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NOTES

BANK CERTIFICATES OF DEPOSIT: NOTES NOT IN TUNE WITH SECURITIES REGULATION

I. Introduction

The United States banking industry, suffering from a steady outflow of bank deposits,¹ introduced the twenty-six week high-yield time deposit to the public in 1978.² Commercial banks and savings

1. See Hyatt, *Certificate Linked to Treasury Bill Rates is Planned by U.S. to Boost Savings Flow*, Wall St. J., May 11, 1978, at 6, col. 2; Wall St. J., May 12, 1978, at 3, col. 2. See also *Savings Banks Lose Heavily*, N.Y. Times, Feb. 26, 1982, at D1, col. 1. The outflow of dollars from commercial banks and savings and loan associations was due in large part to the "rapid rise in money market rates relative to deposit rate ceilings. . . ." 43 Fed. Reg. 21437 (1978).

2. 43 Fed. Reg. 21435-39 (1978). The six-month time deposit was created "in order to increase returns for savers by providing [a] deposit categor[y] that [is] competitive with interest rates available in the market on instruments possessing similar characteristics." *Id.* at 21436. A primary concern of the banking bodies was to "increase the flow of mortgage credit and assist the housing market." *Id.* Evidenced by and popularly known today as "six-month certificates of deposit," this new category of time deposit was authorized simultaneously by the Board of Governors of the Federal Reserve System (Federal Reserve Board), Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. *Id.* at 21435-39. The savings certificate is non-negotiable and earns a fixed rate of interest during its twenty-six week life, a rate comparable to the prevailing six-month Treasury bill at commercial banks and 1/4% higher at savings institutions. *Id.* at 21437; 12 C.F.R. §§ 217.7, 329.6(c), 329.7(6)(7) (1981).

In 1980, Congress enacted the Depository Institutions Deregulation Act of 1980, Act of March 31, 1980, 94 Stat. 142, Pub. L. No. 96-221. The purpose of the act is to phase out the interest rate ceilings which limit the interest paid on accounts in depository institutions because such limitations "discouraged persons from saving money, create[d] inequities for depositors, impede[d] the ability of depository institutions to compete for funds, and [did not provide] an even flow of funds for home mortgage lending." *Id.* § 202(a). The act transferred the authority conferred by § 19(j) of the Federal Reserve Act, 12 U.S.C. § 371b (1976 & Supp. III 1979), § 18(g) of the Federal Deposit Insurance Act, 12 U.S.C. § 1828(g) (1976 & Supp. III 1979), and § 5B(a) of the Federal Home Loan Bank Act, 12 U.S.C. § 1425b(a) (1976), to prescribe rules governing the payment of interest and dividends and the establishment of classes of deposits or accounts to the Depository Deregulation Committee. *Id.* § 203(a). See also REPORT OF SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS ON H.R. 4986, S. REP. NO. 368 (1979), in which the Inter-Agency Task Force on Deposit Interest Rate Controls and Housing Credit recommended the phase out of deposit interest rate ceilings.

As of June 1978, standard six-month savings certificates had a 5.75% ceiling interest rate at savings banks and a 5.5% ceiling at commercial banks. By compari-

and loan associations have been advertising this high-yield deposit aggressively—at times touting the savings certificates which evidence the deposit as “investments” and characterizing depositors as “investors.”³ Widespread acceptance⁴ of savings instruments has produced litigation in the federal courts concerning the rights and liabilities of the issuer and holder of such notes.⁵ For example, the Supreme Court currently is faced with the question of whether a certificate of deposit⁶

son, as of May 1978, six-month Treasury bills had an average return of 6.986%. Hyatt, *Certificate Linked to Treasury Bill Rates is Planned by U.S. to Boost Savings Flow*, Wall St. J., May 11, 1978, at 6, col. 2.

3. For example, one newspaper advertisement asserts, “With a . . . CD [certificate of deposit], your future can be a lot more predictable than the economy’s.” N.Y. Times, Feb. 19, 1982, at A9 (advertisement). The advertisement copy explains, “[t]his is how it works: we simply give you a bookkeeping loan against a 30 month certificate, but it’s not a loan in the usual sense. . . . At maturity, your ‘investment’ and your ‘loan’ simply cancel each other out automatically.” *Id.* “For example, if you deposit \$40,000 you’ll earn \$200 extra [interest than for any current six-month CD]; with an \$80,000 investment you’ll earn an extra \$600! . . . On top of that, your investment is FDIC insured.” *Id.*

4. The introduction of the certificates has been successful—banks issued some \$9.5 billion of the new instruments during the first 30 days of availability. *A Fresh Tool for Savings Catches On*, U.S. NEWS & WORLD REP., Aug. 28, 1978, at 72, col. 1. Moreover, in the period of 1970-1980, individual savings deposits in the nation’s banks decreased 29.3%; by contrast, high-yield time deposits (including 6- and 30-month money-market certificates), increased a staggering 147.4%. Scharff, *The Savings Revolution*, Time, June 8, 1981, at 58, col. 1. In 1980, 189 of the top 200 banks in the nation (as determined by the amount of assets held) contained more time deposits than demand deposits in their vaults. *Bank Scoreboard*, Bus. Wk., April 13, 1981, at 88, col. 1.

5. See, e.g., *Meason v. Bank of Miami*, 652 F.2d 542 (5th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (Feb. 23, 1982); *Weaver v. Marine Bank*, 637 F.2d 157 (3d Cir. 1980), *argued*, 50 U.S.L.W. 3569 (Jan. 11, 1982); *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465 (7th Cir. 1980); *Adato v. Kagan*, 599 F.2d 1111 (2d Cir. 1979); *Burrus, Cootes & Burrus v. MacKethan*, 537 F.2d 1262, (4th Cir.), *vacated as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977); *Safeway Portland Employee’s Credit Union v. C.H. Wagner & Co.*, 501 F.2d 1120 (9th Cir. 1974); *Bellah v. First Nat’l Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *SEC v. First Am. Bank and Trust Co.*, 481 F.2d 673 (8th Cir. 1973); *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98041 (E.D.N.Y. June 1, 1981); *Manchester Bank v. Connecticut Bank & Trust Co.*, 497 F. Supp. 1304 (D.N.H. 1980); *Hamblett v. Board of Sav. and Loan Assoc.*, 472 F. Supp. 158 (N.D. Miss. 1979); *Hendrickson v. Buchbinder*, 465 F. Supp. 1250 (S.D. Fla. 1979); *Drovers Bank of Chicago v. SFC Corp.*, 452 F. Supp. 580 (N.D. Ill. 1978); *Garner v. Pearson*, 374 F. Supp. 591 (M.D. Fla. 1974); *Young v. Seaboard Corp.*, 360 F. Supp. 490 (D. Utah 1973); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 300 F. Supp. 1083 (S.D.N.Y. 1969), *aff’d*, 430 F.2d 355 (2d Cir. 1970), *rev’d on other grounds*, 404 U.S. 6 (1971); *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 (S.D.N.Y. 1968).

6. As defined in federal regulations,

[t]he term “time certificate of deposit” means a deposit evidenced by a negotiable or nonnegotiable instrument which provides on its face that the

issued to a time depositor by a bank falls within the statutory meaning of "security"⁷ as defined by federal securities laws.⁸ In *Marine Bank*

amount of such deposit is payable to bearer or to any specified person or to his order:

(1) On a certain date, specified in the instrument, not less than 30 days after the date of the deposit, or

(2) At the expiration of a certain specified time not less than 30 days after the date of the instrument, or

(3) Upon notice in writing which is actually required to be given not less than 30 days before the date of repayment, and,

(4) In all cases only upon presentation and surrender of the instrument.

12 C.F.R. § 217.1(c) (1981).

A certificate of deposit is a receipt for the deposit of funds in a bank of which there are two classes, demand and time. Demand certificates of deposit are payable on demand, and time certificates of deposit are payable on a specified date, or so many days after date, upon proper indorsement. These time certificates are similar to savings deposits, but have a definite maturity, and are evidenced by a certificate instead of a passbook entry. Time certificates of deposit may bear interest, and are, therefore, a convenient means of investing temporarily idle funds, which otherwise would be unemployed.

G. MUNN, *ENCYCLOPEDIA OF BANKING OF FINANCE* 178-79 (F.L. Garcia rev. ed. 1973). See also note 16 *infra*.

7. The definition of "security" in the 1933 Act is as follows:

When used in this subchapter, unless the context otherwise requires,— [t]he term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77(b)(1) (1976). The definition of "security" in the 1934 Act is as follows:

When used in this chapter unless the context otherwise requires . . . [t]he term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security;" or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. 78c(a)(10) (1976).

8. Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. §§ 77a-77aa (1976 and Supp. III 1979); Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. §§ 78a-78kk (1976 and Supp. III 1979).

v. Weaver,⁹ the plaintiffs alleged that a certificate of deposit which they pledged as a guaranty for a loan made to a financially unstable business was a security.¹⁰ Inclusion of certificates of deposit within the statutory definition¹¹ of security would result in the application of the antifraud provisions of the Securities Act of 1933¹² (1933 Act) and

9. 637 F.2d 157 (3d Cir. 1980), *argued*, 50 U.S.L.W. 3569 (Jan. 11, 1982).

