.⁵⁶ Though superseded by subsequent legislation, the case remains of interest both for its reliance on historical practices and for expressing an apparent willingness to consider approving branch banking as an incidental power even though branching is not among the enumerated powers.

The safe-deposit business was conclusively sanctioned by the United States Supreme Court in *Colorado Nat'l Bank v. Bedford*.⁵⁷ Although the business arguably is incidental to the business of receiving deposits, the Court did not tie the power to conduct a safe-deposit business to any of the enumerated powers.⁵⁸ Rather the Court found that "national banks do and for many years have carried on a safe-deposit business."⁵⁹ The Court concluded that "such a generally adopted method of safeguarding valuables must be considered a banking function authorized by Congress."⁶⁰

The United States Court of Appeals for the Fifth Circuit heavily relied on customary practices in *Saxon v. Georgia Ass'n of Independent Insurance Agents, Inc.*,⁶¹ when it overruled an administrative ruling of the Office of the Comptroller of the Currency (OCC) allowing national banks to act as agents in the general insurance business (selling, *inter alia*, automobile,

55. *Id.*

56. *Id.* at 661; *see also* Talmage v. Pell, 7 N.Y. 328, 344-45 (1852) (court disapproves proposal to deal in stocks on grounds that activity did not fall within an enumerated power nor was part of traditional bank practice, and noting "[w]e were told that prohibitions against dealing in stocks were inserted in all bank charters in this state from 1791 to 1836 . . . [we] view [this] as an unequivocal declaration by successive legislatures, that trading in stocks was not, in the language of this act 'necessary to carry on the business of banking'").

57. 310 U.S. 41 (1940).

58. Just six years prior to its decision in *Bedford*, the Court had adopted a strict test for determining whether a power is incidental to an enumerated power in *Texas & Pac. Ry. Co. v. Pottorff*, 291 U.S. 245, 255 (1934). In order for the *Bedford* Court to have reached its conclusion under the incidental powers test, it would have had to reject implicitly the *Pottorff* test. *See infra* notes 121-126 and accompanying text.

59. *Bedford*, 310 U.S. at 49. The Court also noted that the McFadden Act had implicitly approved the business (at least for bank subsidiaries) by imposing regulatory limitations on the activity without affirmatively granting banks the power to engage in the activity. *Id.* *See* H. REP. NO. 83, 69th Cong., 1st Sess. 4 (1926) (the safe deposit business "is a business which is regularly carried on by national banks and the effect of [the McFadden Act provision] is . . . primarily regulatory").

60. *Bedford*, 310 U.S. at 50. *But see* *Pottorff*, 291 U.S. at 255 (even a commonly pursued practice may be illegal).

61. 399 F.2d 1010 (5th Cir. 1968).

home, casualty, and liability insurance from offices in cities with populations in excess of 5000).⁶² The principal issue in *Saxon* was whether section 92 of the banking code, which gave national banks the authority to broker general insurance in towns with less than 5000 people, implicitly prohibited banks from brokering general insurance in larger towns, or whether banks had general insurance powers under section 24(Seventh).⁶³ The court looked to past practice and legislative history to conclude that section 92 did bar banks from selling insurance in towns of more than 5000 and that section 24(Seventh) did not give banks a general power to broker insurance products.⁶⁴ Serving as a general insurance broker traditionally had fallen outside the banking business.⁶⁵ Prior to 1916 (when section 92 was enacted), it was "universally understood that no national banks possessed any power to act as insurance agents."⁶⁶ Moreover, the Comptroller of the Currency had never suggested banks had power to operate general insurance agencies. In fact, just prior to the enactment of section 92, the Comptroller testified to Congress that "[n]ational banks are not given either expressly nor by necessary implication the power to act as agents for insurance companies."⁶⁷

Of course, by tying the business of banking to customary banking practices, the *Saxon* court's reasoning now could be used to support the opposite proposition—that banks should be able to act as general insurance brokers. Many state-chartered banks have been selling insurance for many years, at no detriment to their safety and soundness. Similarly, national banks have been successfully selling all forms of insurance in small towns and selling and underwriting more limited insurance products nationwide. By relying on tradition to define the business of banking, the *Saxon* reasoning actually opens the way for change as customary practices in segments of the banking industry evolve.

The United States Court of Appeals for the First Circuit closely followed the reasoning in *Saxon* in *Arnold Tours, Inc. v. Camp*,⁶⁸ holding that national

62. *Id.* at 1013.

63. *Id.* at 1012-13.

64. *Id.* at 1013-18; see also *O'Connor v. Bankers Trust Co.*, 289 N.Y.S. 252, 270 (N.Y. Sup. Ct. Special Term 1936), *aff'd*, 1 N.Y.S.2d 641 (N.Y. 1937), *aff'd*, 16 N.E.2d 302 (N.Y. 1938) (a determination of the incidental powers which are necessary to carry out the business of banking involves a careful consideration of banking experience and history).

65. General insurance brokerage activities (i.e., operating a full-service insurance agency selling all forms of insurance) have never been found to be within the business of banking. Over time, however, many insurance products and services have been determined to be part of or incidental to the business of banking (e.g., underwriting and selling municipal bond and credit life, accident, and health insurance) and therefore permissible. See, e.g., *American Ins. Ass'n v. Clarke*, 865 F.2d 278, 282 (2d Cir. 1988); 12 C.F.R. § 2 (1994).

66. *Saxon*, 399 F.2d at 1013.

67. *Id.* (citing 52 CONG. REC. 11001 (1916)).

