

THE CONVERGENCE OF COMMERCIAL AND INVESTMENT BANKING: NEW DIRECTIONS IN THE FINANCIAL SERVICES INDUSTRY

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1. Introduction

Historically, the financial services industry in the United States was comprised of firms that operated, contentedly, in their respective areas of specialization: commercial banks only took demand deposits and made commercial loans; the “thrift” industry (savings and loan associations and mutual savings banks) emphasized savings deposits and home mortgages; insurance companies conducted only an insurance business; and only investment banks and securities brokerage houses were engaged in securities-related activities. In fact, for decades, the financial services industry effectively was compartmentalized by the specialized legislation that governs various sectors of the industry. In particular, the Banking Act of 1933, commonly known as the Glass–Steagall Act (hereinafter the “Act”), segmented the industry by separating the business of commercial and depository banking from the business of selling, dealing in, and underwriting securities [1].

This compartmentalization of the financial services industry was effected by regulatory schemes that offered special benefits, protections, and obligations to each segment of the industry. However, during the 1970s, the impetus of technological advances and a changed economic climate, characterized by sustained high levels of inflation, prompted firms to venture out of their respective traditional competitive arenas, both for the short term and in the context of long-term restructuring of their businesses. Recently, the pace of this change has quickened and has been accentuated by a number of well-publicized expansion and diversification efforts. In particular, the intersection of

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commercial and investment banking activities has become so pronounced – and exists in so many aspects of the financial services industry – that one commentator was prompted to term the Glass–Steagall Act “the Maginot Line of finance” [2].

In this context, some of the most striking – and complex – legal issues presented by developments in the modern financial services industry arise in connection with efforts of banking institutions to enter the securities field through the development of new products and the acquisition of securities firms and, conversely, with securities firms’ development of new products and acquisition of entities that engage in certain banking activities. This homogenization not only runs counter to much of the historical divergence between the American banking system and the country’s securities industry, not to mention the basic precepts of the Glass–Steagall Act; it also implicates an array of other statutes.

Faced with these developments, federal banking regulators generally have not enforced a strict separation between banking and securities activities. Rather, the banking agencies have tended to evaluate the permissibility of new banking/securities activities on an ad hoc basis; an approach which has permitted agencies to interpret statutes in light of the modern circumstances presented and which frequently has led to the conclusion that novel activities are permissible. This ad hoc approach, however, also has led to frequent skirmishes between regulators and firms challenging particular regulatory agency decisions.

This article reviews developments in the financial services industry and the legal issues presented as the industry’s statutory infrastructure – some of it nearly a half-century old – is applied to novel and innovative financial products and services.

2. Historical separation of commercial and investment banking

2.1. Formation of the U.S. banking system

The banking system in the United States evolved along lines similar to the British system, with banks generally excluded from the conduct of a securities business. Consistent with this fundamental separation, the National Banking Act of 1864 prohibited national banks from dealing in securities [3]. However, the Comptroller of the Currency – the regulator of national banks chartered under federal (rather than state) law – periodically took a permissive attitude toward enforcing this ban, and, in a ruling issued early in the 1900s, national banks expressly were permitted to deal in corporate debt securities. Banks then sought to expand upon this authority and deal in corporate equity securities as well. In this effort, national banks employed “securities affiliates”, chartered

under state law, to engage in the securities activities that national banks were prohibited from conducting directly [4].

The stock market crash of 1929, and the ensuing Great Depression, led to the failure of thousands of U.S. banks. In assessing blame for this disaster, Congressional fingers were pointed at the activities of bank securities affiliates. Congressional hearings, which revealed self-dealing and other unethical practices involving banks and their securities affiliates, lent support to these charges [5].

In particular, hearings held by Senator Carter Glass revealed a range of activities undertaken by bank securities affiliates which adversely affected the safety and soundness of the parent banks. These abuses included:

- borrowing money from parent banks on concessionary terms;
- repurchase agreements between banks and affiliates designed to avoid lending limits;
- trading upon the public identification between affiliates and parent banks;
- “dumping” of undesirable securities on parent banks by the affiliates;
- loans by parent banks to customers for the purpose of purchasing securities offered for sale by affiliates;
- unsound shifting of assets between parent banks and the affiliates; and
- the assumption of questionable risks by affiliates that were impermissible for the parent banks [6].

In an effort to prevent a repeat of these problems, and in order to prevent the conflicts of interest that had given rise to such abuses, the Glass–Steagall Act was enacted by Congress in 1933 to separate the business of dealing in and underwriting securities from that of commercial and depository banking. Five sections of the Glass–Steagall Act, in particular, were critical to this effort.

Three of these sections prohibit banks and securities firms from *directly* crossing the barrier erected between the two industries. Thus, Section 16 of the Act prohibits national banks from underwriting any issue of securities or stock; it authorizes national banks to purchase and sell for their own account only certain defined “investment securities”, and to deal in, underwrite, and purchase for their own account only U.S. government securities and state and municipal general obligation bonds. Otherwise, Section 16 provides that “the business of dealing in securities and stock by [banks] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order and for the account of customers” [7]. Section 5 of the Act makes these restrictions applicable to state-chartered banks which are members of the Federal Reserve System [8]. And, Section 21 prohibits any organization which receives deposits from concurrently engaging in the business of “issuing, underwriting, selling, or distributing...stocks, bonds, debentures, notes or other securities” [9]. State and non-member banks are, however, permitted to conduct securities activities to the extent that such activities are permissible for national banks pursuant to Section 16, and all banks are expressly permitted to deal in real estate loans.

In order to preclude indirect circumvention of these sweeping prohibitions, Congress complemented these sections with two additional restrictions. Section 20 of the Act further prohibits national and state member banks from being affiliated with any person or organization “engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities” [10]. Section 32 of the Act erects the final barrier between banking and securities activities by prohibiting individuals from concurrently serving as employees, officers, or directors of a national or member bank, and as employees, officers, or directors of firms “primarily engaged in the issue, flotation, underwriting, public sale or distribution” of stocks, bonds, debentures, notes, or other securities [11].

As will be seen, however, the Glass–Steagall Act’s once formidable barrier between banking and securities activities is today under heavy attack.

3. Legal issues presented by securities-related activities of banks

3.1. *Investment funds*

3.1.1. *Bank common trust funds*

3.1.1.1. *Application of federal banking laws.* The traditional type of bank investment fund, the common trust fund had its genesis in Section 11(k) of the Federal Reserve Act, which authorized national banks to act in the same fiduciary capacities “in which State banks, trust companies or other corporations which come into competition with national banks are permitted to act under the laws of the state in which the national bank is located” [12]. The Federal Reserve Act granted the Board of Governors of the Federal Reserve System (the “Board” or the “Federal Reserve Board”) authority to issue regulations governing the exercise of fiduciary powers by national banks. Pursuant to this authority, the Board issued Regulation F, which permitted national banks to exercise trust powers to the extent permitted to state banks [13].

Subsequently, various states enacted legislation permitting their state banks to establish common trust funds, and the Federal Reserve Board, relying on its authority under Section 11(k) of the Federal Reserve Act, amended Regulation F to permit the commingling of trust funds under certain conditions [14]. Common trust funds became increasingly popular thereafter, although this trend temporarily was reversed in 1936, when the United States Court of Appeals for the Second Circuit ruled that a common trust fund administered by the Brooklyn Trust Company was taxable as an association, thus denying the fund a favorable flow-through tax treatment [15]. The Court’s decision

prompted the banking industry to press for amendments to the Internal Revenue Code (the "Code"). A new provision to the Code was enacted to grant tax exempt status to common trust funds maintained by a bank when the trust funds are: (a) exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as trustee, executor, administrator, or guardian; and (b) in conformity with the Board's rules and regulations prevailing from time to time, pertaining to the collective investment of trust funds held by national banks [16].

Thereafter, the Federal Reserve Board determined that collective investment of funds would be permitted for funds held for "true fiduciary purposes" [17]. The Board's amended Regulation F sought to prevent common trust funds from being marketed as investment vehicles, however, and made clear that "the operation of such common trust funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited" [18]. This position was reiterated in 1940, when the Board declared that it was improper for a bank to "operate a common trust fund as an investment trust attracting money, seeking investment alone and to embark upon what would in effect be the sale of participations in a common trust fund to the public as investments" [19]. The Board further limited bank-sponsored common trust funds in 1945, when it amended Regulation F to provide that banks "shall not advertise or publicize the earnings realized on any common trust fund or the value of the assets thereof" [20]. Furthermore, in 1953, the Board declared that it was not permissible for a bank to invest in a common trust fund the assets of individuals who are "not primarily concerned with the establishment of trusts for true fiduciary purposes" [21].