10. In *Weaver*, the plaintiffs alleged that the defendant Marine Bank issued a certificate of deposit to them and, in doing so, violated the antifraud provisions of the 1934 Act. 637 F.2d at 159. To secure a guaranty on a loan made to a meat packing company, the plaintiffs pledged the \$50,000 certificate of deposit to the bank. *Id.* at 161. The plaintiffs alleged that the bank characterized their pledge as involving little risk because the value of the collateral was substantial enough to protect both them and Marine Bank. Brief for Appellant at 7-8, *Weaver v. Marine Bank*, 637 F.2d 157 (3d Cir. 1980). When the loan eventually became due, the bank claimed that the collateral was inadequate and asserted that it intended to resort to the certificate. 637 F.2d at 159.

11. Two statutory definitions of "security" that ostensibly apply to modern high-yield certificates of deposit do not: (1) "certificate of deposit, for a security," and (2) "any note . . . which has a maturity at the time of issuance of not exceeding nine months. . . ." See note 7 *supra*. "Certificate of deposit, for a security" refers to instruments issued by security holders' protective committees in the course of corporate reorganizations. Courts do not construe this term to include a certificate of deposit issued in exchange for currency. *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465, 468 (7th Cir. 1980); *Burrus, Cootes & Burrus v. MacKethan*, 537 F.2d 1262, *vacated as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 300 F. Supp. 1083 (S.D.N.Y. 1969), *aff'd*, 430 F.2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U.S. 6 (1971). Section 3(a)(10) in referring to a "certificate of deposit, for a security," can further be construed to imply the negative; that is, a certificate of deposit issued for currency is excluded. *Burrus, Cootes & Burrus*, 537 F.2d at 1265.

Section 3(a)(3) of the 1933 Act, 15 U.S.C. § 78c(a)(10), exempts from the statute's registration provisions those notes which have a maturity not exceeding nine months. This does not affect time deposit savings certificates with maturities less than nine months as "section 3(a)(3) applies only to prime quality negotiable [commercial] paper of a type not ordinarily purchased by the general public, that is, paper used to facilitate well recognized types of current operational business requirements and of a type eligible for discounting by Federal Reserve banks." *Zabriskie v. Lewis*, 507 F.2d 546, 550 (10th Cir. 1974), *quoting* SEC Release No. 4412; 26 Fed. Reg. 9158 (1961); 17 C.F.R. 231.4412 (1961).

12. Section 17 of the Securities Act of 1933 provides that:

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

the Securities Exchange Act of 1934¹³ (1934 Act) to time deposit savings certificates issued by the banking industry. Such statutory construction would provide a federal forum¹⁴ and potential remedies for prospective plaintiffs above and beyond the provisions already

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77Q(a) (1976).

13. Section 10b of the Securities and Exchange Act of 1934 reads as follows: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1976). See generally L. LOSS, SECURITIES REGULATION 1421-1519 (2d ed. 1961 & Supp. 1969).

SEC Rule 10b-5 provides that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1981).

14. "The relative ease with which one may recover for a violation of SEC Rule 10b-5 has led prospective plaintiffs to seek redress in federal forums even though their claims do not involve instruments which fall within the everyday conception of securities." Comment, *Commercial Notes and Definition of "Security" Under the Securities and Exchange Act of 1934: A Note is a Note is a Note?*, 52 NEB. L. REV. 478, 478-79 (1973) [hereinafter cited as *A Note*]. The existence of a private cause of action for violations of SEC Rule 10b-5, the regulation that implements the 1934 Act's antifraud provision, is well established by case law. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); *A Note, supra* at 479 n.2. The existence of a private right of action under § 17(a) of the 1933 Act, however, has not been acknowledged universally. The Supreme Court has not yet ruled on the issue. *Aaron v. SEC*, 446 U.S. 680, 689 (1980); *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 557 n.9 (1979); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 754 (1975). Some circuits have supported a private right of action under § 17(a). *Stephenson v. Calpini Conifers II, Ltd.*, 652 F.2d 808, 815 (9th Cir. 1981) (private right exists in light of "minimal differences" between § 17(a) of the 1933 Act and § 10(b) of the 1934 Act); *Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir. 1978) (private right under § 17(a) exists once it is established that plaintiff has an action under § 10(b) of

existing in the federal banking laws.¹⁵ The Securities and Exchange Commission, under whose scrutiny savings certificates would fall should the instruments be deemed securities, supports a broad statutory interpretation including the item as a security.¹⁶ By contrast, the banking lobby has taken the position that "Congress intended to protect bank depositors by means of the banking laws"¹⁷ and that application of the antifraud provisions of the securities acts would be tantamount to "regulatory overkill."¹⁸

the 1934 Act); *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223, 1245-46 (7th Cir. 1977), *rev'd on other grounds*, 439 U.S. 507 (1979)). *See also* *Engl v. Berg*, 511 F. Supp. 1146 (E.D. Pa. 1981). *But see* *State of Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687, 689 n.1 (10th Cir. 1981) ("[T]here is considerable doubt as to whether a private right of action exists under § 17(a) of the 1933 Act."); *Wachovia Bank & Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342, 350 n.19 (D.C. Cir. 1980) (court declined to decide whether a private right of action under § 17(a) existed). The Eighth Circuit has denied such a right of action. *Shull v. Dain, Kaiman & Quail, Inc.*, 561 F.2d 152, 159 (8th Cir. 1977), *cert. denied*, 434 U.S. 1086 (1978). *See also* *Reid v. Mann*, 381 F. Supp. 525 (N.D. Ill. 1974); *Hardy v. Samson*, 356 F. Supp. 1034 (N.D. Ga. 1973); *Dyer v. Eastern Bank & Trust Co.*, 336 F. Supp. 1980 (D. Me. 1971).

15. The Federal Reserve Board and the Federal Home Loan Bank Board are required to maintain a separate division of consumer affairs to receive complaints and take appropriate action to prevent unfair or deceptive acts or practices by banks or savings and loan institutions, where such acts affect commerce. 15 U.S.C. § 57a(f) (1976 & Supp. III 1979). In addition, Federal Reserve regulations contain the following provision concerning advertising of interest on deposits:

Every advertisement, or solicitation relating to the interest paid on deposits in member banks shall be governed by the following rules:

* * *

(g) Accuracy of Advertising. No member bank shall make any advertisements, announcement, or solicitation relating to the interest paid on deposits that is inaccurate or misleading or that misrepresents its deposit contracts.

(h) Solicitation of deposits for banks. Any person or organization that solicits deposits for a member bank shall be bound by the rules contained in this section with respect to any advertisement, announcement, or solicitation relating to such deposits.

12 C.F.R. § 217.6 (1981). Similarly, regulations of the Federal Deposit Insurance Corporation provide: "Accuracy of Advertisements. No insured nonmember bank shall make any advertisement, announcement, or solicitation relating to the interest or dividends paid on deposits which is inaccurate or misleading or which misrepresents its deposit contracts." 12 C.F.R. § 329.8 (1981).

16. 31 Fed. Reg. 16582 (1966). *See* note 108 *infra* and accompanying text.

17. American Bankers Association Brief as *Amicus Curiae* in Support of the Petitioner at 21, *Weaver v. Marine Bank*, 637 F.2d 157 (3d Cir. 1980), *argued*, 50 U.S.L.W. 3569 (Jan. 11, 1982) (Brief for Supreme Court).

18. *Id.* at 20.

This Note analyzes the legislative history of the 1933 Act,¹⁹ 1934 Act,²⁰ and the Banking Act of 1933 (Glass-Steagall Act)²¹ to ascertain whether Congress may have intended to include modern instruments such as high-yield time deposit savings certificates—items utilized today as alternative investment vehicles to minimize the effects of double digit inflation and interest rates. It examines the split among the circuits which have attempted to reconcile statutory language and congressional intent with the practicalities of the modern complex financial marketplace in determining whether promissory notes, including certificates of deposit,²² are securities. This Note concludes that Congress did not intend to cover certificates of deposit within the scope of the securities acts. Furthermore, in view of the potential over-regulation of the banking industry, courts should not stretch the statutory definition of a security to afford an additional jurisdictional means for aggrieved certificate holders to be heard before the federal bench.

II. Securities and Banking Legislation in the Seventy-Third Congress

In the wake of the stock market crash of 1929 and subsequent depression, the Seventy-third Congress enacted three statutory schemes—the 1933 Act, the 1934 Act, and the Glass-Steagall Act—designed to cure abuses within the financial marketplace.²³ The

19. 48 Stat. 74 (1933) (codified as amended, 15 U.S.C. §§ 77a-77aa (1976 & Supp. III 1979 & Supp. IV 1980)).

20. 48 Stat. 881 (1934) (codified as amended, 15 U.S.C. §§ 78a-78kk (1976 & Supp. III 1979 & Supp. IV 1980)).

