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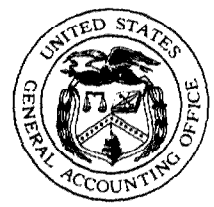
United States General Accounting Office
Fact Sheet for Members of Congress

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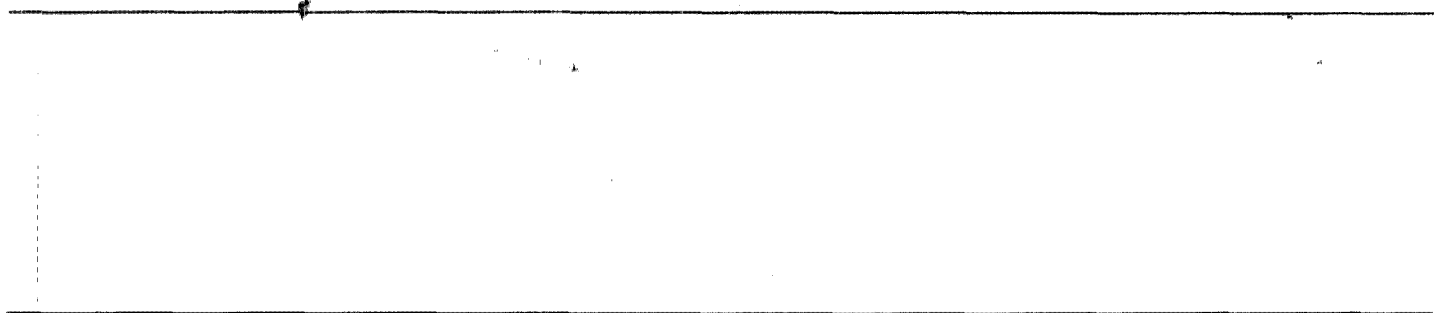
March 1986

FINANCIAL SERVICES

Information on Nonbank Banks



034877





UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

March 21, 1986

GENERAL GOVERNMENT
DIVISION

B-221766

The Honorable Jake Garn
Chairman, Committee on Banking, Housing
and Urban Affairs
United States Senate

The Honorable Fernand J. St Germain
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives

The Honorable Doug Barnard, Jr.
Chairman, Subcommittee on Commerce,
Consumer and Monetary Affairs
Committee on Government Operations
House of Representatives

Late last summer we briefed the staffs of your subcommittees on information we had gathered on the nonbank bank, a form of limited purpose bank. Because these banks do not offer both demand deposits and commercial loans, they fall outside of the narrow definition of "bank" found in the Bank Holding Company Act of 1956. Our work provided information on the history of nationally chartered nonbank banks and on the applicants for federal nonbank bank charters--who they are, why they want nonbank banks, how they plan to structure their banks, and which services they might provide.

At the time of our work, two major cases affecting the future of nonbank banks were before the Supreme Court. Together, they had the effect of bringing into question the legitimacy of nonbank banks and their activities. Recent action has occurred in both cases, renewing congressional interest in the topic. We therefore have decided to formally issue and distribute this briefing paper, prepared last summer, to contribute to the ongoing debate.

In a case involving Dimension Financial Corporation, the Federal Reserve Board (Fed) had tried to broaden the definitions of "demand deposit" and "commercial loan" to effectively bring nonbank banks under its regulatory purview. On January 22, 1986, however, the Supreme Court ruled that the Fed had exceeded its

authority in defining banks as it had done. In the second case, involving a New York bank holding company, the Fed had said that it felt "constrained" to approve U.S. Trust's application to expand activities of its Florida subsidiary to include demand deposits and consumer loans. The U.S. Court of Appeals for the 11th Circuit disagreed, saying that the Fed should have used its authority under the Bank Holding Company Act to deny the nonbank bank application. However, on January 27, 1986, the Supreme Court directed the case back to the Court of Appeals for further consideration in light of the Dimension case. These two decisions have removed some of the major obstacles to the chartering of nonbank banks. A Florida District Court's injunction against the chartering of nonbank banks has been in effect since February 15, 1985.