In 1962, Congress transferred the responsibility for regulating the trust activities of national banks from the Board to the Comptroller of the Currency (the "Comptroller") [22]. Although the Comptroller liberalized the regulation of bank funds in other respects, in defining permissible common trust fund activities the Comptroller maintained restrictions on the promotion of the funds by national banks. The Comptroller's regulations have continued to prohibit advertising of common trust funds by banks, and permit the distribution of the funds' financial reports only upon request or to prospective trust customers [23].

3.1.1.2. Application of federal securities laws. Common trust funds may be subject to registration as investment companies under the Investment Company Act of 1940 (the "ICA") [24] and interests in such funds may be required to be registered as securities under the Securities Act of 1933 (the "Securities Act") [25], since the United States Securities and Exchange Commission (the "SEC") has taken the position that common and collective investment funds maintained by a bank are entities separate and distinct from the sponsoring bank, and thus cannot rely on federal securities laws exemptions available to

banks [26]. Common trust funds may be exempt from registration, however, if they qualify under the exemptions particularly applicable to such funds, *i.e.* Section 3(c) (2) of the Securities Act [27] and Section 3(c) (3) of the Investment Company Act [28].

The SEC has attempted to harmonize its approach to the bank common trust fund exemptions under the securities laws with the concept of a common trust fund reflected in the rules of the Federal Reserve Board and the Comptroller of the Currency. Thus, according to former SEC Chairman Cary, the SEC has applied the securities law trust fund exemptions “in a manner consistent with the Federal Reserve Board’s concept about the proper scope of activities of a bank common trust fund” [29].

For example, the SEC has consistently taken the position that exemptions do not cover funds used or promoted as “vehicles for general investment by the public” [30]. Furthermore, for the exemptions to apply, customers’ accounts must be created for “true fiduciary purposes” [31]. Generally, such purposes pertain to estate planning and non-investment oriented trust services and fiduciary functions [32]. Moreover, the bank must act in a traditional fiduciary capacity with respect to its customers’ accounts [33].

3.1.2. *Collective investment funds*

3.1.2.1. *Application of federal banking laws.* The growth of tax qualified corporate-sponsored employee retirement plans during the 1950s prompted the Federal Reserve Board to revise Regulation F to permit banks to establish another type of investment fund; a collective fund for corporate-sponsored employee retirement plans [34]. The Board did not extend to these funds the same restrictions on advertising it had applied to common trust funds in order to prevent the latter from being used as investment vehicles, however.

In 1962, Congress transferred supervisory authority over the trust powers of national banks from the Federal Reserve Board to the Comptroller of the Currency [35], and the Comptroller instituted major changes in the regulation of collective investment media. The Comptroller’s new Regulation 9 eliminated the requirement of a “true fiduciary purpose” for accounts participating in common trust funds [36]. Regulation 9 also authorized banks collectively to invest and manage monies delivered separately to the bank for investment management, rather than for fiduciary purposes.

However, a version of this type of fund was held to be a violation of the Glass–Steagall Act by the Supreme Court in *Investment Company Institute v. Camp* [37]. The Supreme Court concluded that, while a bank could either commingle bona fide *trust* funds for convenience or act as a managing agent for *separate* accounts, the union of both these powers gave birth to an investment fund virtually indistinguishable from a mutual fund – a fund prohibited to banks by the Glass–Steagall Act since it placed a bank in the

position of issuing, underwriting, selling and distributing “securities” within the meaning of the Act.

From the time of this decision, the Comptroller’s collective investment fund regulations have permitted banks collectively to invest assets: (a) in a common trust fund maintained by the bank exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act [38], or (b) in a fund consisting solely of the assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from federal income taxation under the Internal Revenue Code [39].

3.1.2.2. Application of the Federal Securities Laws. Prior to the amendment of the Investment Company Act in 1970, the SEC staff administratively had taken “no-action” positions that collective investment funds for corporate-sponsored employee benefit plans were exempt from the requirements of the ICA and that interests in such funds were exempt from the registration requirements of the Securities Act. This position was based, in part, on the fact that the Comptroller prohibited banks from advertising and publicizing pooled investment funds for corporate sponsors of the plans and that such funds were offered to a small universe of relatively sophisticated corporate-sponsored retirement plan managers. The SEC staff had also taken “no-action” positions that pooled funds for so-called Keogh plans (retirement plans for self-employed individuals) were exempt from the ICA. However, the SEC did not treat interests in pooled funds for Keogh plans as exempt under the Securities Act [40].

The Investment Company Act Amendments of 1970 codified the SEC staff’s “no action” position regarding the exemption of both pooled funds for corporate-sponsored and Keogh plans, by exempting such funds from the definition of an investment company in Section 3(c) (11) of the Investment Company Act [41]. Also, Section 3(a) (2) (seventh clause) was added to the Securities Act, incorporating the SEC’s traditional “no-action” practice of exempting interests in corporate-sponsored pooled funds (but not Keogh funds) from the registration requirements of the Securities Act [42].

The SEC staff has taken a very literal approach to the exemption provided in Section 3(a) (2) of the Securities Act for corporate-sponsored employee retirement plans, which exempts plans qualified under Section 401 of the Code, maintained by a bank. Not only is the exemption inapplicable to interests in pooled funds for Keogh plans [43], but the exemption also does not apply to pooled funds containing assets of Industrial Retirement Accounts (“IRAs”) [44], because IRAs are qualified under Section 408, not Section 401, of the Internal Revenue Code. However, many banks rely on the “intrastate offering” exemption of Section 3(a) (11) of the Securities Act to maintain pooled Keogh funds without registering under the Securities Act [45]. Similarly, the ICA

exemption for pooled funds is available for funds consisting *solely* of assets of plans that are tax exempt under Section 401 of the Code [46].

3.1.3. *Collective investment funds for individual retirement accounts*

Recently, the Comptroller of the Currency approved a plan by Citibank, N.A., to invest IRA assets in a common investment fund created by Citibank, a development which, if upheld by the courts, could presage a substantial expansion of the use of bank-sponsored funds as investment vehicles [47]. Normally, Citibank would be required to comply with the Comptroller's regulations which restrict marketing and promotion of common and collective funds. Citibank, however, informed the Comptroller that it was required to register the fund with the SEC as an investment company under the ICA, and interests in the fund as securities under the Securities Act, and the Comptroller granted Citibank extensive exemptions from the Comptroller's rules that conflicted with those federal securities laws [48]. Thus, interests in the Citibank fund may be marketed to the IRA investing public on the same scale as any other type of security.

In approving Citibank's request for exemptions from the Comptroller's rules, the Comptroller declined to apply the Glass-Steagall Act to block Citibank's fund even though the fund entailed creation of an investment company and resulted in the issuance of securities of that investment company. The Comptroller's opinion attempted to distinguish the current Citibank fund from the Citibank collective fund held to be impermissible by the Supreme Court in *Investment Company Institute v. Camp* [49], and asserted that *Camp* actually was supportive of the Comptroller's conclusion that the prohibitions of the Glass-Steagall Act did not apply to the collective investment of IRA trust assets in the manner proposed by Citibank. The Comptroller's decision characterized the *Camp* decision as recognizing that banks traditionally have commingled trust assets, and relied upon the distinction between funds commingled in a trust capacity and the commingled agency account at issue in *Camp*. Specifically, the Comptroller's opinion focused on language in the *Camp* decision where the Supreme Court noted that "[f]or at least a generation... there has been no reason to doubt that a national bank can, consistently with the banking laws, commingle trust funds" [50].

The Comptroller also noted that, while the IRA trusts (and participations in the fund) would be offered as "securities" and registered pursuant to the Securities Act, the Comptroller had never viewed the meaning of the term "securities" under the securities laws as necessarily synonymous with its meaning under the Glass-Steagall Act. In particular, the Comptroller concluded that the IRA investments being offered by Citibank were more akin to a fiduciary service than a security and did not present the hazards and potential abuses which Congress sought to avoid when it enacted the Glass-Steagall Act. Therefore, the Comptroller reasoned, it was inappropriate

to regard participations in the new Citibank fund as “securities” for Glass–Steagall Act purposes since the “securities” “merely represent[ed] the formal manifestation of a traditional banking service” [50a].

However, irrespective of the Comptroller’s conclusion that the Citibank fund faced no Glass–Steagall Act impediment, the fund does present some meaningful Glass–Steagall Act issues which are likely to be carefully scrutinized and have engendered opposition from the securities industry [50b]. For example, while the Supreme Court’s decision in *Camp* did allow that there had been no reason to doubt that a national bank could commingle trust funds, the Court was apparently referring to the “traditional” role of banks as trustee for pre-existing trusts which were commingled for ease of management – not to a situation where banks marketed an investment vehicle which, incidentally, involved a trust relationship.