21. Banking Act of 1933, ch. 89, 48 Stat. 162 (1933) (codified at 12 U.S.C. § 227 (1976)).

22. A certificate of deposit is “a note of the issuing bank which recites that an amount of money has been deposited and will be paid by the bank to a named person or bearer.” F. BEUTEL, *BANK OFFICER'S HANDBOOK OF COMMERCIAL BANKING LAW* 85 (4th ed. 1974) (emphasis added). It ordinarily constitutes a promissory note. MICHIE, *BANKS AND BANKING* § 313 n.84 (1973 & Supp. 1981). See also *Wightman v. American Nat'l Bank of Riverton*, ___ Wyo. ___, 610 P.2d 1001, 1004 (1980) (“a certificate of deposit is simply a commercially glamorous name for a promissory note”); *Worden v. Thornburg*, 564 S.W.2d 480, 483 (Tex. Civ. App. 1978) (“[a] non-negotiable certificate of deposit represents a form of promissory note”).

23. The securities acts were passed at the urging of President Roosevelt who called for new laws requiring full publicity and disclosure of all “essentially important element[s]” attending every issue of new securities. Letter from President Franklin D. Roosevelt to Congress (Mar. 29, 1933), reprinted in 77 CONG. REC. 937 (1933). The legislation was intended to encourage “honest dealing in securities and thereby bring back public confidence” in the investment markets and, moreover, to eliminate the “unethical and unsafe practices of bank and corporate officers.” *Id.*

contemporaneous enactment of banking and securities legislation, each of which potentially governs high-yield certificates of deposit, raises the question of whether Congress intended the statutes to regulate mutually exclusive subject matter. Congress included in the 1933 and 1934 Acts, antifraud provisions,²⁴ which prohibit fraudulent interstate transactions in securities (section 17 of the 1933 Act)²⁵ or the use of manipulative and deceptive devices in connection with the purchase or sale of a security (section 10b of the 1934 Act).²⁶ According to a Senate report, the 1933 Act was intended to "protect the investing public" by "informing the investor of the facts concerning securities . . . and providing protection against fraud and misrepresentation."²⁷ Moreover, the drafters of the statutes sought to afford protection "wherever there are savings accounts, wherever people invest their funds . . . in banks [and where they have] suffered because of lack of information concerning investments that have been recommended to them."²⁸

During the eighteen month period in which Congress enacted the 1933 and 1934 Acts, it established a separate scheme of legislation, the Glass-Steagall Act,²⁹ for the regulation of the banking industry and

24. See notes 12-14 *supra*.

25. See note 12 *supra* for text of § 17.

26. See note 13 *supra* for text of § 10b.

27. S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933).

28. 77 CONG. REC. 2914 (1933). During the debate on H.R. 9323, (the Securities Exchange Act of 1934), Representative Studley of New York predicted that Wall Street would move to Canada if the bill were passed. He bemoaned that "if the Congress [passes the bill] more than a billion dollars worth of real estate south of Fulton Street in Manhattan alone will become unproductive and tenantless. More than a hundred thousand people in New York City would be thrown out of employment and into the bread lines." 78 CONG. REC. 7943 (1934). Although the concepts of securities legislation were not without its detractors, most lawmakers shared the views of Congressman Mapes, one of the statutes' drafters, who stressed the obligation to protect investors by ensuring the availability of material information about the securities which the public was being asked to purchase. 77 CONG. REC. 2912 (1933). Similarly, the Supreme Court has recognized the remedial purpose of the 1933 and 1934 Acts: "The Securities Act of 1933 . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud. . . . [T]he 1934 Act was intended principally to protect investors against manipulation of stock prices. . . ." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194-95 (1976). See generally *Ellenberger & Mahan*, I *Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934*, Landis, *The Legislative History of the Securities Act of 1933*, 28 *Geo. Wash. L. Rev.* 29 (1959-60); Loomis, Jr., *The Securities Exchange Act of 1934 and The Investment Advisers Act of 1940*, 28 *Geo. Wash. L. Rev.* 214 (1959-60).

29. Banking (Glass-Steagall) Act of 1933, ch. 89, 48 Stat. 162 (1933) (codified at 12 U.S.C. § 227 (1976)).

the protection of depositors.³⁰ The statute was intended to separate the large private banks, whose chief business was investment, from deposit banking.³¹ Designed to supervise closely the financial activity and stability of banks, the act created the Federal Deposit Insurance Corporation³² to insure deposits against loss. The statute regulated interest payable on demand deposits and payment of interest in accordance with the terms of any certificate of deposit;³³ purchase of investment securities;³⁴ prohibition of dealing in securities and acceptance of bank deposit by the same entity;³⁵ and restriction of involvement by bank officers in the securities business.³⁶ In addition, the Act attempted to separate banking and investment activities by prohibiting member banks of the Federal Reserve System from owning or controlling affiliated securities firms.³⁷

30. Representative Steagall, co-sponsor of the bill, stated that "the purpose of this legislation is to protect the people of the United States in the right to have banks in which their deposits will be safe." 77 CONG. REC. 3837 (1933). The creation of the Federal Deposit Insurance Corporation was intended to alleviate these concerns. See note 32 *infra*.

31. 77 CONG. REC. 3730 (1933). During the debate on the Senate version (S.1631) of the banking bill, Senator Glass declared that "[t]he main purpose of the bill . . . was to prevent, under penalty, the use of Federal Reserve banking facilities for stock-gambling purposes." *Id.* at 3725. In the debate in the House of Representatives, it was stated that the bill "prohibits institutions dealing in securities and underwriting securities from accepting deposits." *Id.* at 3835. "[T]he Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression." Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61 (1981).

32. 48 Stat. 168 (1933), (codified at 12 U.S.C. § 1811 (1976)). FDIC insurance covers both principal and interest of bank accounts up to \$100,000. 12 U.S.C. § 1813(m)(1) (1976 & Supp. III 1979), as amended by Act of March 31, 1980, Pub. L. No. 96-221, § 308(b)(1), 94 Stat. 132, 147 (1980). For provisions governing time deposits, see part 329 of the Rules and Regulations of the FDIC, 12 C.F.R. § 329.0-101 (1981). To qualify for federal deposit insurance, a bank must satisfy Federal Deposit Insurance Corporation standards with respect to the use of the bank's capital structure, financial history, potential for future earnings, management and relationship to the community it will serve. 12 U.S.C. § 1816 (1976).

33. 48 Stat. 181 (1933).

34. *Id.* at 185. Investment securities are construed herein as "marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as 'investment securities' . . . as may by regulation be prescribed by the Comptroller of the Currency." *Id.* See generally Plotkin, *What Meaning Does Glass-Steagall Have For Today's Financial World?*, 95 BANK L.J. 404, 404 n.1 (1978).

35. 48 Stat. 189 (1933) (codified as amended 12 U.S.C. § 378 (1976 & Supp. III 1979)).

36. *Id.* at 194 (codified as amended 12 U.S.C. § 78 (1976)).

37. *Id.* at 188-89 (codified as amended 12 U.S.C. § 377 (1976)).

III. Judicial Definition of Security and the Treatment of Promissory Notes

Although there have been few Supreme Court decisions³⁸ defining security under the "virtually identical"³⁹ provisions of the 1933 and 1934 Acts,⁴⁰ the Court repeatedly has held that securities legislation should be construed broadly to effectuate its remedial purpose.⁴¹ In

38. *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 570 (1979) (noncontributory compulsory pension plan under a collective bargaining agreement held not to be a security); *United Hous. Found. v. Forman*, 421 U.S. 837, 858 (1975) (shares in a "nonprofit" cooperative housing project held not to be a security); *Superintendent of Ins. v. Bankers Life and Casualty Co.*, 404 U.S. 6, 10 n.6 (1971) (United States Treasury Bonds are securities); *Tcherepnin v. Knight*, 389 U.S. 332 (1967) (withdrawable capital shares in a savings and loan association held to be securities where amount of dividends was tied directly to profits); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211-12 (1967) (life annuity contract with flexible returns which appealed to purchaser because of its growth through investment management held to be security); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ("variable" annuity contract which guaranteed periodic payments, the amount of which was not fixed but varied according to investment policy, held to be a security); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (contracts for sale of land in citrus grove development and for cultivating and marketing crops held to be securities); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (sale of parcels of oil leases under promise of exploration are securities).

39. "The definition of 'security' [is] substantially the same as [that] in the Securities Act of 1933." S. REP. NO. 792, 73d Cong., 2d Sess. 14 (1934). See also *Tcherepnin v. Knight*, 389 U.S. 332 (1967), where the Supreme Court characterized the two definitions as "virtually identical." *Id.* at 342. *Accord* *National Bank of Commerce v. All Am. Assurance Co.*, 583 F.2d 1295, 1298 (5th Cir. 1978) (definitions in 1933 and 1934 Acts functionally equivalent); *United Cal. Bank v. THC Fin. Corp.*, 557 F.2d 1351, 1356 (9th Cir. 1977); *Great W. Bank & Trust Co. v. Kotz*, 532 F.2d 1252, 1255 (9th Cir. 1976); *SEC v. Diversified Indus., Inc.*, 465 F. Supp. 104, 107 (D.C. Cir. 1979).