Officials of the Office of the Comptroller of the Currency and the Federal Reserve Board provided technical comments on a draft of this report which we have incorporated where appropriate. Copies of this document are being provided to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Financial Institutions Examination Council, and are available to others on request. If you have any questions or need additional information, I can be reached on 275-8678.



Craig A. Simmons
Associate Director

THE NONBANK BANK

The concept of the limited purpose financial institution is not new. For many years such institutions have provided consumer financial services including insured deposit-taking, with few or no commercial services. These institutions include over 3,000 savings and loan associations, 400 mutual savings banks, 1,200 industrial banks and industrial loan companies, and a small number of limited purpose banks performing functions such as credit card operations. However, beginning about 1980 another class of limited financial institution--the nonbank bank--began to receive attention.

Nonbank banks operate under either a state or federal charter, as other banks do. The Office of the Comptroller of the Currency (OCC) grants national charters under the National Banking Act, whereas state authorities grant state charters. Those institutions offering deposits are able to do so on an insured basis. State and federal banking agencies regulate the limited purpose banks as they regulate other chartered financial institutions. While the average consumer might consider these institutions to be banks, they are not subject to the Bank Holding Company Act. The Act defines a bank as an institution that

- accepts deposits which the depositor has a legal right to withdraw on demand (a demand account), and
- engages in the business of making commercial loans.

Nonbank banks are institutions that have chosen to forego one of these two functions.

A firm controlling even one state or federally chartered bank is a bank holding company under provisions of the Act and subject to Federal Reserve Board (Fed) regulation. The Act

- generally restricts the right of bank holding companies to acquire banks in more than one state, unless specific state legislation permits interstate acquisition;
- prohibits, with exceptions, bank holding companies from owning or controlling nonbanking companies; and
- empowers the Fed to specify what activities may be performed by a bank holding company.

The numerous federally and state chartered limited purpose banks which have existed for years have, for the most part, been owned by financial parents. This situation began to shift in the 1980's. In August 1980 OCC allowed Gulf and Western Corporation, a commercial conglomerate, to acquire Fidelity National Bank which had divested itself of all commercial loans

and had promised not to make such loans in the future. In March 1981 the Fed reasoned that since Fidelity would accept demand deposits but not make commercial loans, it was not a bank under the Bank Holding Company Act's definition. Therefore, since Gulf and Western did not own a "bank," it was not a bank holding company and therefore was not subject to bank holding company restrictions and the associated Fed regulation. Therefore, Gulf and Western could continue its other commercial activities without divesting itself of any of those activities.

In fact, the Gulf and Western decision was not the first time the Fed had commented on the definition of a bank. In several decisions in the 1970's the Fed addressed commercial loans under the Bank Holding Company Act. The Fed had defined a commercial loan and described a level of activity necessary to be in the commercial loan business. Subsequent to the Fed's allowing Gulf and Western to acquire the Fidelity nonbank bank, however, a small number of other firms began to follow suit. They could avoid coverage under the Act by converting a bank into a nonbank bank. Conversion was accomplished by divesting the bank of either its commercial loan business or its demand deposits.

Bank holding companies were slower to follow the path than the other firms. The number of state or federally chartered nonbank banks sought or acquired by banking parents was small and was frequently related to special purposes, such as credit card operations. Bank holding company officials told us that the bank holding companies were hesitant to apply for nonbank banks since they believed that the Fed would act to stop such an expansion by a bank holding company even if OCC did approve an individual application. The Fed has more direct control over bank holding companies since they are under Fed supervision regardless of their acquiring a nonbank bank.

The situation changed appreciably after March 1984 when the Fed permitted a New York bank holding company, U.S. Trust Corporation, to expand the activities of its Florida trust subsidiary to accept demand and time deposits and to make consumer loans. U.S. Trust had said that it would seek the Fed's approval before making commercial loans in Florida; the Fed's approval was in fact conditioned on U.S. Trust's not linking demand deposits and commercial lending. In late 1983 OCC had already conditionally approved the expansion of the Florida trust subsidiary's operations provided that it would not make commercial loans. Subsequent to the U.S. Trust decision, the number of applications for national nonbank banks increased dramatically.