Moreover, although the fund at issue in *Camp* involved Citibank acting as managing agent rather than trustee, even so, Citibank acted in a fiduciary capacity materially indistinguishable from its status with respect to its IRA fund. The *Camp* decision also specifically made reference to the fact that the fund at issue was an investment company under the Investment Company Act – as is the new Citibank fund – and emphatically rejected a narrow reading of the term “securities” for Glass–Steagall Act purposes. Also, the Federal Reserve Board, in applying and interpreting Section 32 of the Glass–Steagall Act, has viewed the operation of a registered open-end investment company as an activity forbidden to banks. Indeed, in response to a recent request for information concerning the status under Section 32 of certain personnel interlocks between Citibank and its new fund, the Board reiterated its long-standing view that “an officer, director, or employee of a member bank of the Federal Reserve System may not serve in an interlocking relationship with an open-end investment company” [51]. Thus, it remains to be seen whether the new Citibank fund for IRA trust assets will withstand a challenge under the Glass–Steagall Act

3.1.4. *Investment companies sponsored by bank subsidiaries*

The Supreme Court’s decision in *Board of Governors of the Federal Reserve System v. Investment Company Institute* [52], which upheld regulations issued by the Board permitting bank holding companies and their non-bank affiliates to serve as investment advisers to closed-end investment companies, has encouraged some banking institutions to employ subsidiary corporations as a structural device to attempt to avoid the application of the Glass–Steagall Act. In footnote 24 of that opinion, the Court analyzed Section 21 of the Glass–Steagall Act:

Section 21 prohibits firms engaged in the securities business from also receiving deposits. Bank holding companies do not receive deposits and the language of Section 21 cannot be read to include within its prohibition separate organizations related to ownership with a bank, which does receive deposits [53].

One interpretation of the Court's language is that Section 21 of the Glass-Steagall Act only prohibits the combination of banking and securities activities when *both* are conducted by a single legal entity. The implications of this reading of Section 21 are formidable, since the section is the only section of the Glass-Steagall Act which, by its literal terms, applies to all types of depository institutions.

Whether the Supreme Court actually intended the *Board of Governors* decision to endorse a conclusion that the Glass-Steagall Act could be avoided by the expedient of acquiring or creating wholly-owned securities subsidiaries is open to debate. For example, the discussion in footnote 24 was in the context of the Court's conclusion that a bank subject to Section 21 would not be prohibited from engaging in the investment advisory activities the Federal Reserve Board sought to authorize for bank holding companies. Thus, the decision did not explicitly sanction the use of an affiliate to conduct an activity that a bank itself was prohibited from conducting directly. Moreover, in *Board of Governors*, the subsidiary's activities were required to be "closely related to banking" under Bank Holding Company Act standards. No such "closely related" limitation applies, however, with respect to a subsidiary of a bank not within a holding company complex. This fact also may limit the holding of *Board of Governors*.

Even if Section 21 were interpreted to apply only where securities and depository activities are conducted by a single legal entity, it does not necessarily follow that bank securities activities conducted through subsidiaries would not be subject to Section 21. Particular circumstances may indicate that a subsidiary is an *alter ego* of its parent bank, employed by the bank for the purpose of avoiding the application of the Glass-Steagall Act to the bank. In such a case, the subsidiary's corporate form would be disregarded and the acts of the subsidiary would be treated as the acts of the controlling bank [54].

At least two state chartered non-member banks, however, have relied upon footnote 24 in the *Board of Governors* case to attempt to conduct an investment company business through subsidiaries. The Boston Five Cents Savings Bank established The Boston Five Fund Distributor (renamed The School Street Fund Distributor), and The Boston Five Fund Adviser (renamed The School Street Fund Adviser), respectively, to underwrite and distribute, and advise a newly created mutual fund, The Boston Five Mutual Fund (renamed The School Street Mutual Fund). Another non-member bank, the Washington Mutual Savings Bank, has also acquired an existing brokerage firm and an investment adviser to a family of mutual funds [55], and Guaranty Savings and Loan Association has attempted to start two mutual funds [55a].

Prompted by objections raised to The Boston Five Cents Bank's proposed securities activities, the Federal Deposit Insurance Corporation (the "FDIC") issued a "Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks" [56]. The

FDIC's Policy Statement relied upon footnote 24 in the *Board of Governors* case to conclude that the Glass-Steagall Act "does not reach the securities activities of a *bona fide* subsidiary of an insured non-member bank", thus, apparently recognizing the relevance of *alter ego* concepts to the application of Section 21 of the Glass-Steagall Act. However, the FDIC permitted the proposed activities of the Boston Five Cents Savings Bank to proceed and declined to address assertions made by securities industry groups that the bank's securities activities would violate the Glass-Steagall Act [57].

3.1.4.1. Application of federal securities laws. The exemptions from the federal securities laws applicable to "banks" do not apply to subsidiaries or affiliates of banks; thus, an investment company sponsored by a bank subsidiary is fully subject to the ICA, the shares of the fund are subject to registration under the Securities Act, and investment adviser and distributor affiliates of the bank are subject, respectively, to the Investment Advisers Act and the broker-dealer requirements of the Securities Exchange Act (the "Exchange Act").

Recently, the SEC has grappled with the ramifications of the treatment under the securities laws of bank efforts to create and operate investment companies through bank subsidiaries. The catalyst for this examination was the case of the mutual fund created, and to be operated and advised by, Boston Five Cents Savings Bank subsidiaries.

The Boston Five Mutual Fund applied to the SEC to accelerate the effectiveness of its registration statement under the ICA and the Securities Act. Under Section 8(a) of the Securities Act, however, the SEC may take such action only after considering several specified factors, including the public interest [58]. In this context, the SEC observed that "the legality under the Glass-Steagall Act and other banking laws of this proposed relationship between a banking institution and an investment company is unclear" [59], and indicated that it was therefore unable to make the requisite finding that it would be in the public interest to permit the fund to begin operation.

Recognizing the "novel and innovative relationships between banks and investment companies [were] becoming more common" and that the SEC would likely be faced with other similar situations, the SEC sought the "opinion of the FDIC as to whether operation of the fund in the proposed manner would be lawful under the Glass-Steagall Act and other laws with respect to which the FDIC has jurisdiction" [60]. The SEC also indicated that, in the future, it would seek the opinion of the relevant federal banking agency in situations where banks proposed to engage in securities activities that raise issues under the Glass-Steagall Act and other banking laws [61]. However, the FDIC declined to give a specific response to the SEC's inquiry and referred the SEC to the FDIC's policy statement. The SEC ultimately found the FDIC's implicit clearance of The Boston Five Cents Savings Bank's securities activities to be sufficient, and permitted acceleration of the effectiveness of the registration statement of the bank's fund.

Subsequently, the SEC determined that it would not refuse to accelerate the effectiveness of registration statements for funds involving banks where a bank was acting merely as a medium to distribute shares of the fund, *i.e.* checking account “sweeps” [62]. In these situations the SEC indicated that it would require full disclosure of Glass–Steagall Act issues in the fund’s registration statement. But, where a fund was created, managed, and operated, directly or indirectly, by a bank or depository institution, the SEC concluded that it would not grant requests for accelerated treatment until it received an indication of the legality of the proposed fund from the relevant federal banking agency [63].

3.1.4.2. Applying the Investment Company Act to investment companies created and operated by bank subsidiaries. Because the ICA was adopted after the Glass–Steagall Act had presumably separated commercial and depository banking from investment banking activities, the ICA does not contemplate bank involvement in the creation and operation of investment companies. The ICA thus may create impediments to certain structures established by banks to operate investment companies.

For example, Section 17(a) of the ICA restricts purchases of securities or other property from, and sales of securities or other property to, an investment company by an affiliated person, promoter, or principal underwriter, or affiliated person of any such person [64]. Thus, where an investment company is sponsored by a banking institution or bank affiliate, the sale by the bank of its certificates of deposit to its affiliated investment company would be prohibited under Section 17(a) of the ICA, unless the SEC, upon application, issued an order pursuant to Section 17(b) of the ICA permitting the transaction. Alternatively, the SEC could, by rule, regulation, or order, exempt the transaction from Section 17(a) if it found that the exemption was necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the ICA [65].

Section 12(d) (3) of the ICA also prohibits a registered investment company from purchasing or otherwise acquiring any security issued by, among others, any person who is a broker, a dealer engaged in the business of underwriting, or either an investment adviser of an investment company or an investment adviser registered under the Investment Advisers Act [66]. This section may prohibit an investment company from acquiring securities, including certificates of deposit, of a bank which was the investment adviser to the investment company.