40. See note 7 *supra* for the statutory definitions of "security."

41. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). "As used in both the 1933 and 1934 Acts, security 'embodies a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits.'" *Id.* at 338, quoting *SEC v. W.J. Howey*, 328 U.S. 293, 299 (1946). See also *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1077 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972). Similarly, in *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975), the Supreme Court stated that in defining "security," Congress sought "[t]o define 'the term . . . in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" *Id.* at 847-48, citing H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933). Therefore, "[f]ederal securities legislation enacted for the purpose of avoiding frauds [should] be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972), quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1077 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

SEC v. W. J. Howey Co.,⁴² the Court articulated a test to distinguish an investment contract or security from commercial dealings not regulated by securities law: "whether the scheme involves [1] an investment of money in [2] a common enterprise [3] with profits [4] to come solely from the efforts of others."⁴³ Repeating the test in *United Housing Foundation, Inc. v. Forman*,⁴⁴ the Court added, "[t]he touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."⁴⁵

The circuit courts have differed⁴⁶ over the implementation of the *Howey* and *Forman* rules and have developed three approaches to determine whether a promissory note falls under the statutory definition of security.⁴⁷ Although the application of one approach rather than another does not necessarily lead to different results,⁴⁸ the three views emphasize different factors in the Supreme Court formulations and reflect competing policies within the securities acts. Given the close relationship of certificates of deposit to promissory notes,⁴⁹ courts have used one of these three approaches in assessing whether such notes are securities.⁵⁰

42. 328 U.S. 293 (1946).

43. *Id.* at 301.

44. 421 U.S. 837 (1975).

45. *Id.* at 852.

46. In a recent Fifth Circuit case, the court cited Judge Friendly's criticism in *Exchange National Bank* that the *Howey* test cannot be applied universally and is of "dubious value" when a court must decide whether a note is a security. *Meason v. Bank of Miami*, 652 F.2d 542, 550 n.17 (5th Cir. 1981), *citing* *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1136 (2d Cir. 1976). *See also* *Sprague v. Touche Ross & Co.*, No. 79-1374 (D. Mass. Jan. 21, 1982) (holding that certain notes were securities, the court stated that it "is not bound by any of the [three tests] because this Circuit has yet to adopt a particular approach"); *SEC v. Diversified Indus., Inc.*, 465 F. Supp. 104, 108-11 (D.C. Cir. 1979) (to determine whether a purchase money mortgage issued by a corporation to a trust is a security, the court examined the approaches taken by the different circuits because the courts of appeal "unfortunately" had devised different tests to determine whether a note constitutes a security).

47. *See* notes 55-94 *infra* and accompanying text.

48. *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431 (9th Cir. 1978); *SEC v. G. Weeks Sec., Inc.*, 483 F. Supp. 1239, 1243 (W.D. Tenn. 1980).

49. *See* notes 6 and 22 *supra*.

50. *See* notes 55-94 *infra* and accompanying text. *See generally* Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L.J. 219 (1974); Lipton & Katz, "Notes" Are Not Always Securities, 30 BUS. LAW. 763 (1974-75); Sonnenschein, *Federal Securities Law Coverage of Note Transaction: The Antifraud Provisions*, 35 BUS. LAW. 1567 (1980); Comment, *Commercial Notes and Definition of a "Security" Under the Securities and Exchange*

The Third, Fifth, Seventh and Tenth circuits, following the “commercial-investment dichotomy”⁵¹ approach, hold that the transaction involving a note must be of an “investment” rather than of a “commercial” nature for the note to be a security. By contrast, the “risk-capital”⁵² test followed by the Ninth Circuit examines whether the lender contributes risk capital, the return of which depends on the managerial skills and efforts of the borrower. Finally, the “literal” view⁵³ of the Second Circuit applies a strict reading of the statutory definitions and treats “any note” as a security “unless the context otherwise requires.”⁵⁴

A. Commercial-Investment Dichotomy Approach

Those circuits which apply the commercial-investment dichotomy evaluate the context of the underlying transaction in which the note is issued to determine whether the note is a security.⁵⁵ As one court

Act of 1934: A Note is a Note is a Note?, 52 NEB. L. REV. 478 (1973); Annot., 39 A.L.R. FED. 357 (1978 & Supp. 1981).

51. See notes 55-72 *infra* and accompanying text.

52. See notes 73-80 *infra* and accompanying text.

53. See notes 81-94 *infra* and accompanying text.

54. *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1137 (2d Cir. 1976).

55. *First Nat'l Bank of Las Vegas, N.M. v. Estate of Russel*, 657 F.2d 668 (5th Cir. 1981) (defendant claimed that a sale and repurchase agreement involving Treasury notes was not a purchase or sale of a security according to the commercial-investment dichotomy analysis; the court withheld judgment, holding that summary judgment in favor of the defendant was improper); *American Fletcher Mortgage Co. v. U.S. Steel Credit Corp.*, 635 F.2d 1247 (7th Cir. 1980) (loan participation was conducted in a commercial context not a security); *United Am. Bank of Nashville v. Gunter*, 620 F.2d 1108 (5th Cir. 1980) (loan participation interest deemed mere promissory note issued in context of a commercial transaction); *National Bank of Commerce of Dallas v. All Am. Assurance Co.*, 583 F.2d 1295 (5th Cir. 1978) (loan evidenced by a promissory note and secured by a pledge of securities not a security); *McGovern Plaza Joint Venture v. First Nat'l Bank of Denver*, 562 F.2d 645 (10th Cir. 1977) (loan commitments used to finance a hotel construction not of an investment nature); *C.N.S. Enters., Inc. v. G & G Enters., Inc.*, 508 F.2d 1354 (7th Cir. 1975) (promissory notes delivered to bank for loans used to purchase the assets of a business deemed ordinary commercial paper, not securities); *Zabriskie v. Lewis*, 507 F.2d 546 (10th Cir. 1974) (notes given to an unsophisticated investor for promotion of a corporation were securities); *McClure v. First Nat'l Bank of Lubbock*, 497 F.2d 490 (5th Cir. 1974) (one of two factors indicate a transaction of investment nature: (1) the notes were either for speculation or investment, or (2) the notes were exchanged to obtain investment assets directly or indirectly); *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974) (notes issued by a broker as partial reimbursement for losses to customers sustained in connection with discretionary trading were held to be securities since the context of their issuance was commercial); *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974) (six-month promissory note renew-

explained, the test arose because securities laws “evinced the concern of Congress about practices associated with investment transactions, and . . . [because] the securities laws were not designed to regulate commercial transactions.”⁵⁶ One commentator has noted that the commercial-investment approach has considerable flexibility as it excludes commercial transactions that do not qualify for the protection of securities law, yet provides protection where notes are issued in an investment context.⁵⁷

In *Zabriskie v. Lewis*,⁵⁸ a real estate agent and a broker promised the plaintiff⁵⁹ a return of 120 percent on money she loaned a third party to promote a new corporation, and she was given a promissory note in exchange.⁶⁰ When the short term notes became due, the plaintiff’s attempts to recover her funds were unsuccessful.⁶¹ Faced with the issue of whether the promissory notes made by the third party were securities under the 1934 Act,⁶² the court summarized the rationale of the commercial investment approach:

This test is based on the purpose of the Act to protect investors, the “unless the context otherwise requires” language, and the practical considerations of subjecting commercial notes to the registration provisions of the Securities Act as well as fear of the resulting litigation flooding the federal courts if commercial notes were included.⁶³

The plaintiff initially approached the defendant for the purpose of securing an investment for her.⁶⁴ In addition, one defendant emphasized that the plaintiff’s funds were to be used to promote “one of the

ing prior bank loans issued to finance a livestock business held to be of a “commercial” rather than an “investment” nature); *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973) (transaction in which plaintiff gave cash and notes for two franchise license agreements held to be of a commercial context); *Old Sec. Life Ins. Co. v. Waugneux*, 484 F. Supp. 1302 (S.D. Fla. 1980) (reinsurance agreement held not an investment transaction).

56. *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431 n.6 (9th Cir. 1978) (applying risk capital test).

57. *Lipton & Katz, Notes Are Not Always Securities*, 30 *BUS. LAW.* 763, 770 (1975).

58. 507 F.2d 546 (10th Cir. 1974).

59. The court characterized the investor as “unsophisticated.” *Zabriskie*, 507 F.2d at 551.

60. *Id.*

61. *Id.* at 549.

62. *Id.*

63. *Id.* at 551. See note 83 *infra* for a discussion of the “unless the context otherwise requires” language.

64. 507 F.2d at 551.

greatest stock developments he had ever heard of. . . .”⁶⁵ In view of these findings, the court held that the transaction took place in an investment context.⁶⁶

Utilizing the same approach, the Third Circuit reached a different result in a decision involving franchise license agreements. In *Lino v. City Investing Co.*,⁶⁷ two such agreements were purchased from the defendant’s subsidiary for cash and promissory notes.⁶⁸ The court characterized the transaction as “commercial,” noting that it involved promissory notes issued by a private party. Under the terms of the agreements, the plaintiff was to open and staff a sales center, recruit and train distributors, and devote his full time and “best efforts” to the business.⁶⁹ The court noted that the *Howey* test examined whether a transaction involved profits coming “solely from the efforts of [others]. . . .”⁷⁰ Rejecting a literal application of “solely” in order to carry out the remedial purpose of securities legislation, the court observed that the plaintiff’s efforts in the enterprise were “not [to be] nominal or insignificant”⁷¹ under the terms of the agreements. Thus, the court concluded that the notes were not securities under the acts.⁷²

B. Risk Capital Test

The “risk capital” approach taken by the Ninth Circuit analyzes the risk accompanying the transaction to the party providing the funds or risk capital.⁷³ The test applies the *Howey* rule by assessing whether

65. *Id.* at 548.