Table 1: Number of Applications for National Nonbank Banks Filed with OCC through May 20, 1985^a

<u>Period</u>	<u>Bank holding co.</u>	<u>Other holding co.</u>	<u>Total</u>
Prior to April 1, 1984	8	45	53
April 1, 1984 to May 20, 1985 ^{b,c}	<u>348</u>	<u>40</u>	<u>388</u>
Total	<u>356</u>	<u>85</u>	<u>441</u>

^aThe totals do not include requests for trust companies. They only include requests for de novo (newly chartered) banks and conversions from full service trust companies to nonbank banks. May 20, 1985, is the date that the 11th Circuit Court of Appeals overturned the Fed's U.S. Trust decision. (See p. 6.)

^bFiled by 61 bank holding companies and 7 nonbanking holding companies.

^cThrough January 1, 1986, one additional application has been filed by a nonbanking holding company.

Along with the increase in the number of nonbank bank applications came opposition. Certain members of Congress, certain regulators, smaller bank representatives, and others believed that nonbank banks were

- threatening to the regulation of the banking industry;
- creating an opportunity for large money center banks to enter local markets;
- leading to the exportation by money center banks of local funds into distant national and international markets, thus handicapping local development; and
- circumventing the intent if not the letter of banking legislation, damaging the dual federal-state authority system governing banking, and opening the doors to unrestricted interstate banking.

The controversy led to congressional debate, legal actions, and two moratoria by the Comptroller of the Currency who, as noted earlier, is legally charged with granting national charters used by many nonbank bank applications. The stated purpose of the moratoria was to allow Congress time to consider the matter. In late 1984, the Comptroller, saying that he could no longer wait

for congressional action, lifted the last moratorium, and approvals began anew. However, in May 1985, the 11th Circuit Court of Appeals issued a major decision in the U.S. Trust case (Florida Department of Banking and Finance v. Board of Governors, 760 F.2d 1135 (11th Cir. 1985)). The court declared that the Fed should have used its authority under the Bank Holding Company Act to deny U.S. Trust's application to expand its Florida activities. The court reasoned that even though the activities would not fall literally within the statutory definition of a bank, the Fed's failure to deny the acquisition, when the state did not allow out-of-state holding companies to establish banks within its jurisdiction, violated the policy of the Act. In another case involving Dimension Financial Corporation, the Federal Reserve sought to broaden the definitions of "demand deposit" and "commercial loan" in order to effectively bring nonbank banks under its regulatory purview. Dimension Financial and other institutions succeeded in challenging the Federal Reserve's expanded definitions in the Court of Appeals for the 10th Circuit. Both decisions--U.S. Trust and Dimension--were appealed to the Supreme Court.

On January 22, 1986, the Supreme Court ruled in the Dimension case that the Federal Reserve had exceeded its statutory authority in defining demand deposits and commercial loans as it had done (Board of Governors v. Dimension Financial Corp., 54 U.S.L.W. 4101 (Jan. 22, 1986)). Also, on January 27, 1986, the Supreme Court directed the U.S. Trust case back to the Court of Appeals for the 11th Circuit for further consideration in light of its January 22 Dimension decision. Also, a Florida court's injunction against the chartering of nonbank banks by the OCC has been in effect since February 15, 1985.

Chronology of Key Dates Regarding National Nonbank Banks

August 1980, March 1981 Gulf and Western Corporation (a commercial conglomerate) received first OCC, then Federal Reserve approval to acquire Fidelity National Bank (no commercial loans).

August 1982 McMahan Valley Stores of California (furniture company) received a charter from OCC to establish The Western Family Bank (no commercial loans).

February 1983 Dreyfus Corporation (a securities firm) received OCC permission to charter the Dreyfus National Bank despite the Fed's contention that the bank violated the Glass-Steagall Acts' prohibition against the linking of banking and securities.

April 1983 The Comptroller of the Currency announced a limited moratorium (until December 31, 1983) on the chartering of new national nonbank banks in order to permit congressional debate on the subject.

August 1983 OCC conditionally approved U.S. Trust Corporation's application to expand activities of its Florida subsidiary, on the condition that it not make commercial loans.

December 1983 The Comptroller extended the moratorium until March 31, 1984.

March 1984 The Fed granted U.S. Trust Corporation permission for its Florida trust company subsidiary to accept demand and time deposits and to make consumer loans.