Section 17(d) of the ICA restricts joint transactions between an investment company and certain related entities, prohibiting an affiliated person or underwriter of an investment company or an affiliated person of any such person, from effecting any transaction in which the investment company is a

joint or a joint and several participant with such affiliated person, underwriter, or affiliated person of an affiliated person or underwriter [67]. Thus, Section 17(d) could prohibit a bank from bolstering a company to which it had made a loan by causing an affiliated investment company, to buy stocks, bonds, or other securities issued by that company [68].

Also, Section 35(d) of the ICA provides that it is unlawful for a registered investment company to adopt, as part of its name or title, any word or words that are deceptive or misleading. Where an investment company, sponsored by a bank affiliate, uses the bank's name, such use might violate Section 35(d) because it misleadingly connotes that investments in the investment company are as secure as insured deposits in the bank [69].

3.1.4.3. Depository Institutions Deregulation Act of 1980 and interest rate ceilings. The ability of banks to conduct securities activities through subsidiaries may also be influenced and restricted by federal banking laws such as the Depository Institutions Deregulation Act of 1980 (the "DIDA") [70]. The DIDA is designed to provide an orderly phase-out, and ultimate elimination, of ceilings on rates of interest payable on deposits and accounts by federally regulated depository institutions, but continues in force certain interest rate restrictions established by federal banking agencies [71]. Thus, where a bank employs a subsidiary to establish and operate an investment company, the bank may create a means for the transfer of funds from the bank's interest-rate-regulated accounts to that investment company, and the structure may be deemed a means to offer a higher rate of return than permissible under the DIDA and applicable federal regulations.

However, the recently enacted Garn-St. Germain Depository Institutions Act of 1982 [72] should substantially reduce the temptation for depository institutions to create structures to avoid the application of interest rate ceilings. That Act authorizes depository institutions to offer a new "money market deposit account" which is not subject to a limitation on the rate of interest payable on the account [73]. Moreover, the Depository Institutions Deregulation Committee (the "DIDC") has also authorized another account, termed a "Super NOW" account, which also pays a market rate of interest and which, in addition, offers unlimited checking features [74]. ("NOW" is an abbreviation of "negotiable order of withdrawal".) Thus, depository institutions are now more able to compete with securities industry products by offering deposits that pay a market rate of return.

3.1.4.4. Financial Institutions Supervisory Act. The Financial Institutions Supervisory Act (the "FISA") grants to the respective federal banking agencies the power to take action against banks and depository institutions which have engaged, are engaged, or are about to engage in an "unsafe or unsound [banking] practice" [75]. An activity need not violate federal or state laws or

regulations to constitute an unsafe and unsound banking practice. The activity also need not be intrinsically improper, unsafe, or unsound. The test is whether, under the circumstances, the activity poses a danger to the financial soundness and integrity of the bank, portends a loss of public confidence in the bank's soundness and integrity, or presents a conflict of interest which might endanger independent and disinterested banking judgment [76].

In this context, as banks begin to engage in securities activities, the legislative history of the Glass-Steagall Act is relevant since it indicates a Congressional concern that bank involvement in securities activities would create unique conflicts of interest which would risk unsafe and unsound banking practices. During the course of the FDIC's consideration of its "Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks", for example, the Chairman of the FDIC indicated that concerns for safe and sound banking practices would need to be addressed if banks were to be permitted to engage in securities activities. Shortly thereafter, the FDIC requested public comments on the safeguards, if any, that the FDIC should apply to banks that proposed to engage in securities activities [77].

3.1.4.5. Federal Trade Commission Act. Section 18 of the Federal Trade Commission Act (the "FTC Act") [78], grants the federal banking agencies the authority to prohibit "unfair or deceptive acts or practices" by banks and to take appropriate action under the FISA against any bank subject to a given agency's jurisdiction which engages in such practices. Regulations promulgated by the Federal Reserve Board provide that an act or practice that is "not prohibited by current federal or state laws or regulations" may nevertheless constitute an unfair and deceptive practice [79]. Thus, the FTC Act contains yet another standard against which bank securities activities may be judged.

3.1.4.6. Federal Deposit Insurance Act. Pursuant to its authority under the Federal Deposit Insurance Act, the FDIC has promulgated regulations prohibiting insured banks from "causing or permitting any change to be made in the general character or type of business exercised by [them] without the prior written consent of the [FDIC]" [80].

The purpose of the FDIC's regulation is to guarantee that insured banks do not make significant changes in the business they conduct and become engaged in activities which could adversely affect the security of the bank's deposits and the ultimate exposure of the FDIC [81]. Thus, because involvement in securities activities is, at least, in unconventional bank activity, the creation and operation of an investment company by a bank might require prior FDIC approval.

3.1.5. Investment funds linked to banks

"Private label" funds, group sponsored funds, checking account "sweep"

arrangements, and other non-traditional arrangements between banks and third parties to provide securities products to bank customers have also presented novel questions concerning the extent to which the provision of these products by banks is subject to challenge under the Glass–Steagall Act or other federal statutes.

(1) Checking account “sweeps” are arrangements whereby shares of a mutual fund (usually a money market mutual fund) are automatically purchased with funds from a customer’s bank account that exceed a predetermined threshold. These shares are then automatically redeemed if the balance of the customer’s bank account falls below another predetermined amount. To accomplish these “sweeps”, the customer designates the bank as his agent for the purchase and sale of the fund shares [82].

(2) “Private label” funds or proprietary funds come in many varieties, but generally are money market funds, established by an unrelated third party at the behest of and pursuant to arrangements with a bank. These funds are linked to accounts at that bank via a “sweep” arrangement and are available solely to the bank’s customers – hence the “private label” terminology [83]. In many cases, the sponsoring bank or a subsidiary will serve as a co-adviser to the sponsor of the fund. For this service, the bank generally receives a fee based upon a percentage of the net asset value of the fund. The bank may also be compensated for serving as custodian or transfer agent for the fund.

(3) Group sponsored funds, are another type of bank-linked investment product. A group fund is sponsored not by a single bank but by an entity, the members of which are banks. Group funds generally operate in the same manner as “private label” funds, linking a customer’s checking or NOW account at a group member bank to the fund by a “sweep” arrangement [84]. Group funds may also offer customers combinations of other financial products and services in conjunction with bank accounts.

3.1.5.1. Glass–Steagall Act implications. For Glass–Steagall Act purposes, the status of a bank or other depository institution in a sweep will vary depending upon the extent to which the bank is involved in promoting and servicing the fund used in the sweep. Generally, the greater the bank’s involvement in providing services in connection with the sweep arrangement, the closer is the Glass–Steagall Act question presented.

For example, a bank may perform a number of functions in a sweep arrangement. The bank or an affiliate may be custodian, subcustodian, transfer agent, adviser, co-adviser, subadviser, administrator, or subadministrator of the fund. The fund may be a “private label” fund, or a group fund, available only to customers of a particular bank or banks. A sweep arrangement may also be provided as part of a financial services package, including the sweep, a checking or NOW account, brokerage account (perhaps with a margin feature), and a debit card.

The legality under the Glass–Steagall Act of sweep programs where the bank does not provide services to the fund in connection with the sweep, hinges upon whether the bank’s activity constitutes “purchasing and selling securities and stock without recourse, solely upon the order and for the account of customers” as permitted by Section 16 of the Act. The scope of this exception from the Glass–Steagall Act’s prohibitions was discussed in detail by the district court in *New York Stock Exchange v. Smith* [85], in connection with the provision of an automatic investment service (the “AIS”) by a bank, which the court ultimately found to be permissible under the Glass–Steagall Act.

Sweep arrangements bear a strong resemblance to the AIS addressed in *New York Stock Exchange v. Smith*. However, the characteristics of the AIS the district court found significant in its decision may not be present in all types of sweeps. For example, the court in *New York Stock Exchange v. Smith* stressed that AIS banks only provide a *service*, and are not under pressure to increase a fund’s profit (or sales) from which the bank’s compensation would be derived. Also, in the AIS program the bank was not offering any investment advice, directly or indirectly, concerning the securities purchased through AIS.

Where a bank plays a number of roles in a sweep arrangement, however, the bank’s additional involvement presents the question of whether the bank’s conduct has crossed over into underwriting and distribution of securities prohibited by the Glass–Steagall Act. Examples of extensive involvement include situations in which (i) funds are transferred from bank customers’ accounts into a single “private label” fund – arguably, if the bank were truly acting only as an agent, it could choose from a variety of available investments; (ii) a bank performs extensive services for the fund; or (iii) the bank markets the fund to bank customers in a manner implying that the bank is sponsoring the fund [86].