66. *Id.* at 551-52. See also *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment.

67. 487 F.2d 689 (3d Cir. 1973).

68. *Id.* at 690.

69. *Id.* at 693-94.

70. *Id.* at 691.

71. *Id.* at 693.

72. *Id.* at 696.

73. *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426 (9th Cir. 1978) (construction loan made to finance a shopping center not “risk capital”); *United Cal. Bank v. THC Fin. Corp.*, 557 F.2d 1351 (9th Cir. 1977) (put letter agreement and notes not a security); *Great W. Bank and Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976) (note issued in commercial finance transaction with a bank not a security); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir. 1974) (transaction involving note issued for money used to purchase mutual funds which were

an investor commits "assets to the enterprise in such a manner as to subject himself to financial loss."⁷⁴ Thus, in *Great Western Bank and Trust v. Kotz*,⁷⁵ the court examined whether the lender had contributed funds subject to the entrepreneurial efforts of others.⁷⁶ In *Kotz*, the plaintiff bank failed to receive payment of an unsecured note which signified a line of credit for commercial loans whose proceeds were to be used for the borrower's working capital.⁷⁷ Alleging that material misrepresentations were made in the course of the transaction, the bank argued that the note was a security under the 1933 and 1934 Acts. Examining the commercial-investment test adopted by other circuits, the *Kotz* court shifted the analysis to an examination of risk, reasoning that the distinction between investment and commercial transactions was less meaningful in the banking context.⁷⁸ The

pledged as collateral for the loan held not to involve risk capital). The risk capital approach has recently been adopted by the Sixth Circuit to determine if the "presence of an investment" exists for the purpose of applying the *Howey-Forman* test. See text accompanying note 42 *supra*, *Union Planters Nat'l Bank of Memphis v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir. 1981) (loan participation agreement not risk capital). See also *State of Ohio v. Crofters*, 525 F. Supp. 1133, 1138 (S.D. Ohio 1981).

The test originated in California state court in *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961). The issue in that case was whether a country club promotion financing plan entailed the sale of securities under state securities law. *Id.* at ___, 361 P.2d at 908, 13 Cal. Rptr. at 188. Promoters planned to finance a country club operation by the sale of non-equity memberships which they claimed were not investments. The plaintiffs claimed the club memberships fell within the statutory language, "beneficial interest or title to property, profits, or earnings," included in the definition of security. The court recognized that a member's contractual right to use club facilities did come within the language of the statute. However, in finding the promotional memberships to be "securities," the court relied on the fact that the capital solicited to finance the venture for profit was put at risk; that is, "only because [a purchaser] risks his capital along with other purchasers can there be any chance that the benefits of club memberships will materialize." *Id.* See Carney & Fraser, *Defining a Security: Georgia's Struggle with the "Risk Capital" Test*, 30 EMORY L.J. 73, 91 (1981). This was pursuant to a state corporation code. 55 Cal. 2d at ___, 361 P.2d at 907, 13 Cal. Rptr. at 187. As formulated in *Silver Hills*, the objective of the "risk capital" approach was "to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another." *Id.* at ___, 361 P.2d at 908-09, 13 Cal. Rptr. at 188-89.

74. *Hector v. Wiens*, 533 F.2d 429, 432 (9th Cir. 1976).

75. 532 F.2d 1252 (9th Cir. 1976) (per curiam).

76. See also *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426 (9th Cir. 1978); *United Cal. Bank v. THC Fin. Corp.*, 557 F.2d 1351 (9th Cir. 1977); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir.), cert. denied, 419 U.S. 900 (1974).

77. *Kotz*, 532 F.2d at 1254-55.

78. *Id.* at 1257. The court, therefore, distinguished "risky" loans made in a commercial context from notes evidencing "risk capital," using six factors to deter-

court determined that the return of the loan amount did not depend upon the efforts of the borrower whose use of the funds was restricted in the loan agreement.⁷⁹ It concluded, therefore, that “[a] note given to a bank in the course of a commercial financing transaction was not generally a security within the meaning of the Federal securities acts.”⁸⁰

C. The Literal View

Expressly rejecting the risk capital and commercial-investment approaches, the Second Circuit⁸¹ has adopted a third view which focuses on the literal wording of the acts. Under this view, if a note falls within the plain terms of both acts,⁸² it is a security and the party asserting the nonapplicability of the acts has the burden of proving

mine whether the lender contributed risk capital: time, collateralization, form of the obligation, circumstances of issuance, the relationship between the amount borrowed and the size of the borrowers' business, and the use of the proceeds. *Id.* at 1257-58. See also *Provident Nat'l Bank v. Frankford Trust Co.*, 468 F. Supp. 448, 452 n.8 (E.D. Pa. 1979).

In *State of Ohio v. Crofters*, 525 F. Supp. 1133 (S.D. Ohio 1981), the court applied the risk capital test to determine if promissory notes which became uncollectible due to the issuer's bankruptcy were securities. The court found that:

the transactions involved “risk capital” because the notes were not payable for two years, were not secured with collateral, placed no restrictions on use of the loan proceeds or the financial operations of [the borrower], and reflected an amount borrowed that appeared to be relatively large in relation to [the borrower's] business thereby indicating the taking of a substantial risk in [the borrower's] enterprise.

Id. at 1138.

79. *Kotz*, 532 F.2d at 1259.

80. *Id.* at 1260.

81. *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976). See also *Aldrich v. New York Stock Exch.*, 446 F. Supp. 348, 356 (S.D.N.Y. 1977) (court recited literal view test but did not reach the question due to failure of plaintiff to allege adequately the existence of a “purchase or sale” of securities under the Act); *Commercial Discount Corp. v. Lincoln First Commercial Corp.*, 445 F. Supp. 1263, 1266 (S.D.N.Y. 1978) (loan participation agreement was a “security” even though the underlying loan was held not to be). Although the Second Circuit's approach has been rejected by most courts, see note 94 *infra*, the District Court for the District of Columbia commented that “the Second Circuit's approach is most consistent with the language of the statute and Congressional intent and is by far the easiest test to apply.” *SEC v. Diversified Indus., Inc.*, 465 F. Supp. 104, 108-10 (D.C. 1979) (court undertook to analyze issue under all three approaches without expressing preference for any one test). Recent decisions of district courts located in the Second Circuit have not followed the literal view. See, e.g., *Tanuggi v. Grolier, Inc.*, 471 F. Supp. 1209 (S.D.N.Y. 1979) (examining *Forman* factors); *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98,041 (E.D.N.Y. 1981).

82. See note 7 *supra* for text of the definitional sections of the 1933 and 1934 Acts.

that the "context otherwise requires."⁸³ An early decision to suggest this approach was *Movielab, Inc. v. Berkey Photo, Inc.*,⁸⁴ where the Federal District Court for the Southern District of New York examined whether promissory notes payable in installments for the purchase of business assets were securities.⁸⁵ The court found no ambiguity in the statutory definition of security and noted that "a literal reading of the language [did not] defeat or hamper Congress' apparent purpose."⁸⁶ As a result, it held the promissory notes to be securities.⁸⁷

Relying in part on the *Movielab* rationale, the Second Circuit, in *Exchange National Bank of Chicago v. Touche Ross & Co.*,⁸⁸ advised "greater recourse to the statutory language."⁸⁹ In *Exchange National Bank*, a bank acted in reliance on accountants' financial statements and purchased notes that became worthless. The court rejected the defendant accountants' argument that no note given to evidence a bank loan could be a security by taking recourse to the literal language of the statute.⁹⁰ The court reasoned that "[e]xcept for the . . . lan-

83. *Exchange National Bank*, 544 F.2d at 1137-38. This Second Circuit test focuses on the prefatory language to the statutory definition sections which begin, "when used in this title, unless the context otherwise requires. . . ." § 2 of 1933 Act, 15 U.S.C. § 77b(1) (1976); § 3 of 1934 Act, 15 U.S.C. § 78c(a)(10) (1976), quoted in *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d at 1131. In addition, the court gave examples of transactions in which a note would not be a security including: "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets. . . ." *Id.* at 1138. See also *The Fund of Funds, Ltd., v. Vesco*, FED. SEC. L. REP. (CCH) ¶ 95,644 (S.D.N.Y. 1976) (the court applied the *Exchange National Bank* holding and found that a promissory note given in a forced loan transaction between parent and subsidiary was a security).

84. 321 F. Supp. 806 (S.D.N.Y. 1980), *aff'd*, 452 F.2d 662 (2d Cir. 1971) (*per curiam*).

85. *Id.* at 807. The plaintiff promisor failed to make timely payment. When the defendant accelerated the payment schedule, the plaintiff alleged that the defendant had made false representations and concealed certain material facts. *Id.* at 808.

86. *Id.* at 809.