68. 472 F.2d 427 (1st Cir. 1972).

banks did not have the authority to operate a travel agency business.⁶⁹ The decision is notable on two accounts. First, the court repeatedly looked at the historical involvement of banks in the travel agency business, concluding that few national banks had engaged in the business.⁷⁰ The court was particularly troubled by a 1935 statement and a 1949 rule issued by the OCC that both indicated that national banks could not engage in the general travel agency business.⁷¹

Second, the court articulated a new test for determining whether an activity falls within a bank's incidental powers. Under the court's test, all "incidental" bank powers must be "directly related to one [of the] express powers."⁷² While the court did not make clear what would qualify as a "direct relation" to an express power, it hinted that the test was not necessarily rigorous.⁷³ The court implied that a proposed activity would have a sufficient relation to the enumerated powers if it "primarily involves the performance of financial transactions pertaining to money or substitutes thereof."⁷⁴ This latter formulation of the incidental powers test is similar to a functional equivalency approach (i.e., whether a proposed activity is functionally equivalent to the performance of financial transactions pertaining to money or money substitutes).

The United States Supreme Court considered whether a new activity was functionally equivalent to a recognized banking power in its first bank powers case under the National Bank Act—*Merchants' Bank v. State Bank*,⁷⁵ where it confirmed banks had authority to certify checks.⁷⁶ Although check certification did not fall within one of the enumerated powers, the Court held that banks could certify checks because certified checks "have many of the properties of . . . commercial paper," which banks are expressly authorized to circulate.⁷⁷ In doing so, the Court considered in detail the check certifying process and its similarities to, and differences from, commercial paper.⁷⁸ While the Court's powers clause discussion was not par-

69. *Id.* at 438.

70. *Id.* at 435.

71. *Id.* at 434 & n.11, 435 (stating that under the 1949 regulation Rule 67 provided that "a national bank does not have the legal right to act as agent or representative of transportation companies in the operation of a regular travel agency . . . in the same manner as private travel agencies are operated as a business for profit").

72. *Id.* at 431. The *Arnold Tours* court, like others, viewed all bank powers not expressly enumerated as "incidental powers." It did not consider whether a non-enumerated power could fall within a bank's general authority to conduct the "business of banking." See *supra* note 48.

73. *Id.* at 430.

74. *Id.* (quotation describes approach used by district court which reached same result). *But see* *Guaranty Mortgage Co. v. Z.I.D. Assocs.*, 506 F. Supp. 101, 105 (S.D.N.Y. 1980) (in brief analysis, court appeared to apply strict construction of *Arnold Tours* test).

75. 77 U.S. 604 (1871).

76. *Id.* at 647.

77. *Id.*

78. *Id.* at 647-48.

ticularly coherent, the opinion established that banks would not be strictly limited to the enumerated powers and that other activities functionally equivalent to approved bank powers would be permissible under section 24(Seventh).

The United States Supreme Court appealed again to the notion of functional equivalency in *First National Bank v. National Exchange Bank*.⁷⁹ There, the Court concluded that banks could accept payment of stocks in satisfaction of valid debts.⁸⁰ Noting that the situation was similar to other approved debtor-creditor relationships, the Court stated that "whatever might be done in the one case ought not to be excluded from the other under the same circumstances."⁸¹ Likewise, in *Wyman v. Wallace*,⁸² the Court affirmed that a bank could borrow money to meet pressing demands because, in doing so, the bank "simply exchanges one creditor for others."⁸³

In *M&M Leasing Corp. v. Seattle First National Bank*,⁸⁴ the United States Court of Appeals for the Ninth Circuit tried to bring a functional equivalency perspective into the standard incidental powers analysis by exploring the traditional notion that there be a "connection" between a proposed activity and an approved banking power.⁸⁵ The *M&M Leasing* court found that an activity was sufficiently "connected" to an approved power (and therefore permissible) if it was "functionally interchangeable" with an expressly authorized activity.⁸⁶ The court then endorsed bank leasing of personal property on the grounds that the activity was functionally equivalent to loaning money on personal security, one of the enumerated powers in section 24(Seventh).⁸⁷ "We believe," the court stated, that "the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking."⁸⁸ Although leases of personal property and secured loans are regarded as distinct in both the rhetoric and regulation of the banking business, "it is their functional interchangeability that [was] the touchstone of [the court's] decision."⁸⁹

79. 92 U.S. 122 (1876).

80. *Id.* at 128-29.

81. *Id.* at 128; *see Miller v. King*, 223 U.S. 505, 511 (1912) (banks "may do those acts . . . which are usual or necessary").

82. 201 U.S. 230 (1906).

83. *Id.* at 243.

84. 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978).

85. While acknowledging that a more relaxed test could be appropriate, the court repeated the *Arnold Tours* formulation of the incidental powers test, i.e., that the activity "must be convenient or useful in connection with the performance of one of the bank's established activities." *Id.* at 1382.

86. *Id.* at 1383.

87. *Id.* at 1382-83.

88. *Id.* at 1382.

89. *Id.* at 1383; *see infra* notes 159-168 and accompanying text for further discussion as to why leasing and secured lending can be functionally equivalent.

The district court in *American Insurance Ass'n v. Clarke (AMBAC)*,⁹⁰ explicitly adopted the functional equivalency approach, going so far as to rephrase the test for determining whether an activity was incidental to, or part of, the business of banking:

The question then is not . . . whether the National Bank Act expressly authorizes banks to engage in the municipal bond insurance business, or whether that business is directly related and useful to what the plaintiff narrowly conceives as the lending function—i.e., the direct advance of funds to a borrower. Rather, the question is whether . . . the issuance of standby credits in the form of municipal bond insurance is a basic credit transaction permissible under the Act.⁹¹

The United States Court of Appeals for the District of Columbia affirmed the district court's finding that municipal bond insurance was, in essence, a credit transaction, with credit being one of a bank's principal products.⁹² In fact, the court concurred with the Comptroller's determination that municipal bond insurance was "the functional equivalent" of standby letters of credit, a long-recognized service provided by banks.⁹³

According to the decision in *AMBAC*, municipal bond insurance was functionally equivalent to standby letters of credit for several reasons. Both types of businesses served the same purpose; namely, to facilitate transactions by substituting the credit of the bank for that of one of the con-

90. 656 F. Supp. 404 (D.D.C. 1987), *aff'd*, 865 F.2d 278 (D.C. Cir. 1988).