3.1.5.2. Application of the federal securities laws. Bank-linked investment funds also raise novel questions under the federal securities laws. For example, when the VISA Money Market Fund first applied to the SEC to register as an investment company under the ICA and to register its shares for sale to the public under the Securities Act, the SEC staff declined to accelerate the fund’s effectiveness. In large measure, the effective date was not accelerated because the fund’s objective of benefiting VISA-participant banks was regarded as fundamentally inconsistent with the statutorily established objectives of investment companies under the ICA – to further the interests of fund investors above all. The SEC staff reportedly commented that “for any fund to agree to be set up where the linchpin of its objectives is not maximization of investors’ profit but investing in the certificates of deposit (“CDs”) of the sponsoring group is something that does not fit quite right” [87]. The VISA Money Market Fund also was alleged to present a variety of other issues under the Investment Company Act and several banking statutes [88].

The effort of the VISA fund to obtain registration under the ICA pointed up several respects in which bank-linked funds may involve activities that run counter to the policies of the ICA, and prompted the SEC to hold hearings to further examine these issues [89]. For example, where a fund has an investment policy that relates the purchase of securities issued by financial institutions (e.g. bank certificates of deposit) to the volume of sales of fund shares to customers of those institutions (a “sales-related investment policy”), have persons with fiduciary duties with respect to the fund under Section 36(a) of the ICA properly discharged their fiduciary duties to act only in the best interests of the fund [90]? Does a sales-related investment policy constitute participation in a joint enterprise or joint arrangement between the fund and its affiliated persons, principal underwriter, or affiliated persons thereof, prohibited under Section 17(d) of the ICA? If a financial institution provides to its customers shares of a fund that follows a sales-related investment policy, is that institution an underwriter of those shares for the purposes of Section 2(a) (4) of the ICA [91]? If so, then would Section 12(d) (3) of the ICA, which prohibits an investment company from purchasing a security issued by, or other interest in, the business of a person engaged in the business of underwriting, bar the fund from buying certificates of deposit from its participating banks [92]?

The involvement of banks in “sweep” arrangements also raises novel disclosure questions. For example, Rule 12b-1 under the ICA permits an investment company to finance the distribution of its own securities [93]. Under this provision, banks that sweep customers’ accounts or provide other services to facilitate the distribution of the fund’s shares may be compensated for their services. But a fund paying a bank for those services must also fully disclose that fact and otherwise comply with Rule 12b-1. Disclosure is required of the purposes for which the payments are made and of the services actually provided. This, in turn, highlights the question of whether the bank’s services actually involve distributing the fund’s shares, and may impliedly characterize the bank’s activity as one prohibited by the Glass–Steagall Act.

3.2. Underwriting and securities placement

3.2.1. Permissible underwriting by banks

Section 16 of the Glass–Steagall Act permits national banks (and by reference state banks that are members of the Federal Reserve System) to underwrite “obligations of the United States or general obligations of any state or of any political subdivision thereof” and the securities of certain U.S. government agencies and specified state and local revenue bonds [94]. Revenue bonds qualifying to be underwritten by banks must be backed by the general taxing power of a state or municipality [95].

3.2.2. Underwriting by bank holding company affiliates

On a case-by-case basis, the Federal Reserve Board has approved applications under Section 4(c) (8) of the Bank Holding Company Act [95a] to permit bank holding companies to engage in dealing (1) in obligations of the United States, (2) in general obligations of states and their political subdivisions, and (3) in other obligations that state-member banks are authorized to underwrite and deal in, pursuant to Section 16 of the Glass–Steagall Act [96].

3.2.3. Private placements

In general, private placement activities, *i.e.* sales of securities not constituting a public offering, conducted by banks, include making recommendations regarding the terms and timing of a transaction, assisting in the preparation of a financing memorandum describing the terms of the placement, contacting institutional investors for signs of interest in the proposal, gathering together the investors' comments for the prospective issuer, arranging meetings between the customer and potential investors, and assisting in subsequent negotiations [97].

In the 1970s, the Comptroller of the Currency issued several letters indicating that banks could be viewed as engaged in underwriting prohibited by the Glass–Steagall Act when they participated in negotiating the terms of a private placement and were compensated on a contingent basis [98]. In fact, in 1977, the Federal Reserve Board denied an application by a prospective bank holding company to retain an interest in a company which was registered as a broker–dealer and was engaged in the business of assisting business enterprises in private placements of debt and equity securities [99]. The Board later issued a clarifying letter, however, which stated that its earlier order was not intended to determine the legality under the Glass–Steagall Act of private placement activities, but only to prevent such activities from being conducted under the Bank Holding Company Act by non-bank subsidiaries of bank holding companies.

In June 1977, the staff of the Federal Reserve Board issued a *Private Placement Study*, (the “Study”) which concluded that, “while the answers are not completely free from doubt, the stronger case would support a conclusion that private placement activities are not prohibited either by [Sections 16 or 21] of the Glass–Steagall Act” [100]. The *Study* rejected the earlier positions expressed by the Comptroller and the Board itself, stating that those positions had not properly taken into account the definition of “underwriting” contained in the Securities Act for the purposes of defining the term under the Glass–Steagall Act. Relying upon the definition of the term “underwriting” used in the Securities Act, the *Study* asserted that banks were not engaged in underwriting in violation of the Glass–Steagall Act because banks were not acting as “firm commitment” underwriters (*i.e.* not purchasing securities for resale to third parties) [101].

The *Study* conceded that bank involvement in private placements on a contingent free basis could constitute “best efforts” underwriting. But, the *Study* reasoned, that even if the bank’s involvement were deemed to be “best efforts underwriting”, the activity was not necessarily forbidden under the Glass–Steagall Act because the Securities Act definition of the term “underwriter” applies only to persons involved in public, as opposed to private, offerings of securities. The *Study* argued that neither “best efforts” nor “firm commitment” underwriters who perform only private placements are considered underwriters for the purposes of the Securities Act [102]. The *Study* also indicated that investors purchasing bank private placements are virtually always large institutional investors [103].

Shortly after the issuance of the *Study*, the Comptroller of the Currency indicated his concurrence in the view that the “Glass–Steagall Act does not prohibit private placement activity as presently conducted by commercial banks” [104]. More recently, the Comptroller again followed the approach of looking to the Securities Act for the definition of a term used in the Glass–Steagall Act. In an interpretive letter, the Comptroller took the position that a private placement by a bank that would not involve a “distribution” as that term is used in the Securities Act was not prohibited under the Glass–Steagall Act [105].

3.2.4. *Commercial paper activities*

In 1978, Bankers Trust Company, a state-chartered member bank of the Federal Reserve System, began offering third-party commercial paper for sale – that is, commercial paper issued by industrial corporations. Bankers Trust’s effort to begin marketing third-party commercial paper included a marketing campaign aimed at issuers of the paper whereby Bankers Trust agreed to act as the seller of the commercial paper and emphasized its ability to perform services competitive with other securities dealers. As part of the advertising, Bankers Trust also offered to lend the issuer of commercial paper money equal to the amount of paper to be sold. Then, if Bankers Trust were unable to sell all of the issuer’s paper, the bank would take back notes reflecting the amount of unsold paper. In practical effect, these transactions resembled underwriting the sale of the commercial paper. However, Federal Reserve Board took the position that the commercial paper activities of Bankers Trust were not precluded by the Glass–Steagall Act because commercial paper is not a “security” for the purposes of that Act.

In support of this position, the Board had to confront the fact that commercial paper is deemed to be a security for purposes of the Securities Act. The Board argued that the meaning of the term “security” as used in the Securities Act of 1933 was *not* relevant to illuminate the meaning of the same term as used in the Glass–Steagall Act. The Board thus declined to follow its staff’s reliance on Securities Act definitions in the *Private Placement Study* –

where reference to of Securities Act definitions had assisted the staff in reaching the conclusion that bank private placement activities were *not* “underwriting” prohibited by the Glass–Steagall Act.

The Board’s conclusion that commercial paper was not a “security” for Glass–Steagall Act purposes was challenged by the securities industry [106]. The first court to consider the case agreed with the challengers and held that commercial paper was a security within the meaning of the Act [107]. This district court decision subsequently was reversed, however, by the court of appeals, which held that the purpose, language, and legislative history of the Glass–Steagall Act supported the Board’s original conclusion that commercial paper was *not* a Glass–Steagall Act “security” [108].

However, the court of appeals’ decision may be even more meaningful for the manner in which the court reached its result – according substantial deference to the determination of the Federal Reserve Board. The court of appeals, in effect, expressly endorsed the Board’s effort to modernize the application of the Glass–Steagall Act through “interpretation”, and thus the court’s decision may encourage similar, *ad hoc* modernization efforts by the Board and other federal banking agencies – which, in turn, is likely to engender a variety of lawsuits against those agencies. Review of the decision of the court of appeals has been sought.