Try as we may, we fail to detect in the 1934 Act any grant of discretionary power to the court to construe the term "security" as including certain types of notes but not others. Congress apparently decided that it would pass a sweeping prohibition rather than attempt to draw such distinctions. We are bound by that decision.

Id.

87. *Id.* On appeal, the defendants argued that the district court had lacked subject matter jurisdiction; they conceded, however, that the statutory definition of "security" included "any note," and the court rejected their argument with no further analysis that "[if t]he term 'security' means any note . . . [it] therefore includes some notes at the very least." 452 F.2d at 663.

88. 544 F.2d 1126 (2d Cir. 1976).

89. *Id.* at 1137.

90. *Id.*

guage ['unless the context otherwise requires'], the terms of the 1933 Act would . . . have the result of subjecting to the anti-fraud provisions, in contrast to the registration requirements, any note, however short the term and however far the transaction was from being an investment security."⁹¹ A closer reading of statutory language, the court reasoned, would result in a test easier⁹² to apply than the commercial-investment dichotomy⁹³ or the risk capital test.⁹⁴

91. *Id.* at 1132. See also *Banco Nacional de Costa Rica v. Bremar Holdings Corp.*, 492 F. Supp. 364, 368 (S.D.N.Y. 1980). The court said that for a promissory note to be a security, it must bear "a strong family resemblance" to the examples given by the court in *Exchange National Bank*, see note 83 *supra*. But see *Altman v. Knight*, 431 F. Supp. 309, 313 (S.D.N.Y. 1977) (promissory note given in a business acquisition not a security because "the context otherwise required"). In justifying its reading of the statute, the *Exchange National Bank* court stated that application of the "unless context otherwise requires" language would not violate the Supreme Court's "anti-literalist" stance. In *Forman*, the Supreme Court had stated:

Because securities transactions are economic in character Congress intended the application of [the securities acts] to turn on the economic realities underlying a transaction, and not on the name appended thereto. Thus, in construing [the securities acts] against the background of their purpose, we are guided by a traditional canon of statutory construction: "[A] thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."

421 U.S. at 849, quoting *Church of the Holy Trinity v. United States*, 143 U.S. 457, 459 (1892). *Union Planters Nat'l Bank v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir. 1981), however, describes *Exchange National Bank* as representing "a new literalism." *Id.* at 1180 n.7. Other courts also have severely criticized the Second Circuit approach. See note 93 *infra*.

92. *Exchange National Bank*, 544 F.2d at 1138.

93. Though it emphasized the investment nature of the instrument, see text accompanying note 91 *supra*, the Second Circuit criticized the "commercial-investment" dichotomy as being too hard to implement: "the polarized extremes [in the dichotomy] are conceptually identifiable. . . . In between is a gray area which, in the absence of further congressional indication of intent or Supreme Court construction, has been and must be . . . subjected to case-by-case treatment." *Id.* at 1135, quoting *C.N.S. Enters. Inc. v. G & G Enters. Inc.*, 508 F.2d 1354, 1359 (7th Cir.), *cert. denied*, 423 U.S. 825 (1975). Cf. *SEC v. Diversified Indus., Inc.*, 465 F. Supp. 104, 110 (D.D.C. 1979) (the court discussed the three approaches and endorsed the literal view as the easiest to apply).

94. *Exchange National Bank*, 544 F.2d at 1136-37. "Directing district courts to 'weigh' a number of . . . dubious factors, without any instructions as to relative weights . . . is scarcely helpful. . . ." *Id.* at 1137. The Fifth Circuit has often stated that "although the 1934 Act defines 'security' as including 'any' note, judicial decisions have restricted the application of the Act to those notes that are investment in nature and have excluded notes which are only reflective of individual commercial transactions." *First Nat'l Bank of Las Vegas, N.M. v. Estate of Russell*, 657 F.2d 668, 674-75 (5th Cir. 1981), quoting *McClure v. First Nat'l Bank of Lubbock*, 497 F.2d 490, 492 (5th Cir. 1974). See also *United Am. Bank of Nashville v. Gunter*, 620 F.2d 1108, 1114 (5th Cir. 1980) ("[a]lthough the definitional sections of the Exchange Act and Securities Act literally apply to 'any note,' a literal application of

IV. Should Certificates of Deposit Be Considered Securities?

A. An Application of the Promissory Note Tests

The certificate of deposit issued by a bank in exchange for currency should not qualify under any of the three approaches used to determine the nature of a promissory note. Under the commercial-investment test, savings certificates fall within the commercial realm:⁹⁵ a depositor purchases a note promising return of capital plus fixed interest over a stated period. This transaction can best be viewed as mercantile in nature, an exchange between a consumer (depositor) and a merchant (banker).⁹⁶ The certificate holder merely purchases a promissory note—not investment assets, a share in a speculative investment, or an interest in a business venture.⁹⁷

Similarly, a certificate of deposit would not qualify as a security under the Ninth Circuit risk capital test.⁹⁸ A time depositor faces little risk of not receiving the stated interest promised by the issuer of the certificate for two reasons. First, a certificate holder contributes funds to a bank or savings and loan association in exchange for a simple pledge to pay fixed interest payments⁹⁹ and repayment of

these statutes was rejected by the Supreme Court.”); *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109, 1113-14 (5th Cir. 1974); *LTV Fed. Credit Union v. UMIC Gov't Sec., Inc.*, 523 F. Supp. 819, 828 (“It is well established that in determining whether a financial instrument is a ‘security,’ the court is not to take the ‘literal approach’ but is to look to the economic realities underlying the transaction”). The Third Circuit has held that the statutory definition of a security cannot be read literally and in context, a “note” may be outside the statute. *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973). Indeed, recently a United States District Court within the Second District rejected the literal approach and stated “that Congress never intended to regulate the time deposits hereunder [examined] through the securities laws.” *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98,041 (E.D.N.Y. 1981). As one treatise on statutory construction states:

The policy that a remedial statute should be liberally construed in order to effectuate the remedial purpose for which it was enacted is firmly established . . . [but] [t]he rule of liberal construction will not override other rules where its application would defeat the intention of the legislature or the evident meaning of an act.

3 C. SANDS, *SUTHERLAND STATUTORY CONSTRUCTION* 29 (4th ed. 1974).

95. See text accompanying notes 67-72 *supra*.

96. See note 57 *supra* and accompanying text.

97. See generally Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 *HASTINGS L.J.* 219 (1974); Lipton & Katz, “Notes” Are Not Always Securities, 30 *BUS. LAW.* 763 (1974-75); Comment, *Bank Loan Participations as Securities: Notes, Investment Contracts, and the Commercial/Investment Dichotomy*, 15 *DUQ. L. REV.* 261 (1977).

98. See notes 73-80 *supra* and accompanying text.

99. The concept of fixed return has been considered important in determining whether an instrument is a security. See *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98,041, at 91,376 (E.D.N.Y. 1981). The court stated that

capital. The entrepreneurial or managerial efforts of the promisor¹⁰⁰ have little bearing on the promisee's return on his investment. Second, even in the event of bank failure, the time deposit is insured by the Federal Deposit Insurance Corporation.¹⁰¹

Finally, although the literal view¹⁰² arguably is simple in application,¹⁰³ it may afford the greatest risk of misconstruing legislative intent by failing to consider the activities of the Seventy-third Congress when it enacted the 1933 and 1934 Acts and the Glass-Steagall Act.¹⁰⁴ This view assumes that any note is a security unless it is proved that the context requires a different construction.¹⁰⁵ Application of this approach would afford an avenue of action against alleged perpetrators of fraud by providing federal jurisdiction for any plaintiff who alleges a failure to make full disclosure concerning a transaction involving a note. Given the widespread issuance of savings certificates,¹⁰⁶ there would be a flood of litigation in the federal courts should the literal approach be applied universally.¹⁰⁷

The Securities and Exchange Commission has long taken the position that a debt interest such as a certificate of deposit for cash is a security under the federal securities laws, urging that "solicitation of investors' funds [is] not significantly different from any corporate enterprise seeking debt financing."¹⁰⁸ The American Law Institute,

an examination of the time deposits issued by [defendant] reveals that they are substantially identical to savings accounts—the investment is based on a contract which provides for a *fixed rate of interest*, the interest payable to depositors is unrelated to the earnings of the bank, and the amount payable to depositors is federally insured. These salient features . . . [were factors in persuading] us that the term "security" . . . does not include the time deposits hereunder examination.

Id. at 91,379 (emphasis added) (citations omitted).

100. See notes 42-45 *supra* and accompanying text for the *Forman* test.

101. Federal Deposit Insurance Corporation Act, 12 U.S.C. § 1811 (1976).

102. See notes 81-94 *supra* and accompanying text.

103. SEC v. Diversified Indus., Inc., 465 F. Supp. 104, 110 (D.D.C. 1979) (where the court endorsed the literal view as the easiest to apply).

104. See notes 23-27 *supra* and accompanying text.

105. See note 7 *supra* for text of statutory definition of "security" in the securities acts.

106. See note 4 *supra*.

107. See, e.g., *Zabriskie v. Lewis*, 507 F.2d 546, 551 (10th Cir. 1974), where the court expressed its concern for "the resulting litigation flooding the federal courts if commercial notes were included [within the statutory definition of security]."