May 1984 After approving a number of charters, the Comptroller imposed a moratorium until the end of the then current session of Congress.

October 1984 After Congress recessed without acting, the Comptroller announced that he would not renew the moratorium.

February 1985 The Federal District Court in Jacksonville, Florida, issued a preliminary injunction barring OCC from granting charters to nonbank banks.

May 1985

The Court of Appeals for the 11th Circuit ruled that the Fed had acted improperly in approving U.S. Trust Corporation's application in March 1984 because approval violated the policy of the Bank Holding Company Act.

January 1986

The Supreme Court overruled the Federal Reserve in the Dimension case and directed the Court of Appeals for the 11th Circuit to reconsider its decision in the U.S. Trust case in light of the Dimension case.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of this study were to describe the development and the status of the national nonbank bank to provide some insight into

- the companies that sought national nonbank bank charters,
- the reasons that they sought them,
- the criteria for selecting particular nonbank bank locations,
- the services and products contemplated,
- the relationship between nonbank banks and parent firms and other subsidiaries, and
- the companies' views of the nonbank bank as a means for product and/or geographic diversification.

Although states may charter nonbank banks, our work focused on national nonbank banks and generally did not include state chartered institutions. These institutions can raise an additional series of issues.

During our survey, we

- extensively reviewed literature dealing with nonbank banks and interstate banking;
- discussed the subject with federal regulators, industry and trade officials, and bankers; and
- reviewed a portion of the 388 national bank charter applications for nonbank banks filed with the Office of the Comptroller of the Currency between April 1, 1984, and May 20, 1985, by bank holding companies (348 applications) and by other holding companies (40 applications).

Bank holding companies

We concentrated our efforts on identifying the applications for national charter filed at OCC by the 50 largest bank holding companies, i.e., those generally thought to be the most heavily involved in geographic diversification and the interstate expansion of banking related activities. We found that 26 of the 50 had filed a total of 222 applications between April 1, 1984, and May 20, 1985. (Eighteen of the 26 were among the 25 largest bank holding companies.) We gathered information regarding 214 of the above cited applications which had been filed by 25 bank holding companies. (OCC could not easily provide the remaining eight applications.)

Other holding companies

Because of congressional staff interest in possible differences between the treatment of applications submitted by different types of holding companies, we reviewed as many other holding company files as possible. We examined eight applications for national charters filed at OCC by four nonbanking holding companies. Although these four companies had filed 51 applications, 43 were not readily available for our review. We also requested access to an additional 24 applications filed by another 10 nonbanking firms. Again, these applications were not readily available at the time that we requested them. During the time of our file review (May 1985), OCC officials indicated that the application files were with legal counsel for review, at OCC field offices, or otherwise not readily available. Because of time limitations, we mutually agreed not to pursue the missing applications.

In examining bank and other holding companies' application files, we gathered information regarding

- banking/marketing strategy,
- services and products offered,
- capitalization, and
- anticipated relationships with parent firms and other subsidiaries.

Following these application reviews, we talked with holding company representatives. We selected the holding companies to interview based on

- their locations,
- the significance of holding company participation in the movement toward nonbank banks (211 of a total of 441 applications filed prior to May 20, 1985),
- the locations of the proposed nonbank banks (34 states and the District of Columbia), and
- the involvement of the parent company in interstate banking-related activities (for bank holding companies) or in financial activities (for other holding companies).

Table 2: Number of Holding Companies Contacted and Included in Review

Type of holding Company	<u>Number contacted</u>	<u>Applications filed</u>	<u>Companies included in our application review</u>
Banking	14	171	13 ^a
Other	<u>7</u>	<u>40</u>	<u>3^b</u>
Total	<u>21</u>	<u>211</u>	<u>16</u>

^aThe remaining one was not ranked among the top 50 bank holding companies and therefore was not in our application review.

^bAn additional three had filed federal applications, but we had not reviewed them; the remaining one had not filed a federal application but did own a state-chartered nonbank bank.