3.3. *Marketing of debt instruments*

3.3.1. “Retail repos”

3.3.1.1. *Nature of a “retail repo”.* Retail repurchase agreements, so-called “retail repos”, are financial instruments – not subject to interest rate ceilings – developed by banks and savings and loan associations to compete with the market rates of interest provided by investments offered by the securities industry. Retail repos are, in effect, debt obligations of banks and savings and loan associations (“S&Ls”) that are collateralized by an interest in a security or a pool of securities that are direct obligations of, or are guaranteed by, the United States or a U.S. government agency. Retail repos are issued in denominations of less than \$100,000, with maturities of less than 90 days [109]. Although retail repos typically are marketed as a “sale” of a U.S. government security or sale of a share in such a security, the purchaser of a retail repo actually acquires only a limited interest in the underlying security. For example, the investment return on a retail repo theoretically is independent of variations in the market value of or the interest paid on the underlying securities. In reality, what is “sold” is a bank’s or S&L’s obligation to pay a predetermined amount secured by an interest in underlying government instruments.

3.3.1.2. *Application of the federal securities laws to retail repos.* In September 1981 the Securities and Exchange Commission issued an interpretive release, together with two staff “no-action” letters, addressing the general status of retail repos under the federal securities laws [110]. The no-action letters concluded that the retail repos sold by a bank or an S&L would be treated as securities of the bank or S&L, rather than participations in the underlying government security, and were therefore exempt from registration under Sections 3(a)(2) and 3(a)(5) of the Securities Act [111].

The SEC staff relied upon the following factors in reaching its conclusion: (1) purchasers look to the bank or S&L for payment of the principal and interest due them; (2) purchasers obtain no economic characteristics of ownership of the underlying government security, including no risk of loss or opportunity of gain from capital value fluctuations of the underlying security; (3) the “resale” price to be paid by the bank or S&L represents a return on the purchaser’s initial purchase price, plus interest; (4) the interest to be paid by the bank or S&L is not limited to or dependent upon the interest rate earned by the underlying government security; and (5) the maturity of the government security is not coterminous – except coincidentally – with the maturity of the retail repo agreement. The SEC staff also indicated that the repos would be exempt from the indenture qualification requirements of the Trust Indenture Act pursuant to Section 304(a) (4) (A) [112], and that the bank or S&L was not required to register with the SEC as a broker–dealer under the Securities Exchange Act.

The staff also indicated that the pool of government securities collateralizing the retail repos would not be considered an investment company separate from the bank or S&L, unless other factors were present, such as holding out the retail repo arrangement as the conveyance of an interest in a government security or pool of government securities. Had the staff concluded that an investment company existed, the bank or S&L would be distributing securities (investment company participations) in violation of the Glass–Steagall Act [113].

The SEC’s Release stressed that the antifraud provisions of the federal securities laws apply to transactions involving retail repos, and urged that “[B]anks and savings and loan associations proposing to offer retail repos... take steps to assure that all documents used in connection with retail repo programs are accurate and contain no material misstatements or omit to state facts necessary in order to make the statements made not misleading” [114].

The SEC recently reaffirmed these concerns by publishing a Report of Private Investigation conducted by the SEC’s Division of Enforcement concerning false and misleading statements of material facts made by Fidelity Savings and Loan Association (Fidelity S&L) and its parent corporation, Fidelity Financial Corporation (Fidelity Corp.), in connection with the offer and sale of retail repurchase agreements by Fidelity S&L [115]. The Report

indicated that Fidelity S&L and Fidelity Corp. had violated the antifraud provisions of the federal securities laws by making materially false and misleading statements and omitting to state material facts to offerees and purchasers of retail repurchase agreements sold by Fidelity S&L, concerning (1) nature of the security interest in the collateral backing the retail repos; (2) the existence of a trust holding the securities, and (3) the financial condition of the S&L. These firms also failed to disclose material information concerning Fidelity S&L's financial condition in a year-end press release. (Fidelity S&L was declared insolvent several months later.)

3.3.1.3. Banking law issues raised by retail repos. In May 1981 the Comptroller of the Currency and the Federal Home Loan Bank Board each issued advisory materials regarding supervisory and legal issues raised by retail repo programs [116]. The respective banking agencies' guidelines focused on several major features of retail repo arrangements:

(1) Institutions were urged to develop safeguards to prevent mismatching of assets and obligations where the funds are used to purchase fixed rate investments with maturities longer than that of the retail repos.

(2) The market value of the collateral underlying a retail repo at least should equal the principal amount of the issuing institution's obligation.

(3) The customer's security interest in the collateral security underlying the retail repo should be perfected under state law.

(4) Customers should receive disclosures concerning the material aspects of the retail repo arrangement [117].

The Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, and the Federal Reserve Board have also approved new rules permitting federal S&Ls automatically to renew retail repurchase agreements [118]. In addition, the three agencies determined to allow retail repos to be used in connection with "sweeps" from a customer's account into a retail repo. Under these arrangements, funds above a certain balance may be automatically transferred into a retail repo issued by the bank or S&L with minimum delay and paperwork. Previously, the inability of banks and S&Ls to renew automatically their retail repos made sweeps into retail repos cumbersome and unattractive because customers were required to write or telephone the bank or S&L to renew repos every time the repo was scheduled to mature. In addition, because a new retail repo instrument was issued each time new funds were swept from the account, customers conceivably would be required to contact the bank or S&L every day [119].

3.3.2. The money market deposit account

Recent legislation has empowered depository institutions to offer a non-interest rate regulated deposit account in order to compete with money market funds. Pursuant to the Garn-St. Germain Depository Institutions Act of 1982,

the Depository Institutions Deregulation Committee is directed to authorize a new deposit account which must be "directly equivalent to and competitive with money market mutual funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940" [120].

The new insured deposit account has the following principal characteristics:

- The minimum balance must be no less than \$2,500.
- Compliance with the minimum balance requirement may be determined by using an average balance for a period no longer than one month.
- No limitation exists on the amount of interest that may be paid unless the average balance falls below \$2,500, during which period the 5.25% NOW account interest rate ceiling will be imposed.
- The account is available to all types of depositors.
- No minimum maturity period is required, but institutions must reserve the right to require at least seven days notice prior to withdrawal, and may not obligate themselves to pay any fixed or indexed rate for a period greater than one month.
- Depository institutions whose accounts allow no more than six transfers per month, no more than three of which can be effectuated by draft, are not required to maintain any reserves to back money market accounts held by individuals and are required to maintain reserves of only 3% for business accounts subject to such restrictions. The minimum denomination of the drafts and the preauthorized or automatic transfers is left to the individual institutions to determine.
- There are no restrictions on the size and frequency of withdrawals by mail, messenger, or in person. Telephone transfers to other accounts of the depositor at the same institution are considered pre-authorized or automatic transfers for the purposes of the six-transfer-limit on the account.
- There are no regulatory restrictions on additional deposits, and sweeps *from* other accounts are permitted.
- Loans to meet the \$2,500 minimum balance are prohibited.
- The rate of interest and other charges imposed on an overdraft credit arrangement offered in connection with the account must not be less than those imposed on overdrafts for customers that do not possess the account.
- To ensure compliance with the limits of six transfers per month, based on either the date of the draft or date of payment, institutions may either prevent a greater number of transfers or adopt procedures to monitor accounts on an *ex post* basis and contact customers who have a greater number of such transfers [121].

In addition, depository institutions may also offer a second type of money market account: a "Super NOW" account which allows an unlimited number of checks [122]. A depository institution may pay any rate of interest on a "Super NOW" account, provided that the following restrictions, which also apply to the money market deposit account, are observed: (1) an institution

must reserve the right to require seven days' notice prior to withdrawal; (2) compliance with the \$2,500 average balance requirement may be computed over a period no longer than one month; (3) the existing NOW account rate (5.25%) applies to accounts that do not meet the average balance requirement; (4) an interest rate may not be guaranteed for a period longer than one month; and (5) loans are not permitted to meet the \$2,500 initial or average balance requirement.

This type of account is only available to individuals, non-profit organizations operated primarily for religious, philanthropic, charitable, educational, fraternal and other similar purposes, and to governmental units, and must be backed with reserves of 12% of the deposit balances of such accounts.

Because sweeps into money market deposit accounts are permitted, retail repos may be employed less frequently in sweep arrangements as the market-rate instrument into which "swept" funds are invested.

3.4. Brokerage activities

3.4.1. Dividend reinvestment plans

In a dividend reinvestment plan, a bank arranges with shareholders of a corporation for their dividends to be paid directly to the bank. The bank then aggregates the dividends and buys additional shares of the company's stock on behalf of each shareholder. The bank deducts certain fees and commissions as compensation for the services it performs. Banking regulators have viewed this activity as a variation on the traditional, permissible, agency activities that banks perform on behalf of their customers [123].