91. *Id.* at 408. The district court rejected the insurance industry's literalistic construction of § 24(Seventh), stating that it:

proceeds from a narrow and artificially rigid view of both the business of banking and the statute that governs that business, a view that the Comptroller, and this Court, reject. Whether or not the five enumerated powers set out in the National Bank Act are an exhaustive list or, as some commentators have argued, merely illustrative, the Court cannot accept [such a] cramped and simplistically literal interpretation of the banking industry's lending power. At bottom "[t]he business of banking reduces to the provision of financial support for the transactions of others." Banks can and do provide such support by means other than direct loans of their own funds. As then Judge Cardozo explained over fifty years ago, the business of banking involves the substitution of the "[bank's] own credit, which has general acceptance in the business community, for the individual's credit, which has only limited acceptability. . . . It is the end for which a bank exists."

Id. (citations omitted). The D.C. Circuit agreed. *See Clarke*, 865 F.2d at 281, 284 (court agrees with Comptroller's approach that focused on the essence of municipal bond insurance rather than attempting to correlate it to a specific power in § 24(Seventh)).

92. *Clarke*, 865 F.2d at 287.

93. *Id.* at 283. While not included in the enumerated powers of § 24(Seventh), banks have long been permitted to provide standby letters of credit. *See, e.g.*, Trimble, *supra* note 18; 12 C.F.R. § 7.7016 (1994); First Empire Bank-New York v. Federal Dep. Ins. Corp., 572 F.2d 1361, 1367 (9th Cir.), *cert. denied*, 439 U.S. 919 (1978); HENRY HARFIELD, BANK CREDITS AND ACCEPTANCES 165-66 (5th ed. 1974).

tracting parties.⁹⁴ Both kinds of businesses also utilized similar banking skills. As with standby letters of credit, a bank in the municipal bond insurance business would conduct a traditional financial analysis of its customers.⁹⁵ Thus, the bank would not need to develop new or substantially different skills in order to conduct the new business.⁹⁶ Finally, both activities imposed the same type of risks on the bank. The bank would rely on the financial strength of the bond issuer, not the estimated likelihood of default. This is the same type of risk that banks assume in any credit transaction.⁹⁷

In *VALIC*,⁹⁸ the Supreme Court relied heavily on the functional equivalency concept. The Court approved bank annuity sales on the grounds that they were "functionally similar"⁹⁹ to other financial investment products banks have been long-authorized to sell. The Court stated, "[i]n sum, modern annuities, though more sophisticated than the standard savings bank deposits of old, answer essentially the same need. By providing customers with the opportunity to invest in one or more annuity options, banks are essentially offering financial investments of the kind congressional authorization permits them to broker."¹⁰⁰ The Court further indicated that the Comptroller had discretion to permit banks to sell other financial investment instruments.¹⁰¹

94. *Clarke*, 865 F.2d at 282. Both the district and appellate courts noted that banking, at its core,

involves the substitution of the "[bank's] own credit, which has general acceptance in the business community, for the individual's credit, which has only limited acceptability. . . . It is the end for which a bank exists." Indeed, the extension of credit . . . is such a long-standing practice under the National Bank Act that credit is today viewed as one of "[t]he principal banking products." Banks provide this "product" in a variety of forms not specifically enumerated in the National Bank Act: they offer irrevocable lines of credit; standby and mercantile letters of credit, and check guaranty and credit card programs.

Id. at 281 (quoting *United States ex rel. Zundic v. Uhl*, 56 F. Supp. 403, 408 (S.D.N.Y. 1943)) (citations omitted).

95. *Id.* at 283.

96. *Cf.* OCC Interpretative Letter No. 295 (Comptroller rejected bank's application to offer political risk insurance to other banks making offshore loans because the nature of the business required the insuring bank to rely on estimates of the likelihood of political risks causing default, rather than a credit evaluation of the insured banks.).

97. *Clarke*, 656 F. Supp. at 410.

98. *NationsBank v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

99. *Id.* at 811-12 ("annuities . . . are functionally similar to other investments that banks typically sell").

100. *Id.* at 815. The Court noted that annuities were functionally equivalent to other approved bank products from the customer's point of view as well. "[T]he customer is deferring consumption, setting aside money for retirement, future expenses, or a rainy day . . . an annuity is like putting money in a bank account, a debt instrument, or a mutual fund."
Id.

101. *Id.*

In short, when evaluating whether new activities qualify under the powers clause, courts favor activities that functionally resemble recognized banking practices and activities that represent advances on those practices. Both of these related factors allow banks to participate in new ways of conducting the old business of banking.

ACTIVITIES THAT BENEFIT BANK CUSTOMERS OR ARE CONVENIENT OR USEFUL FOR BANKS

Courts are aware of the important role banks play in the nation's economy and of the need to have them maintain that role. Nothing is more important to the capability of national banks to compete successfully than their ability to serve the needs of their customers by offering appropriate products and services. Accordingly, the caselaw reflects a strong predilection for approving activities that benefit bank customers or that are convenient or useful to banks.¹⁰² Conversely, activities that could potentially harm customers or result in anticompetitive or other effects that could damage the industry are disfavored.¹⁰³

One of the first bank powers cases turned on the need and convenience of the bank. In *Curtis v. Leavitt*,¹⁰⁴ the New York Court of Appeals held that New York banks had the authority to borrow money—even though that authority did not appear among the enumerated powers in the New York powers clause.¹⁰⁵ The *Curtis* court's analysis focused on the need for banks to borrow money. The court connected the power to borrow to the express power to issue and receive deposits. If a bank could not borrow, it could not lend much of its deposit funds and could quickly fold if faced with increased deposit withdrawals.¹⁰⁶ Thus, *Curtis* held that the power to

102. See *infra* notes 104-141 and accompanying text.

103. The need for banks to make impartial credit determinations is a further, related reason certain activities have been disfavored. In addition to courts, Congress, in its legislation, and the Office of the Comptroller of the Currency, in its regulations, have recognized the importance of requiring banks to make impartial credit determinations, even when the noncredit product or activity poses no risk of loss to the bank. Congress, for example, has prohibited tying arrangements between the extension of credit and the sale of other products by a bank. 12 U.S.C. § 1972 (1988 & Supp).