108. *Meason v. Bank of Miami*, 652 F.2d 542, 548 (5th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3668 (Feb. 23, 1982) (citing SEC *amicus curiae* memorandum). *MacKethan v. Peat, Marwick, Mitchell & Co.*, 439 F. Supp. 1090, 1094 (E.D. Va. 1977), referring to the SEC brief in *Burrus, Cootes, & Burrus v. MacKethan*, 537 F.2d 1262

by contrast, specifically excludes either an interest in a deposit account with a bank or a bank certificate of deposit that ranks on parity with an interest in a deposit account with the bank from the definition of "security" in its proposed Federal Securities Code.¹⁰⁹

The few courts that have examined whether a high-yield certificate of deposit is a security either have hesitated to rule squarely¹¹⁰ on the issue or have given only a cursory analysis to an issue which requires a decisive answer. In *Weaver*,¹¹¹ for example, the Third Circuit failed to rule on the status of the certificate of deposit,¹¹² noting only that summary judgment was granted inappropriately. It suggested, however, that certificates of deposit were the "functional equivalent" of

(4th Cir. 1976); *Weaver*, 637 F.2d at 164 n.8. See also Letter from Stanley B. Judd, Assistant Chief Counsel, SEC, to Carl L. Shipley, General Counsel, Steadman Security Corp., (Nov. 18, 1978). The SEC has referred to a certificate of deposit as a security in its releases. See, e.g., SEC Release No. 9143 (April 12, 1971); SEC Release No. 5739 (Sept. 7, 1976). In 1966, the Commission expressed the opinion that "deposit and share accounts are subject to the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934." 31 Fed. Reg. 16581-82 (1966). Thirteen years later, the SEC maintained its position that certificates of deposit should be treated as securities within the meaning of the 1933 Act. Letter from Richard K. Wulff, Attorney Advisor of the Division of Corporation Finance, SEC, to David T. Walker, Assistant General Counsel, First Pennsylvania Corp. (May 10, 1979). The letter was sent in response to an inquiry by the First Pennsylvania Corp. which requested an interpretation of the definition of "security" with respect to certificates of deposit issued by a subsidiary bank operating in Colorado. SEC interpretations of the 1933 and 1934 Acts have been determined to hold considerable weight. *E.I. duPont de Nemours & Co. v. Collins*, 432 U.S. 46, 54-55 (1977); *United States v. National Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 719 (1975).

109. 1 ALI Fed. Sec. Code §202(150)(B)(v) (1980), *quoted in Weaver v. Marine Bank*, 637 F.2d 157, 169 (3d Cir. 1980) (Weis, J., dissenting). The Code is the product of more than eleven years of work and has received the endorsement of both the Securities and Exchange Commission and the American Bar Association. The Code consolidates an area referred to generally as securities law. It currently is governed by several statutes which the Code will supercede if enacted. See Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976 & Supp. III 1979 & Supp. IV 1980); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976 & Supp. IV 1980); Public Utility Holding Act of 1935, 15 U.S.C. §§ 79-79z-6 (1976 & Supp. IV 1980); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1976 & Supp. IV 1980); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1-80a-64 (1976 & Supp. IV 1980); Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1-80b-21 (1976 & Supp. II 1978 & Supp. IV 1980). See generally Note, *The Proposed Federal Securities Code: Time To Recognize That Financial Information Becomes Stale*, 9 FORDHAM URB. L.J. 719 (1981).

110. In *SEC v. First Am. Bank & Trust Co.*, 481 F.2d 673 (8th Cir. 1973), the court held that certificates of investment and passbook savings accounts in a bank were securities within the scope of the 1933 Act. *Id.* at 678. That case involved a suit by the SEC against an institution which misrepresented that it had deposit insurance.

111. 637 F.2d 157 (3d Cir. 1980), *argued*, 50 U.S.L.W. 3569 (Jan. 11, 1982). See notes 9, 10 *supra* and accompanying text.

112. *Id.* at 164-65.

withdrawable capital shares in a savings and loan association,¹¹³ instruments which the Supreme Court had deemed securities in *Tcherepnin v. Knight*.¹¹⁴ The Seventh Circuit has upheld a dismissal for lack of subject matter jurisdiction where a plaintiff failed to allege the four factors of the *Howey-Forman* test for an investment.¹¹⁵ In *Canadian Imperial Bank of Commerce Trust Co. v. Finland*,¹¹⁶ the plaintiff sought federal jurisdiction to bring a securities action involving a certificate of deposit of a banking and trust company. Although it ruled on jurisdictional grounds, the court suggested in dictum that it might have been predisposed to rule that a certificate of deposit is not a security had the pleadings been sufficient.¹¹⁷

Unlike the Third and Seventh Circuits, the Fourth Circuit has ruled squarely that a certificate of deposit is not a security.¹¹⁸ In *Burrus, Cootes & Burrus v. MacKethan*,¹¹⁹ the receiver of a savings and loan corporation claimed that a certified public accounting firm acted fraudulently in connection with certificates issued to depositors of the bank. The court based its decision¹²⁰ on a Fifth Circuit ruling, *Bellah v. First National Bank of Hereford*,¹²¹ where the court held that "a certificate of deposit issued in exchange for currency is not encompassed within" the statutory definition of security in the 1934 Act.¹²² Ironically, the Fourth and Fifth Circuit decisions can be traced to a Second Circuit case decided before *Exchange National Bank* which failed even to reach the issue of whether a certificate of deposit was a security.¹²³

113. *Id.* at 164.

114. 389 U.S. 332 (1967). This comparison is erroneous. *Tcherepnin* involved instruments which were capital in nature, had voting rights, were transferable and entitled to dividends based on profits. By contrast, time depositors such as the plaintiffs in *Weaver* possess a certificate merely acknowledging their non-equity deposit and obligation of the issuer to repay the principal at a fixed rate regardless of the issuing bank's profitability.

115. *Canadian Imperial Bank of Commerce Trust Co. v. Finland*, 615 F.2d 465, 468-70 (7th Cir. 1980).

116. 615 F.2d 465.

117. *Id.* at 469-70. In dictum, the court cited *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974), and two lower court rulings which held that a certificate of deposit is not a security. The court was, however, "cautious not to say that *any* document called a certificate of deposit cannot be a security." *Id.* at 470.

118. *Burrus, Cootes & Burrus v. MacKethan*, 537 F.2d 1262, 1265 (4th Cir.), *vacated as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977).

119. *Id.*

120. *Burrus, Cootes & Burrus*, 537 F.2d at 1264.

121. 495 F.2d 1109 (5th Cir. 1974).

122. *Id.* at 1114.

123. *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 300 F. Supp. 1083 (S.D.N.Y. 1969), *aff'd*, 430 F.2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U.S.

B. A Suggested Approach

In their efforts to construe the statutory definitions, the courts have not analyzed sufficiently the context¹²⁴ in which the Seventy-third Congress drafted the securities acts and the Glass-Steagall Act. The drafters of these statutes, designed to cure abuses in investment activities, could not have predicted in 1933 the widespread public acceptance of time deposits as investments—a phenomenon which would arise some forty-five years later.¹²⁵ A broad construction of the securities acts would include today's high-yield certificate of deposit under a theory that these instruments have become a substitute for long-term securities. Proponents of this view have argued that the obligation of the depository bank to pay a fixed return is similar to bonds, debentures or other investments yielding fixed returns that are governed by the securities acts.¹²⁶ Three arguments, however, militate against inclusion of high-yield certificates of deposit in securities laws: the contemporaneous enactment of banking and securities laws;¹²⁷ the existence of specific banking regulations; and the likelihood of over-regulation of the banking industry.

First, in order to curtail speculative investment activity that endangered both the savings and investment capital of the public, the Seventy-third Congress drafted three pieces of remedial legislation designed to operate in mutually exclusive areas. The Glass-Steagall Act separated the banking and investment industries,¹²⁸ specifically regulated interest payable on time deposits,¹²⁹ and insured bank deposits against loss.¹³⁰ The securities acts, by contrast, conferred considerable protection to investors through antifraud provisions giving them

6 (1971). The court did "not reach the novel and difficult question of whether certificates of deposit [which are issued for cash and are pieces of paper evidencing the existence of a time deposit] fall within the statutory definition of the term 'security.'" 300 F. Supp. at 1099.

124. "What the words of a statute say and what they mean are often entirely different. The former is the literal meaning, the latter is the contextual meaning." de Sloovere, *Textual Interpretation of Statutes*, 11 N.Y.U. L.Q. REV. 538 (1934), reprinted in 3 C. SANDS, SUTHERLAND STATUTORY CONSTRUCTION 503 (4th ed. 1974).

125. See notes 2, 3 *supra*.

126. See, e.g., *Weaver v. Marine Bank*, 637 F.2d 157, 164 (3d Cir. 1980), *argued*, 50 U.S.L.W. 3569 (Jan. 11, 1982). "Here . . . [the] Bank's obligation is to pay a sum certain and a fixed interest return. It is in form and in fact a long term debt obligation."

127. "[W]hen it is necessary to resort to the process of construction the court may properly refer to certain other statutes in its effort to determine the meaning of the language used by the legislature, especially where such statutes are preexisting or contemporaneous." CRAWFORD, STATUTORY CONSTRUCTION 428 (1940).