FACTORS INFLUENCING THE CHOICE BETWEEN CONSUMER AND COMMERCIAL NONBANK BANKS

Our general review of literature and testimony, as well as our discussions with individuals close to banking, indicated that the number of consumer nonbank banks, i.e., those not making commercial loans, would probably greatly exceed the number of commercial nonbank banks, i.e., those not taking demand deposits, because

- taking deposits is an important part of the banking business and the reason that many companies reportedly wanted nonbank banks;
- making commercial loans can be easily accomplished through other subsidiary activities, such as loan production offices and commercial credit offices; and
- increasing consumer loan and deposit bases in order to offset reliance on the more volatile commercial and institutional assets and liabilities has become very important to large money center banks.

Our review of application files at the OCC, however, showed a very different situation. The number of commercial nonbank bank applications was much closer than we expected to the number of the consumer ones. Of the 388 applications for federally chartered nonbank banks submitted between April 1, 1984, and May 20, 1985, 42 percent were for commercial nonbank banks, and 58 percent were

for consumer ones. We identified three major reasons that the commercial option is more attractive than originally expected. The last reason, however, is no longer valid because of the recent Supreme Court decision in the Dimension case.

1. The growth of the "other" transactions accounts

The increasingly subtle distinction between types of transactions accounts, such as NOW and checking (demand) accounts, may be one reason that the commercial option is more attractive. In the highly recognized Beehive/Foothill decision (First Bancorporation v. Board of Governors, 728 F.2d 434 (10th Cir. 1984)), which the Supreme Court agreed with in the recent Dimension case, the U.S. Court of Appeals for the 10th Circuit found that while NOW's and Super-NOW's might well be transactions accounts in consumers' eyes, they were technically not "demand deposits." This distinction is not important to a consumer who only cares about the ability to transfer funds on something that looks and works like a check. Thus, as a result of the Court of Appeals' decision, the bank could give up demand deposits and still offer transactions services to the consumer through a nonbank bank.

One major bank holding company that we spoke with indicated that it had planned to open its nonbank banks with only money market deposit accounts until the Court of Appeals' decision. All nonbank banks have been able to offer a money market deposit account with limited transactions capabilities. The bank holding company indicated that it now plans to add NOW accounts to its nonbank banks. Furthermore, this bank believed that the court decision allowing NOW accounts precipitated commercial type applications from other bank holding companies.

Consumers are shifting toward NOW-type account deposits and away from traditional demand deposits. Hence, the banks choosing to give up demand deposits are not giving up as much as would be the case if NOW-type account deposits were considered demand deposits. Table 3 shows the relative importance of NOW and Super-NOW accounts compared to demand deposits.

Table 3: Mix of demand deposits and NOW-type accounts

	<u>Feb.</u> <u>1981</u>	<u>Jan.</u> <u>1982</u>	<u>Jan.</u> <u>1983</u>	<u>Jan.</u> <u>1984</u>	<u>Jan.</u> <u>1985</u>
Demand Deposits	90.0	83.85	79.75	75.98	73.57
NOW and Super-NOW	<u>10.0</u>	<u>16.15</u>	<u>20.25</u>	<u>24.02</u>	<u>26.43</u>
Total	<u>100.0</u>	<u>100.00</u>	<u>100.00</u>	<u>100.00</u>	<u>100.00</u>
Percent change in NOW and Super-NOW over prior year	--	+6.15	+4.10	+3.77	+2.41

2. The desire to service special classes of businesses

While a bank holding company may wish to emphasize consumer banking in its nonbank banks, it may wish to retain the option of doing some business lending to those sectors that may not be so easily serviced by loan production offices or through visitations by loan officers. This is especially true for certain classes of customers whose business banking needs are closely related to their personal needs. For example, professionals such as doctors, lawyers, and accountants, are usually upscale consumers who need both business and household financial services. The commercial loan option assures that the bank can service the full financial needs of such customers. In addition, small business and "middle market" (companies with \$5 million to \$100 million in sales) lending can also be conducted. In effect, by maintaining the commercial option, the bank holding company and its nonbank banks retain the flexibility to service particular markets.