104. 15 N.Y. 9 (1857).

105. *Curtis* is a seminal bank powers case. Hundreds of pages long, it is cited by virtually every commentator in support of a broad construction of § 24(Seventh).

106. *Curtis*, 15 N.Y. at 158 (Brown, J., concurring) ("Before we can say, with any assurance, whether the power to borrow money is to be implied, we must . . . see the nature of the business in which they are to embark, the usual and customary modes in which it is conducted . . . and the emergencies and hazards to which the business is necessarily exposed."); see *First Nat'l Bank v. National Exch. Bank*, 92 U.S. 122, 127 (1876) (A bank's powers are such "as are required to meet all the legitimate demands of the authorized business, and to enable [the] bank to conduct its affairs, within the general scope of its charter, safely and prudently.").

borrow was incidental to the business of banking¹⁰⁷ because it was “convenient” to the bank’s exercise of its express power to receive deposits, notwithstanding the language of the New York Act which limited banks to “such incidental powers as shall be *necessary*” to carry on the business of banking.¹⁰⁸

From the beginning, the United States Supreme Court also emphasized the importance of allowing banks to meet the needs of their customers. In *Merchants’ Bank v. State Bank*,¹⁰⁹ the Court permitted banks to certify checks (even though the activity did not fall within an enumerated power):

*The practice of certifying checks has grown out of the business needs of the country. They enable the holder to keep or convey the amount specified with safety. They enable persons not well acquainted to deal promptly with each other, and they avoid the delay and risks of receiving, counting and passing from hand to hand large sums of money. . . . We could hardly inflict a severer blow upon the commerce and business of the country than by throwing a doubt upon [the] validity [of certified checks].*¹¹⁰

Similarly, in *Clement National Bank v. Vermont*,¹¹¹ the Supreme Court allowed national banks to pay state taxes on depositors’ accounts on the grounds that “the bank should be free to make [such] reasonable agree-

107. *Curtis*, 15 N.Y. at 51-53. Like many cases to this day, *Curtis* relied on the “incidental powers” clause to expand bank powers rather than finding new powers within the business of banking itself. This allowed the court to use more conservative, narrow-view rhetoric, such as the following:

[T]he borrowing of money is spoken of not as a distinct department or branch in the business of banking, but is asserted as the incident and result of two of its most important operations, those of issuing and receiving deposits. A banking corporation, therefore, when it borrows money, exercises an incidental and auxiliary power, not expressed, but implied from those which are expressed.

Id. at 53, 57. By casting the power to borrow money as an incidental power, *Curtis* did not have to expand the “business of banking” beyond the expressly enumerated powers to reach its conclusion. As a result, *Curtis* did not have to address whether the business of banking included any non-enumerated powers. Other courts have followed this approach, and it has resulted in some confusion. Courts have often misdirected their attentions toward finding a “connection” between a new activity and an express power as part of the incidental powers test. In many instances, they would have been better advised to focus on whether the new activity was part of the business of banking. See *American Ins. Ass’n v. Clarke*, 865 F.2d 278, 281 (D.C. Cir. 1988).

108. *Curtis*, 15 N.Y. at 64 (“[N]ecessity is a word of flexible meaning.”); cf. *McCulloch v. Maryland*, 4 Wheat. 316, 4 L.Ed. 579 (1819).

109. 77 U.S. 604 (1871).

110. *Id.* at 648 (emphasis added); cf. *Miller v. King*, 223 U.S. 505, 511 (1912) (although bank was prohibited from acting as trustee generally, bank could bring suit on behalf of a customer because “[t]here was nothing in [the] transaction which was so disconnected with the *banking business* as to make it in violation of [§ 24(Seventh)]”) (emphasis added).

111. 231 U.S. 120 (1913).

ments, and thus promote the convenience of its business.”¹¹² If the bank did not pay the taxes, each of its customers would have needed to submit separate returns and pay the taxes themselves. Thus, the bank advertised the convenience of its taxpaying service, stating “[a]ll taxes are paid by the bank . . . you do not need to report deposits in this bank to the [tax authorities].”¹¹³ The Court found that this arrangement would aid the bank in the performance of its functions and remove “unnecessary obstacles to the successful prosecution of its business.”¹¹⁴

The Supreme Court again stressed the needs of both banks and their customers in *Texas & Pacific R.R. Co. v. Pottorff*,¹¹⁵ where it held that national banks could not pledge their assets to secure private deposits.¹¹⁶ In *Pottorff*, the depositor, a railroad company, had secured such a pledge from its bank before the bank became insolvent. When the bank failed, the railroad tried to enforce the pledge (and hence get preferential treatment) on the grounds that the power to make pledges was incidental to the bank’s express power to receive deposits. The Court disagreed, reacting to what it perceived was both an anti-consumer practice and a potential safety and soundness problem.¹¹⁷ Securing pledges with bank assets violated the principle of equal treatment of depositors.¹¹⁸ Large depositors, like railroads, could obtain such pledges, while small, individual depositors, who would be most vulnerable to a bank failure (at least prior to the advent of federal deposit insurance), could not. Such a practice, if commonly employed, could have shaken the Nation’s confidence in its financial institutions.¹¹⁹ The Court felt the activity, in the context presented, was contrary to good banking practices.¹²⁰

The Court applied a strict incidental powers test that required the bank to demonstrate that pledging assets to secure private deposits was literally

112. *Id.* at 157.