3.4.2. Individual portfolio management

Individual portfolio management services offered by banks may involve a number of accounts where the bank gives substantially the same investment advice. Portfolio management services are regarded by banking agencies as an extension of the traditional money management services performed by banks for individual investors. If the bank's investment authority is discretionary, however, individual portfolio management services may be subject to registration as an investment company under the Investment Company Act. A bank's authority will be regarded as discretionary if a customer receives the impression "that his business is welcomed or that he will meet his objectives only through consistently following the adviser's recommendations or as long as, even without efforts to discourage the exercise of independent judgment, the customer in fact follows the recommendations slavishly" [124].

3.4.3. Automatic investment services

Automatic investment services generally involve a mechanism where checking account customers of a bank are permitted to designate a sum of money to

be withdrawn, at regular intervals, from their account for investment in a group of selected securities. Although the legality of automatic investment services under the Glass–Steagall Act was challenged by the securities industry, in *New York Stock Exchange v. Smith*, the district court characterized AIS as essentially an automated version of the traditional bank function of acting as an agent for customers in purchasing securities and found the AIS to be permissible under the Glass–Steagall Act and the federal securities laws. [125].

3.4.4. “Discount brokerage”

Banking institutions have recently taken major steps to enter the brokerage business. The two most prominent examples of these expansion attempts are the acquisition by BankAmerica Corporation, parent holding company of the Bank of America, of Charles Schwab, Inc., the nation’s largest discount brokerage firm [126], and the establishment by Security Pacific National Bank of a newly created subsidiary to engage in discount brokerage activities [127]. Another example is the plan announced by the Union Planters Bank of Memphis to acquire Brenner Steed & Associates, a regional discount broker, and to offer securities brokerage services at the bank’s branch offices and affiliated banks [128]. Other banks, instead of buying brokerage firms, have contracted to have special brokerage services performed on their behalf by third parties [129].

3.4.4.1. Application of the Glass–Steagall Act to bank brokerage activities. Section 16 of the Glass–Steagall Act, 12 U.S.C. §24, provides that the business of dealing in securities and stock by national (and state member) banks “shall be limited to purchasing and selling securities and stock without recourse, solely upon the order of and for the account of customers” [130]. The scope of this language – which was originally viewed and construed narrowly by bank regulators – is crucial to the ability of banks to offer brokerage services.

In 1935, for example, the Comptroller of the Currency testified, in connection with amendments to certain sections of the Glass–Steagall Act, that:

[The proposed amendment] makes it clear §16 of the Banking Act of 1933 was not intended to prohibit national banks or member banks from buying or selling solely for the account of their customers and as an accommodation thereto and not for their own account.

This is extremely important, particularly in communities remote from financial centers, and since there is involved no investment by the bank of its own funds, no objections can be seen thereto [131].

The legislative history of the Securities Exchange Act, enacted just one year after passage of the Glass–Steagall Act, lends support to the argument that banks were exempted from the statutory definitions of the terms “broker” and “dealer” because Congress believed that the Glass–Steagall Act prohibited

banks from being *either* brokers or dealers, except to a *de minimis* extent [132].

In 1936, the Comptroller issued a bulletin cautioning that a “definite effort by [a] bank to engage in the securities business for a profit rather than for accommodation ran counter to the spirit and purpose of §16” [133]. These views were codified in the Comptroller’s first *Digest of Opinions* published in 1948 [134], although the compensation provision was relaxed slightly. In 1957, however, the Comptroller eliminated the requirement that brokerage services be provided on a non-profit basis, but retained the requirement that such services were to be performed only as an accommodation for *existing* bank customers [135]. More recent rulings by the Comptroller have permitted banks to make a profit on stock purchase activities, and have not distinguished between new and pre-existing bank customers [136].

In connection with a dispute as to the legality of a proposal by banks to offer automatic investment services, the Comptroller explained the difference between earlier and more recent positions of the Comptroller’s Office. Characterizing the early decisions as reflecting “the great caution of banking regulations in the years immediately following the 1931–32 debacle” [137], the Comptroller explained that the earlier interpretations contained restrictions that were not imposed by the statute itself, and accordingly were viewed as erroneous [138]. *New York Stock Exchange v. Smith*, which eventually arose from this dispute, upheld the legality of automatic investment services offered by banks, analogizing those services to an automated version of traditional bank agency functions. (The decision was subsequently vacated on procedural grounds and therefore may not serve as a binding precedent.) However, AIS is necessarily connected to an account at the sponsoring bank and, thus, *New York Stock Exchange v. Smith* did not resolve the question whether a bank may conduct a brokerage business serving customers who do not have pre-existing relationships with the bank as banking customers.

The court in *New York Stock Exchange v. Smith* did, however, spend considerable time discussing its conclusion that providing AIS was consistent with the spirit and purposes of the Glass–Steagall Act and did not generate any of the secondary hazards identified by the Supreme Court in *Investment Company Institute v. Camp*, even though the bank made a profit on its brokerage transactions.

The Supreme Court’s decision in *Board of Governors v. Agnew*, has also been offered in support of the proposition that brokerage activities are not within the prohibitions imposed by the Glass–Steagall Act [139]. *Agnew* interpreted Section 32 of the Act, which prohibits directors, officers and employees from jointly serving banks and securities firms. In the course of ascertaining the meaning of the term “primarily” as used in Section 32, the Supreme Court treated the terms “issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other securities”, as excluding brokerage activities [140]. The Court’s opinion

equated the statutorily prohibited activities with underwriting and dealing, and not stock brokerage.

The Supreme Court's recent decision in *Board of Governors v. Investment Company Institute*, however, may hint at a different view of the meaning of similar language in Section 21 of the Act. In its decision, the Court observed that Section 21 "was intended to require securities firms such as *underwriters or brokerage houses* to sever their banking connections" [141].

3.4.4.2. Application of the Glass-Steagall Act to brokerage activities by bank affiliates. The application of the Glass-Steagall Act to bank brokerage activities has been argued to vary somewhat when activities are conducted by an affiliate of the bank, rather than the bank itself. Section 20 of the Act prohibits banks from having affiliates that are "principally" engaged in specified securities activities; thus, even if securities brokerage were prohibited by the Glass-Steagall Act, a secondary question would arise as to whether a bank affiliate was "principally" engaged in the activity. According to the Supreme Court's discussion in *Board of Governors v. Agnew*, the "principally" engaged test of Section 20 involves a higher level of securities involvement than does the "primary" or substantial test under Section 32 of the Glass-Steagall Act [142].

The Comptroller of the Currency examined the application of Section 20 in the course of approving the application by Security Pacific National Bank to offer discount brokerage services through a newly-created bank subsidiary, Security Pacific Discount Brokerage Services, Inc. [143]. Despite previous restrictive interpretations of the permissible extent of bank brokerage activities, the Comptroller concluded that discount brokerage was a permissible activity for the subsidiary of a national bank, characterizing those early interpretations as overly and unnecessarily restrictive, and pointing to *New York Stock Exchange v. Smith*. As another basis for its approval, the Comptroller relied upon the Supreme Court's *Agnew* decision, which appeared to exclude securities brokerage from the type of activities prohibited under certain provisions of the Glass-Steagall Act.

3.4.4.3. Application of the Bank Holding Company Act to brokerage activities by bank holding companies. Still another series of issues is presented where brokerage activities will be conducted, not by a bank or bank subsidiary, but by a bank affiliate which is part of a bank holding company structure. In addition to the question of whether the activity is permissible for a bank affiliate under the Glass-Steagall Act, the Federal Reserve Board must conclude, first, that brokerage activities are "closely related" to banking, and second, that the competitive benefits of the proposed activity outweigh possible adverse effects.

The leading case defining the "closely related" standard under the Bank Holding Company Act is *National Courier Association v. Board of Governors*

[144]. In *National Courier*, the United States Court of Appeals for the District of Columbia Circuit described the criteria used to determine whether an activity is “closely related” to banking so as to be permissible under Section 4(c) (8) of the Bank Holding Company Act. An activity is “closely related” if: (a) banks generally have, in fact, provided the proposed services; (b) banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed services; and (c) banks generally provide services that are intrinsically related to the proposed services as to require their provision in a specialized form [145].

The second standard for approval of an activity under the Bank Holding Company Act is that the competitive benefits of the proposed activity outweigh its possible adverse effects, such as undue concentration of economic resources, decreased or unfair competition, conflicts of interest, or unsafe or unsound banking practices [146].