3. The Fed's broad definition of a commercial loan

There was an additional reason for retaining the commercial loan option. The Fed had broadened the definition of a commercial loan to include other assets and activities. For example, the Fed considered the purchase by a bank of commercial paper or of another bank's certificates of deposit to be commercial loans for purposes of the Bank Holding Company Act. Two major bank holding companies indicated to us that the Fed's broadened definition was a major factor in opting for the commercial nonbank bank. However, as indicated previously, in January 1986 the Supreme Court ruled that the Federal Reserve had exceeded its authority in redefining commercial loans; that certificates of deposit and commercial paper were not within the commonly accepted definition of commercial loans. Therefore, these activities are not precluded to those nonbank banks desiring to go the "demand deposit," or consumer bank route.

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Of course, the particular choice made by an individual bank depends upon a number of variables. The time of the application in relation to the Beehive case may have made a difference. In addition, each holding company had its own overall business strategy that included various other nonbanking activities, such as loan production offices and finance companies, and its choice of any particular type of nonbank bank must be considered in light of that strategy. Furthermore, some banks with a large number of applications may have decided that some diversification would be prudent and may have split their choices somehow in order to hedge against the uncertainty over which approach would be the more appropriate or successful.

VIEWS OF HOLDING COMPANIES ON NONBANK BANKS

During our discussions with the 21 holding companies, we addressed a number of issues regarding the nonbank bank. We discussed broad issues, such as the advantages of a nonbank as a means for diversification, and narrow issues, such as the reasons that the individual firms selected the locations that they did and the factors influencing their selection of either the consumer (accepting demand deposits) or commercial (making commercial loans) nonbank bank option. The following segments address some of the more significant issues discussed.

● Reasons for establishing nonbank banks

Our interviews disclosed the following reasons for establishing nonbank banks:

- to expand banking into other geographic markets;
- to establish a physical presence in anticipation of full or limited interstate banking;
- to accept deposits to fund new as well as existing activities (in some cases these activities are now funded through the sale of more expensive commercial paper);
- to expand the ability to better compete in the middle market loan business;
- to improve the company's image with the consumer (by replacing a finance company with a bank office);
- to create new products to offer (especially cited by nonbanking firms, particularly in regard to offering insured products);

- to obtain access to the Federal Reserve's system of clearing checks for payment, in the case of nonbanking holding companies;
- to match the actions of competitors;
- to attract a larger portion of existing customer business; and
- to establish additional locations in unit banking states.

● Criteria for location of nonbank banks

Reasons for choosing certain locations for nonbank banks were

- the attractiveness of the proposed area as a site for the type of products and services that the holding company intended to offer;
- the overall economic growth potential of the area;
- the existence of subsidiaries, including finance companies, loan production offices, check processing centers, and commercial finance offices (in some cases, either firm or tentative plans existed for the nonbank bank to acquire the assets of existing subsidiaries and to staff the nonbank with personnel from the existing subsidiaries);
- the proximity to the holding company and/or company-operated support services;
- favorable state tax laws and high interest rate ceilings in particular states; and
- favorable state legislation or regulatory atmosphere.

● The products and services of nonbank banks

We found that the proposed nonbank banks we looked at appeared much like full service commercial banks since they would offer many similar products and services. While it did appear that each nonbank bank would not offer all consumer and commercial services and products (especially since demand deposits and commercial loans cannot exist in the same nonbank bank), neither do all full service commercial banks. Most nonbank banks would have a range of services, and only a few would be extremely limited (e.g., credit card services). Two holding companies told us that their nonbank banks would look like savings and loan associations. Some banks planned to emphasize a specific approach such as consumer financing or middle market loans; others did not.

While the individual applications did not necessarily contain complete lists of products and services to be offered, some did include very extensive lists. The following lists, taken from two holding companies' applications on file at OCC, outline products and services planned for one specific commercial and one consumer nonbank bank.