113. *Id.* at 139.

114. *Id.* at 157-58; see *First Nat’l Bank v. Taylor*, 907 F.2d 775, 778 (8th Cir. 1990) (offering of debt collection contracts is an incidental power because it is useful to the bank by providing customers a convenient method of paying off a bank loan in event of death).

115. 291 U.S. 245 (1934).

116. *Id.* at 253.

117. *Id.* at 255.

118. *Id.* at 256; see also *Farmers’ & Merchants’ State Bank v. Consolidated Sch. Dist.*, 219 N.W. 163, 165 (Minn. 1928).

119. See *Baltimore & O.R.R. Co. v. Smith*, 56 F.2d 799, 803 (3d Cir. 1932) (“If a national bank had power to pledge its assets to secure the deposit of one private depositor without the knowledge of its other depositors, the mere possibility of the exercise of this favoritism and preference would breed distrust in depositors and lessen their number. The power conferred upon national banks should not be so interpreted as to authorize an injurious policy unless a fair construction of the language clearly requires it.”).

120. *Pottorff*, 291 U.S. at 254.

“necessary” to the exercise of one of the express powers.¹²¹ The Court even said a “commonly pursued” practice may not be a “necessary” practice and therefore could be illegal.¹²² Prior courts had construed the term “necessary” very broadly.¹²³ It generally was sufficient if the activity was useful or convenient in connection with an expressly permitted banking activity.¹²⁴ The *Pottorff* Court was more stringent. Because the bank had pledged its assets on only one occasion, and because few other banks had done the same, the Court concluded the practice of pledging assets was not “necessary” and therefore not incidental to the banking business.¹²⁵

While the ultimate holding remains good law, the reasoning in *Pottorff* was overly strict. The case is best viewed as an understandable, though exaggerated reaction to a proposed activity perceived to be detrimental both to bank customers and the industry as a whole.¹²⁶

Several years later, the Oregon Supreme Court determined that the safe deposit business fell within the business of banking under the National Bank Act, the benefits of that business to both banks and their customers being a critical factor in the court’s decision:

The operation of a safe deposit vault by a bank is a financial service to the bank’s clientele and others, on the one hand, and a financial benefit to the bank on the other, plainly showing that safe deposit vaults must be considered an integral part of the business of banking, even though such operation is not expressly named in many definitions of banking.¹²⁷

Before *VALIC*, the most recent Supreme Court opinion to address directly the powers clause was *Franklin National Bank v. New York*,¹²⁸ which held that national banks could use the term “saving” or “savings” in their advertisements, notwithstanding a New York law that prohibited com-

121. At the same time, the Court placed significant reliance on an amendment to the National Bank Act, Act of June 25, 1930, ch. 604, 46 Stat. 809, that permitted banks to pledge assets to secure government deposits. Employing the logic of *expressio unius est exclusio alterius*, the Court said if the bank had the power under § 24(Seventh) to pledge assets to secure private deposits, it would have been unnecessary to amend the National Bank Act. *Pottorff*, 291 U.S. at 258.

122. *Id.* at 255. *But see* *Colorado Nat’l Bank v. Bedford*, 310 U.S. 41, 50 (1940).

123. *See, e.g.*, *Curtis v. Leavitt*, 15 N.Y. 9, 64 (1857).

124. *See, e.g.*, *M&M Leasing Corp. v. Seattle First Nat’l Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *see* *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972).

125. *Pottorff*, 291 U.S. at 255.

126. *Id.* at 255-57. The economic and political context of the early 1930s also may have influenced the *Pottorff* Court. When the case was decided in 1934, the country had just experienced the greatest number of bank failures in history, the economy was in a depression, and Congress had recently passed legislation restricting bank powers (e.g., Banking Act of 1933).

127. *Bank of Cal. v. Portland*, 69 P.2d 273, 278 (Or.), *cert. denied*, 302 U.S. 765 (1937).

128. 347 U.S. 373 (1954).

mercial banks from using such words.¹²⁹ National banks had express authority to accept “savings deposits.” The Court held that the power to advertise such services was an incidental power and hence permissible because, *inter alia*, “modern competition for business finds advertising one of the most usual and useful” practices.¹³⁰ Absent some indication from Congress, the Court could not believe banks would be allowed to accept savings deposits but not be allowed to advertise their services.¹³¹

Similarly, in *M&M Leasing*, the Ninth Circuit determined that leasing personal property was “convenient or useful” to the banking business and therefore permissible.¹³² According to the court, leasing (as opposed to traditional secured lending) has numerous advantages from the bank’s standpoint.¹³³ The bank can take advantage of certain tax benefits pertaining to depreciation and investment tax credit unavailable with lending transactions.¹³⁴ Leasing also allows banks more flexibility under certain usury laws.¹³⁵ Customers also benefit.¹³⁶ They more readily can acquire property without the need for a down payment.¹³⁷ And a lease obligation may be reflected on a balance sheet more favorably than a loan.¹³⁸

The same court later qualified the “convenient and useful” standard in *National Retailers Corp. v. Valley National Bank*.¹³⁹ There, the court held that the offering of general data processing services to retailers was not

129. *Id.* at 378-79.

130. *Id.* at 377; see *Auten v. United States Nat’l Bank*, 174 U.S. 125, 141-43 (1899) (in holding that banks had power to borrow money, Court stated that “[a] power so useful cannot be said to be illegitimate, and declared as a matter of law to be out of the usual course of business”); *Aldrich v. Chemical Nat’l Bank*, 176 U.S. 618, 627 (1900); see also *Farmers’ & Merchants’ State Bank v. Consolidated Sch. Dist.*, 219 N.W. 163, 165 (Minn. 1928) (“Banks are intended above all else to be the dependable agents of thrift and commerce.”).