128. See note 37 *supra* and accompanying text.

129. See note 33 *supra* and accompanying text.

130. See note 32 *supra* and accompanying text.

access to material information for those instruments that qualified as securities.¹³¹ The drafters, however, excluded bank deposits and other similar terminology from the extensive list of types of securities contained in the statutory definitions.¹³² In light of references to these instruments in pre-existing¹³³ and contemporaneous legislation,¹³⁴ this omission suggests that the Seventy-third Congress did not intend to place time deposit savings certificates within the jurisdiction of the securities acts.

Second, although certificates of deposit arguably fall within the meaning of security, courts should not permit certificate holders to gain jurisdiction¹³⁵ under the 1933 and 1934 Acts¹³⁶ because banking regulations provide adequate remedies.¹³⁷ The Supreme Court has held that the existence of a specific regulatory scheme may preclude inclusion of such an instrument in other legislation. In *International Brotherhood of Teamsters v. Daniel*,¹³⁸ the Court faced the issue of whether pension plans were securities under the securities acts. Although the Court noted that pension plans were neither included nor excluded from the statutory definition of security,¹³⁹ it emphasized that the existence of a federal regulatory scheme¹⁴⁰ specifically de-

131. See notes 23-28 *supra* and accompanying text.

132. See note 7 *supra* and accompanying text for statutory definitions.

133. Section 19 of the Federal Reserve Act granted commercial banks the authority to offer certificates of deposit to its customers. 38 Stat. 270 (Dec. 23, 1913).

134. Banking Act of 1933, ch. 89, 48 Stat. 162 (1933).

135. In *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109, 1114 (5th Cir. 1974), the court stated,

[T]he Securities Act of 1933 and Securities Exchange Act of 1934 create for participants in note transactions a broad but nevertheless not boundless federal forum for vindicating their grievances. We doubt that Congress intended by these Acts to render federal judges the guardians of all be-guiled makers or payees.

136. While the Banking Act of 1933 guaranteed bank deposits against loss, "[t]he Securities Act of 1933 was designed to provide investors with full disclosure of material information concerning public offerings of securities [and] to protect investors against fraud . . . [t]he 1934 Act was intended principally to protect investors against manipulation of stock prices. . . ." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976) (citations omitted). The securities acts, therefore, set out to make the inherent risk of investing in *securities* an informed one; the Glass-Steagall Act, however, was designed to eliminate any risks associated with depositing funds in a bank. "The passage of [banking legislation in the 1930's] suggest[s], if anything, that Congress was reaffirming its view that national banks should be regulated separately by specific legislation applying only to them." *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 157 (1976).

137. See notes 143-47 *infra* and accompanying text.

138. 439 U.S. 551 (1979).

139. *Id.* at 558.

140. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1381 (1976 & Supp. IV 1980).

signed to govern pension plans "severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans."¹⁴¹ *Daniel*, therefore, suggests that certificates which acknowledge bank time deposits should not fall under the securities laws because bank deposits are governed by separate statutes.

Third, application of the antifraud provisions of the securities laws to bank certificates of deposit would present a significant burden to an industry already subject to comprehensive regulation.¹⁴² Existing controls over the operations of banks satisfy the need to protect time depositors against fraudulent bank practice and the possibility of loss of principal and interest. Both the Federal Reserve Board and the Federal Deposit Insurance Corporation have promulgated regulations prohibiting misrepresentation in the advertisement of bank deposit contracts.¹⁴³ In addition, the Federal Reserve Board and Federal Home Loan Bank Board currently possess express statutory authority

141. *Daniel*, 439 U.S. at 569-70. *Accord* *Salazar v. Sandia Corp.*, 656 F.2d 578, 582 (10th Cir. 1981); *Apponi v. Sunshine Biscuits, Inc.*, 652 F.2d 643, 650 (6th Cir. 1981). "In spite of the substantial use of employee pension plans at the time they were enacted, neither § 2(1) of the Securities Act nor § 3(a)(10) of the Securities Exchange Act, which define the term 'security' in considerable detail and with numerous examples, refers to pension plans of any type." *Daniel*, 439 U.S. at 558. The court added "not only is the extension of the Securities Acts by the court below unsupported by the language and history of those Acts, but in light of ERISA [Employment Retirement Income Security Act] it serves no general purpose." *Id.* at 570. *Cf.* *Ayala v. Jamaica Sav. Bank*, FED. SEC. L. REP. (CCH) ¶ 98,041 (E.D.N.Y. 1981).

The existence of . . . comprehensive protective legislation over banking practices enacted at the time of the enactment of the 1933 and 1934 Acts, considered in the light of the proliferation of banking regulations since that time, militates against our finding that the time deposits issued [by the defendant] are securities. The existence of a comprehensive scheme of regulation over banking practices does not, by itself, provide an answer to the question of whether a time deposit is a security. However, it should be accounted for in determining whether "the context otherwise requires."

142. [T]he regulation of banking may be more intensive than the regulation of any other industry, and it is the oldest system of economic regulation. . . . The regulation extends to all major steps in the establishment and development of a national bank, including not only entry into the business, changes in status, consolidations, reorganizations, but also the most intensive supervision of operations through regular examination of banks.

K. DAVIS, ADMINISTRATIVE LAW TREATISE § 4.04, at 247 (1958).

143. Advertisement, announcements, and solicitations relating to interest or dividends paid on "deposits," which include time certificates of deposit, may not be inaccurate, misleading, or misrepresent the deposit contract. 12 C.F.R. §§ 329.1(b), (c), 329.8(f) (1981). Advertisements and solicitations relating to interest must be stated in terms of annual rates of simple interest. *Id.* § 329.8(a). If an advertised rate is payable only on deposits meeting time or amount requirements, the requirements must be clearly and conspicuously stated. *Id.* § 329.8(d).

to protect bank depositors against any "unfair or deceptive acts or practices" that may be committed by federally regulated banks.¹⁴⁴ Moreover, the banking agencies are authorized "to take appropriate action upon complaints with respect to acts or practices by banks."¹⁴⁵ The FDIC also has the power to order insured state nonmember banks to cease and desist unsafe or unsound banking practices on the violation of any rule or regulation of the agency.¹⁴⁶ In addition to this exhaustive federal regulatory apparatus, commercial banks and savings and loan associations may be subject to comprehensive state banking laws.¹⁴⁷ Indeed, inclusion of high-yield certificates of deposit may frustrate, rather than implement, congressional intent. As the Supreme Court observed in *Forman*, "[t]he primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely *unregulated* securities market."¹⁴⁸

V. Conclusion

The federal securities laws were not drafted in a vacuum. In fact, the Seventy-third Congress enacted two remedial regulatory schemes desiring to keep the securities and banking industries separate from each other. The inclusion of a bank certificate of deposit within the scope of the federal securities laws would violate congressional intent.¹⁴⁹ Moreover, "[t]o treat a certificate of deposit as a security would superimpose on already existing federal and state banking regulatory schemes a second pattern of regulations by the Securities and Exchange Commission with the attendant risks of inter-agency conflict¹⁵⁰ and of the SEC's want of specialized relevant expertise in this area of banking."¹⁵¹ The classification of certificates of deposit as

144. 15 U.S.C. § 57(a)(f) (1976 & Supp. IV 1980).

145. *Id.*; 12 C.F.R. § 227.2 (1981).

146. 12 U.S.C. § 1818(b)(1) (Supp. IV 1980). The FDIC also may conduct special examinations of its insured banks. 12 U.S.C. § 1819 (a) (Supp. IV 1980).

147. *See, e.g.*, N.Y. ADMIN. CODE tit. 3, §§ 13.1-13.6 (Depositor Savings Information); 20.1-20.6 (Payment of Interest on Commercial Bank Deposits); 64.1-64.10 (Time Deposits in Savings Banks and Savings and Loan Associations) (1980).

148. 421 U.S. 837, 849 (1975) (emphasis added).

149. Congress desired to remove from the scope of the securities laws those "types of securities and securities transactions where there is no practical need for [the securities acts'] application or where the public benefits are too remote." H.R. REP. No. 85, 73d Cong., 1st Sess. 5 (1933).

150. *See* note 108 *supra* and accompanying text.

151. *Burrus, Cootes & Burrus v. MacKethan*, 537 F.2d 1262, 1265 (4th Cir.), *vacated as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977).

securities is not only unnecessary in the face of existing banking regulations, but it also would burden both the banking industry and the federal court calendar.

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After this Note went to press, the Supreme Court decided Marine Bank v. Weaver, 50 U.S.L.W. 4285 (Mar. 8, 1982). In a unanimous opinion, the Court held that the certificate of deposit at issue did not fall within the statutory definition of "security" because "the holders of bank certificates of deposit are abundantly protected under the federal banking laws." Id. at 4287. It would appear that the Court resolved the issue of whether a typical certificate of deposit constitutes a security for purposes of the anti-fraud provisions of the 1933 and 1934 Acts. The Court, however, cautioned that

[i]t does not follow that a certificate of deposit between transacting parties invariably falls outside the definition of a security. . . . Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.

Id. at 4288 n.11.