Proposed Services of Nonbank BanksCommercial Nonbank Bank

- home equity loans -fixed rate, fixed terms
 - fixed rate, low periodic payments with balloon payment
 - variable interest rate, fixed monthly payment
- home equity lines of credit
- installment loans -personal unsecured
 - automobile
 - marine
 - secured by possessory collateral
- lines of credit
- insurance services (selling, as an agent, credit life and health)
- savings accounts
- money market deposit accounts
- Certificates of Deposit
- middle market loans (secured and unsecured)

Consumer Nonbank Bank

- | | |
|----------------------------------|-------------------------------|
| --first and second mortgages | --domestic collections |
| --FHA loans | --foreign collections |
| --VA loans | --safe deposit boxes |
| --automobile loans | --discount brokerage services |
| --personal lines of credit | --cashiers checks |
| --education loans | --money orders |
| --home improvement loans | --travelers checks |
| --home equity loans | --U.S. Savings Bonds |
| --credit cards | --funds transfer |
| --debit cards | --direct deposit |
| --demand deposit accounts | --telephone transfer |
| --NOW accounts | --night depository |
| --Super-NOW accounts | --check guarantee cards |
| --Money Market Deposit Accounts | --automatic teller machines |
| --Statement of savings accounts | |
| --Certificates of Deposit | |
| --Keough Plans | |
| --Christmas Club Accounts | |
| --Individual Retirement Accounts | |

● The planned relationship between nonbank banks and other holding company subsidiaries

In our interviews with holding companies the following views were expressed:

- Some holding companies saw nonbank banks as a substitute for other existing bank-related subsidiary activities (finance companies, commercial credit offices, loan production offices, and trust companies).
- Some holding companies envisioned the possibility of subsidiaries:
 - cross-selling each other's products,
 - referring business to each other,
 - jointly participating in lending activities, and
 - sharing back room services, such as centralized purchasing, data processing services, and check processing.

(These plans are in question because of Fed attempts to stop or to discourage relationships among the holding companies and/or subsidiaries. See p. 20.)

- One large bank holding company had no plans to dismantle or rearrange any part of its extensive subsidiary network. It viewed the nonbank bank as a unique entity, separate from the other subsidiaries and representing the holding company as a local bank.

● Views of holding companies on the nonbank bank as a method of expansion

The views of those we interviewed on the efficiency of the nonbank bank as a method of expansion were as follows:

Bank holding companies

- The nonbank bank is not an ideal method for bank expansion; full interstate banking is preferred.
- The current antiquated restrictions on interstate banking force banks/bank holding companies to look for inefficient methods, such as the nonbank bank, to achieve diversification.

Other holding companies

--The nonbank bank fits their requirements for entry into the banking system or for expansion in the financial services industry.

● Alternatives to the nonbank bank

The bank holding companies and other holding companies saw few options for achieving an interstate banking presence if the nonbank bank loophole were closed.

Bank holding companies

Bank holding companies offered the following options:

- opening additional loan production offices or finance companies,
- purchasing troubled thrifts,
- waiting for full interstate banking, and
- expanding through regional (limited) interstate banking agreements.

Regarding the last option, the large money center banks in California, New York, and Texas may be somewhat limited since most existing state banking agreements exclude them, and there is little indication of change at this time.

Other holding companies

For other holding companies, the options cited to achieve an interstate presence were even fewer. These options were limited to

- opening additional finance companies or loan production offices;
- purchasing failing thrifts; and
- convincing the Federal Home Loan Bank Board that its policy prohibiting the purchase of thrifts, other than failing ones, across state lines needs to be reversed.

● Effects of Federal Reserve Board actions on the future of nonbank banks

Several bank holding companies believed that the Fed used stalling tactics to slow the growth of nonbank banks. Company officials cited Fed restrictions placed on recently approved

applications that would prohibit a holding company from providing administrative support to a nonbank bank or using a nonbank bank to link commercial loans and demand deposits, and prohibit a nonbank bank from engaging in transactions with affiliates. Individual comments by bank holding company officials on how Fed actions have affected or could affect their ability to operate nonbank banks follow.

--The cost of operating a nonbank bank might be prohibitive without shared back room services.

--The holding company might withdraw all or some applications because of the Fed restrictions.

--The Fed restrictions make nonbank banks more costly and less desirable.

--Plans for tie-ins with other subsidiaries would have to be modified.

Since these restrictions were imposed, the Fed's staff has suggested to the Board that such an absolute prohibition on the provision of services by the parent to its nonbank bank subsidiary does not appear necessary to assure that a nonbank bank would not, in essence, become a bank. In January 1985 the Fed solicited public comment on whether these restrictions were or were not necessary. No formal Fed response has been issued.

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