131. *Franklin Nat’l Bank*, 347 U.S. at 377-78.

132. *M&M Leasing Corp. v. Seattle First Nat’l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); see *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972) (an activity is incidental to the business of banking if it is “convenient or useful in connection with the performance of one of the bank’s established activities pursuant to its express power under the National Bank Act”); see also *First Nat’l Bank v. Hartford*, 273 U.S. 548, 559-60 (1927) (Court upheld sale of certain mortgages and other evidences of debt as an incidental power, noting that the exercise of this power “has become of great importance in the business of national banks.”).

133. *M&M Leasing*, 563 F.2d at 1381.

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. See *id.*; cf. *First Nat’l Bank v. Taylor*, 907 F.2d 775, 778 (8th Cir.) (debt cancellation contracts—which extinguish debt in the event of borrower death—are incidental to bank lending powers because such contracts are designed to protect loans, only involve the bank and the bank’s borrower, and are convenient and useful both to the bank and the borrower), *cert. denied*, 498 U.S. 972 (1990).

139. 411 F. Supp. 308 (D. Ariz. 1976), *aff’d in part*, 604 F.2d 32 (9th Cir. 1979).

necessarily convenient or useful for banks or retailers and therefore was not permissible.¹⁴⁰ The general data processing services at issue did not directly relate to any of the express powers specified in the National Bank Act. Merely providing another service was not sufficient to meet the convenient or useful threshold. If the data processing services had been more related to financial matters or some other banking function, they should have been permissible under the court's reasoning. In that event, they clearly would have been convenient and useful to both the bank and the customer. But where an activity is only tangentially convenient or useful, the activity will not qualify.¹⁴¹

In sum, when courts evaluate a potential new activity to determine whether that activity falls within (or is incidental to) the business of banking, one of its crucial determinations is whether the activity will benefit customers and/or will be convenient or useful to the bank. Equally important is whether the new activity could potentially harm customers or the industry in general. Courts are inclined to approve the former and reject the latter.

ACTIVITIES THAT PRESENT RISKS SIMILAR TO THOSE ALREADY ASSUMED BY BANKS

Another key consideration in whether courts deem a new activity permissible is the extent it affects bank safety and soundness by exposing the bank to different *types* of risks than those presented by recognized banking functions.¹⁴² In one sense, this consideration is a component of the two considerations discussed previously: whether the new activity is functionally equivalent to a traditional bank activity, and whether the activity benefits banks and bank customers. But a number of courts have placed particular emphasis on the nature of the risks new activities impose on banks.

When the United States Supreme Court first approved the practice of certified checking in *Merchants' Bank v. State Bank*,¹⁴³ it took note of the following:

A bank incurs no greater risk in certifying a check than in giving a certificate of deposit. In well regulated banks the practice is at once

140. *Id.* at 315.

141. See Huck, *supra* note 18, at 544 ("Courts have long recognized that there is a difference between an act being 'incidental' to an express power given and an act which is merely 'beneficial', or 'helpful', or 'profitable' to the corporation.").

142. This is not an issue regarding the level of risk. Indeed, few activities are inherently more risky than some forms of commercial lending. Rather, it concerns the way in which the risk arises (i.e., the nature or type of risk). For example, operating a department store could be less risky than making and holding commercial loans, but the nature of the risk arising from retail merchandising is fundamentally different from the way risks arise in recognized banking activities.

143. 77 U.S. 604 (1871).

to charge the check to the account of the drawer, to credit it in "certified check account," and when the check is paid, to debit that account with the amount. Nothing can be simpler or safer than this process.¹⁴⁴

The Court focused more closely on this issue in *Merchants' National Bank v. Wehrmann*,¹⁴⁵ holding that while a national bank could acquire stock in another corporation in satisfaction of a valid debt,¹⁴⁶ it could not take a general partnership interest (in a real estate development venture) to satisfy a debt because such an interest would subject the bank to "unlimited personal liability."¹⁴⁷ Similarly, in *First National Bank v. Converse*,¹⁴⁸ the Court prohibited a national bank from taking stock (to satisfy a debt) in a corporation organized "to embark in the . . . business of buying and selling the stock and assets of [another corporation]" on the grounds that a bank may not "engage in or promote a pure speculative business or adventure."¹⁴⁹

The New York Court of Appeals addressed the type of risks banks may undertake in *Block v. Pennsylvania Exchange Bank*,¹⁵⁰ holding that under certain circumstances a New York bank could purchase securities for the benefit of a customer under New York banking laws.¹⁵¹ The court stated that the test for determining a bank's power to undertake certain activities is the:

relation of the act to the substitution of credits which is of the essence of the banking function. Whatever risk is incidental to the fulfillment of that function, according to the practice of banking as it has developed in these days, is to be accepted and suffered as one of the perils of the business.¹⁵²

The matter of risk was more recently addressed in *American Society of Travel Agents, Inc. v. Bank of America National Trust & Savings Ass'n*,¹⁵³ where the court expanded the *Arnold Tours* prohibition on bank-operated

144. *Id.* at 648.

145. 202 U.S. 295 (1906).

146. *See generally* *First Nat'l Bank v. National Exch. Bank*, 92 U.S. 122 (1876).

147. *Wehrmann*, 202 U.S. at 301.

148. 200 U.S. 425 (1906).

149. *Id.* at 438-39; *see also* *Awotin v. Atlas Exch. Nat'l Bank*, 295 U.S. 209, 214 (1935) ("purpose and effect of the [National Bank Act] is to protect [bank] depositors and stockholders and the public from the hazards of contingent liabilities"); *Kimen v. Atlas Exch. Nat'l Bank*, 92 F.2d 615, 618 (7th Cir. 1932) ("banks . . . having custody of the funds of their depositors, are intended by all banking statutes, to be conducted in such manner as reasonably to protect the depositors").

150. 170 N.E. 900 (N.Y. App. Div. 1930).

151. *Id.* at 902.

152. *Id.* at 901.

153. 385 F. Supp. 1084 (N.D. Cal. 1974).

travel agencies to cover other travel related services.¹⁵⁴ Bank of America had entered into a contract with an independent travel agency to establish a travel club for the benefit of the bank's customers. The bank argued it was not in the travel agency business (and therefore not subject to the *Arnold Tours* prohibition) because it would not receive any profits from the travel club.¹⁵⁵ The court disagreed, finding that while the bank did not participate in the risk of obtaining a profit, it still assumed the entire risk of losses.¹⁵⁶ According to the court, it was this latter risk that underlaid Congress's concern that banks should not participate in nonbanking activities.¹⁵⁷

National banks are denied the opportunity to earn a profit through investing in ventures unrelated to the business of banking not simply because they might unfairly compete in other industries, but because the pursuit of profit in fields unrelated to banking could tempt bankers to make unwise or improvident decisions and thus could threaten the strength and stability Congress sought to instill in the banking industry.¹⁵⁸

As previously discussed, the Ninth Circuit determined in *M&M Leasing Corp. v. Seattle First National Bank*,¹⁵⁹ that leasing personal property was functionally equivalent to secured lending and therefore permissible.¹⁶⁰ Specifically, the court believed the activities were "functionally interchangeable" because the risks to the bank of such leasing were essentially the same as if the bank had made secured loans to buyers of the same property.¹⁶¹ The lessee, not the bank, assumed the burdens of operating costs, repairs and maintenance, and all risk of loss or damage.¹⁶² Moreover, in the case of open-end leases, the lessee bears the risk and costs if the resale value of the property is less than anticipated. The court found that closed-end leases would not impose a significantly more onerous economic burden on the bank.¹⁶³ The opinion was explicitly qualified so as not to "authorize leases which impose significant financial risks on national banks

154. *Id.* at 1091-92.

155. *Id.* at 1089.

156. *Id.*

157. *Id.* at 1090; see also *Investment Co. Inst. v. Camp*, 401 U.S. 617, 625-31 (1971).

158. *American Soc. of Travel Agents*, 385 F. Supp. at 1089-90.

159. 563 F.2d 1377 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978).

160. For a more complete discussion of *M&M Leasing*, see Note, *The Permissibility of Leasing Under the National Bank Act: M&M Leasing Corp. v. Seattle First National Bank*, 91 HARV. L. REV. 1347 (1978); see also 12 U.S.C. § 24(Tenth) (1988) (In 1987, Congress amended the National Bank Act by adding § 24(Tenth) in order to expand national banks' judicially construed authority to lease personal property.).

161. *M&M Leasing*, 563 F.2d at 1383.

162. *Id.* at 1381.

163. *Id.*

more onerous than those incident to loans.”¹⁶⁴ Given that the property risks are borne by the lessee, the court concluded that a “portfolio of prudently-arranged leases imposes no greater risks than one of equally prudently-arranged loans.”¹⁶⁵ In addition, the bank’s rate of return on leasing transactions compares favorably to that of lending.

The court further noted that, in the leases at issue, the bank looked to the lessee’s creditworthiness for its return on investment, not to the market value of the leased property.¹⁶⁶ If the bank relied on the estimated market value of the leased property for its profit, the transaction would be more akin to renting personal property, with all of the attendant service responsibilities.¹⁶⁷ In the *M&M Leasing* situation, the bank used the same type of skills that it used when making installment loans, i.e., it evaluated the creditworthiness of the customer and had the customer assume all risks of loss.¹⁶⁸

The *VALIC* decision also looked at risk when it upheld the Comptroller’s decision to allow bank annuity sales.¹⁶⁹ The insurance company opposing the bank sale of annuities argued that annuities should be classified as insurance (rather than as investment products that banks can sell) because they incorporate a “mortality risk.”¹⁷⁰ The argument was not persuasive.¹⁷¹ The Court said that mortality risk “is a less salient characteristic of contemporary [annuity] products.”¹⁷² Moreover, “[s]ome conventional debt instruments similarly impose mortality risk,” so such risks are not unfamiliar to banks.¹⁷³

Only the more thorough court opinions discuss the risks new activities place on banks when determining whether an activity is permissible for a national bank.¹⁷⁴ Nevertheless, this factor is an important complement to the first two discussed. An activity that presents risks of a nature markedly

164. *Id.* at 1383.

165. *Id.* at 1381.

166. *Id.* at 1383-84.

167. *Id.* at 1384.

168. *Id.* at 1383 n.5 (citing *Automobile Leasing as an Activity for Bank Holding Companies*, Fed. Reserve Bull., Nov. 1976, 930, 935); see also *American Ins. Ass’n v. Clarke*, 865 F.2d 278, 283 (2d Cir. 1988) (deferring to Comptroller’s judgment, court concurs that mortgage bond insurance “was functionally equivalent to a standby letter of credit because [the bank] will engage in a financial rather than an actuarial analysis . . . [it] will not rely on an estimate of the likelihood of default, but on the issuer’s financial strength in the event of default”).

169. See *NationsBank v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995).

170. *Id.* at 816.

171. *Id.*

172. *Id.*

173. *Id.* In addition, it might be argued that actuarial calculations are just a specialized type of risk analysis, a basic function very familiar to banks.

174. E.g., *M&M Leasing Corp. v. Seattle First Nat’l Bank*, 563 F.2d 1377 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978); *American Soc. of Travel Agents, Inc. v. Bank of Am. Nat’l Trust & Sav. Ass’n*, 385 F. Supp. 1084 (N.D. Cal. 1974).

different from those already assumed by banks is likely to be foreign to the banking business. Thus, in a way, the safety and soundness impact of a proposed new activity becomes a component of the analysis of whether an activity is part of, or incidental to, the business of banking.

A FRAMEWORK FOR DEFINING THE CURRENT AND FUTURE BUSINESS OF BANKING

Given the key principles established by *VALIC* (i.e., the “business of banking” is not limited to expressly enumerated powers), and the guidance derived from the preceding cases, a framework for defining the current and future business of banking can be built upon three principles.¹⁷⁵

IS THE ACTIVITY A CONTEMPORARY FUNCTIONAL EQUIVALENT OR OUTGROWTH OF RECOGNIZED BANKING FUNCTIONS?

The traditional scope of bank powers has been defined by practice and by the courts. *VALIC* refers to “dealing in financial investment instruments.”¹⁷⁶ The *Arnold Tours* court affirmed that the business of banking “primarily involves the performance of financial transactions pertaining to money or substitutes thereof.”¹⁷⁷ Judge Cardozo had written that the business of banking involves the substitution of the “[bank’s] own credit, which has general acceptance in the business community, for the individual’s credit, which has only limited acceptability.”¹⁷⁸ The Supreme Court earlier stated that the function of banks was to, *inter alia*, finance commerce and act as private depositories.¹⁷⁹ In addition, courts have permitted new activities that were “useful,” “convenient,” or “functionally equivalent” to activities already permissible.

A review of historical and contemporary banking practices and caselaw identifies five basic functions as touchstones for recognized banking activities:¹⁸⁰ (i) providing media for customers’ investment, i.e., offering in-

175. These principles are not necessarily independent hurdles that every activity must overcome. Rather, they are interrelated factors that should be considered when evaluating the permissibility of potential new activities.

176. *VALIC*, 115 S. Ct. at 815.

177. *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 430 (1st Cir. 1972).

178. *Block v. Pennsylvania Exch. Bank*, 170 N.E. 900, 901 (N.Y. App. Div. 1930).

179. *Franklin Nat’l Bank v. New York*, 347 U.S. 373, 375 (1954) (“The United States has set up a system of national banks as federal instrumentalities to perform various functions such as . . . financing commerce and acting as private depositories.”).

180. See Harfield, *supra* note 19, at 578 (“The business of banking is fundamentally the business of dealing in money and credit and the provision of whatever financial services the public may seek.”); Donald C. Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672, 676 (1987) (depositors look to banks to provide a combination of three basic services: “investment (i.e., offering some sort of increase in wealth in return for use of capital), safekeeping, and transaction execution (i.e., facilitating transfers of the depositors’ funds to third parties)”).

vestment instruments; (ii) safekeeping; (iii) transaction execution, e.g., facilitating transfers of customers' funds to third parties and brokerage services; (iv) providing management, advice, and risk analysis concerning financial assets and information intermediation of a financial or business nature; and (v) extension of bank resources to third parties for commercial or investment purposes, e.g., making loans, guarantees, letters of credit, and acquiring obligations of their customers.

An activity should be presumed to be part of the business of banking therefore, if it corresponds to one of the previously described categories of functions either because it: (a) shares the common, relevant characteristics of one of the categories of banking functions, (b) represents in substance a logical extension or modern equivalent of a banking function, or (c) is incident to such a function. Similarly, when the substance of a transaction achieves the same effect that would be allowed pursuant to another recognized route, the transaction should be presumed allowable.

DOES THE ACTIVITY BENEFIT CUSTOMERS AND/OR STRENGTHEN THE BANK?

Caselaw has endorsed new activities that have grown out of customer needs and demands and that promote customer convenience. Similarly, courts have recognized that the business of banking also includes activities that would promote the convenience of the bank's business for itself. Therefore, if an activity: (i) increases service, convenience, or options for bank customers; (ii) responds to new customer needs or demands; (iii) lowers the cost to banks of providing a product or service; or (iv) enhances bank safety and soundness, it should be viewed favorably as being part of the business of banking.

ARE THE RISKS OF THE ACTIVITY SIMILAR TO THE TYPE OF RISKS ALREADY ASSUMED BY BANKS?

One of the principal purposes of bank regulation is to maintain a safe and sound banking system. If a new activity would expose banks to financial or operational risks foreign to those banks have assumed and have successfully managed, the activity would be disfavored. In the latter category, for example, new activities that present materially heightened risks of conflicts of interest or anticompetitive effects would be disfavored. In other words, what is permissible must be colored by an assessment of what is safe and sound, and in a modern banking environment, this involves not just fiscal soundness, but also operational due care.

Moreover, it should be expected that even new activities that present risks of a nature similar to those banks traditionally have assumed will be evaluated carefully by bank regulators. While banks have taken on additional and different types of risks over time, this evolution has been grad-

ual. Regulators typically monitor new activities with care, even when the activities represent new forms of traditional risks, until they are comfortable that the risks can be appropriately managed by the bank and adequately supervised by the regulator.

Thus, while the theoretical scope of banking powers is broad, the pace of evolution of banking powers will be influenced by the overarching concern of ensuring that new activities do not imperil the safety and soundness of the banking industry. The delicate task facing bank regulators is to allow innovation in a safe and sound manner, without smothering new activities with unnecessarily burdensome restrictions that undermine the benefits, to banks and their customers, of allowing banks to develop and offer new products and services.

CONCLUSION

To survive, and to fulfill their role as catalysts for the nation's economy, banks must evolve to meet the changing needs of their customers. Fortunately, the *VALIC* decision makes clear that national banks have this ability. The scope of the future business of banking is potentially quite broad and the post-*VALIC* regime for analyzing permissible bank activities should be sufficiently flexible to allow banks to develop and deliver financially related products and services on a competitive, profitable, and safe and sound basis.