The Federal Reserve Board’s consideration – and approval – of the Bank Corp.’s (parent holding company of the Bank of America) acquisition of Charles Schwab & Co., the leading discount securities broker in the United States provided an opportunity for a thorough examination of these Bank Holding Company Act issues as well as the applicability of the Glass–Steagall Act [147]. In approving the acquisition, the Board first concluded that bank holding companies are not prohibited from engaging in the type of discount brokerage services offered by Schwab. The Board determined that Schwab’s activities were closely related to banking because many banks currently offer types of brokerage services to their customers that resemble Schwab’s activities. Moreover, the Board noted that the authority of national banks under 12 U.S.C. §24 to purchase and sell securities without recourse, solely upon the order and for the account of customers, supported the conclusion that Schwab’s brokerage activities, “which are within the plain meaning of the language of this authorization”, were closely related to banking.

The Board also found the extension of margin credit by Schwab to be closely related to banking because “banks generally and traditionally have extended credit to their customers for the purpose of buying and carrying securities”. And, the Board found Schwab’s maintenance of customer securities accounts and securities custodial services to be closely related to banking and a necessary incident to permissible securities brokerage and margin lending activities.

The Board concluded that a variety of public benefits were likely to result from the acquisition of Schwab by BankAmerica, including increased competition and increased convenience and efficiencies. In particular, the Board’s decision indicated that the acquisition “may induce full-line brokers to compete more vigorously for brokerage business on the basis of price”. Moreover, the Board determined that the acquisition would not present significant

adverse effects, in that it was unlikely to result in undue concentration of resources or decreased competition, unfair competitive practices, or other adverse effects.

Finally, the Board determined that the acquisition would be consistent with the Glass–Steagall Act. The Board concluded that Section 20 of the Act, which prohibits affiliations between Federal Reserve member banks and firms engaged in certain securities activities, did not apply to BankAmerica/Schwab because Schwab was not engaged principally in the “public sale” of securities within the proscription of Section 20, by virtue of its retail brokerage activities. The Board reasoned that retail brokerage did not constitute a “public sale” for Section 20 purposes, emphasizing that the term “public sale” was used in Section 20 together with other terms which generally refer to the process by which new issues or large blocks of securities are distributed to the public, and that, therefore, “public sale” should be given a meaning consistent with the scope of those terms. In addition, the Board cited its own interpretations under Section 32 of the Glass–Steagall Act, which did not apply Section 32 to brokerage activities, as well as recent interpretations by the Comptroller of the Currency, including the Comptroller’s recent decision in the case of Security Pacific National Bank. The Board also found no evidence in the legislative history of the Glass–Steagall Act that bank brokerage activities were viewed as a target of the Act’s prohibitions, and rejected references to the legislative history of the Securities Exchange Act as being probative of the scope of the Glass–Steagall Act’s prohibitions.

3.4.5. Municipal securities activities

Any bank, bank subsidiary, or department or division of a bank which acts as a municipal securities dealer within the meaning of the Securities Exchange Act must comply with the Exchange Act’s registration requirements for municipal securities dealers and is subject to the rules of the SEC and the Municipal Securities Rulemaking Board, as well as to those of applicable bank regulatory agencies [148].

The Board’s decision to approve the Schwab acquisition prompted an outcry – and filing of a lawsuit to overturn the board’s order – by securities industry groups that contend that the acquisition violates both the Bank Holding Company Act and the Glass–Steagall Act [147a].

Municipal securities dealer activities include underwriting, trading, and sales of municipal securities and financial advisory and consultant services for issuers of municipal securities [149]. Recently, the staff of the SEC’s Division of Market Regulation advised the Comptroller of the Currency that banks providing private placement advisory activities related to the issuance and sale of industrial development bonds were involved in municipal securities transactions within the meaning of the Exchange Act. The SEC staff concluded, however, that banks did not have to register as municipal dealers if they act

only as brokers, but would be subject to the registration requirements if they buy and sell municipal securities for their own accounts other than in a fiduciary capacity [150].

3.4.6. Futures commission merchant activities

The Federal Reserve Board has also approved applications under the Bank Holding Company Act for J.P. Morgan & Co., Bankers Trust, and Citicorp to act, through subsidiaries, as futures commission merchants ("FCMs") in connection with financial futures [151]. The Board's first decision allowed Morgan Futures Corp., a subsidiary of J.P. Morgan & Co., to act as an FCM for customers by executing and clearing futures contracts in bullion, foreign exchange, U.S. government securities, U.S. government money market instruments, and certain other money market instruments.

The Board's first decision, however, did not signal a general receptiveness to FCM activities. For example, in approving the Morgan application, the Board specifically noted Morgan's century of experience in the cash bullion market. The decision also relied upon the conclusion that Morgan "already trades in futures contracts covering U.S. government securities for its own account, and in the cash and forward markets for U.S. government securities on behalf of its customers", and that Morgan's "experience in these activities has provided it with useful expertise in areas that are operationally or functionally similar to FCM activities for non-affiliated persons in government securities" [152]. In addition, Morgan placed certain voluntary restrictions on its FCM activities to safeguard against unfair competitive practices and unsound banking practices.

In the Board's subsequent approvals of the FCM activities of Bankers Trust's subsidiary, BT Capital Markets Corp., and of similar activities by Citicorp, the Board emphasized the importance of the Morgan decision as a model, stressing the respects in which the subsequent applications paralleled the Morgan application, and that the characteristics of the Morgan operation on which the Board relied in granting Morgan's application were shared by the other applicants.

Shortly after approving Morgan's application, however, the Board concluded that applications of bank holding companies to act as FCMs required consideration on a case-by-case basis. Thus, the Board declined to adopt amendments to its bank holding company regulations to add acting as an FCM to the list of pre-approved permissible bank holding company activities [153].

The Comptroller of the Currency has also approved the application of the North Carolina National Bank to engage in FCM activities through a bank subsidiary. In addition, the National City Bank of Minneapolis has received approval to establish a commodity trading adviser subsidiary [154].

3.5. *Investment advisory services*

The Supreme Court's decision in *Board of Governors v. Investment Company Institute* characterized investment advisory activities as a facet of the traditional fiduciary functions of banks [155]. However, the Court's decision implied that the performance of investment advisory services for an open-end fund (a mutual fund), where a bank has authority to make investment decisions or otherwise to control investments of its advisee open-end investment company, may not be permissible under the Glass-Steagall Act [156].

The *Board of Governors* decision also concluded that investment advisory services, provided in accordance with the restrictions imposed by the Federal Reserve Board's regulations, are closely related to banking and therefore are a permissible activity for bank holding company affiliates under the Bank Holding Company Act [157].

3.6. *Securities activities by U.S. branches of foreign banks*

The International Banking Act of 1978 [158] (the "IBA") permits foreign banks which maintain branches or agencies in the United States to retain ownership or control of certain entities that engage in non-banking activities in the United States, including affiliates (owned or controlled as of July 26, 1978) which engage in the business of underwriting, distributing, or otherwise buying or selling stocks, bonds, and other securities in the United States [159]. Affiliates which do not qualify for this "grandfather" provision, however, are generally subject to the same limitations on their non-banking activities as non-banking affiliates of bank holding companies regulated under the Bank Holding Company Act [160].

3.7. *Savings and loan association securities activities*

3.7.1. *Securities activities conducted directly by S&Ls*

The legislative history of the Glass-Steagall Act contains little reference to savings and loan institutions, reflecting the fact that, at the time of the Act's passage, S&Ls issued share accounts, not deposits, and generally lacked the power, under federal or state law, to engage in the types of activities that gave rise to the conflicts that the Glass-Steagall Act sought to address [161]. However, with the evolution of S&L deposit taking activities and enhancement of other S&L powers, Section 21 of the Glass-Steagall Act, which prohibits "any person, firm, corporation, association, business trust or other similar organization" engaged in enumerated securities activities from also engaging "at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit or other evidence of debt or upon request of depositor" is now applicable to S&Ls.

Other sections of the Glass-Steagall Act refer to national banks and Federal Reserve member banks, however. Therefore, an unresolved question is whether the provisions of Section 16, which permit national banks (and, by reference, state member banks) to purchase and sell securities and stock "without recourse, solely upon the order and for the account of customers" and which has been relied upon, at least in part, as authority for *banks* to conduct discount brokerage activities, may be read as creating an exception to the provisions of Section 21 with respect to S&L activities, such as discount brokerage.

Similarly, most of the securities law exemptions available for banks do not, by their literal terms, refer to S&Ls. Therefore, questions remain as to whether the exemptions from the Securities Act, Exchange Act, Investment Company Act and Investment Advisers Act, available to "banks" and "bank"-sponsored common trust funds and collective funds, are also available to S&Ls and S&L-sponsored funds.

3.7.2. Federal Home Loan Bank Board proposed S&L service corporation regulations

3.7.2.1. Background. One of the most active areas of securities-related activities by savings and loan associations has been in connection with activities conducted – or sought to be conducted – by S&L subsidiaries, known as service corporations. On February 25, 1982, the Federal Home Loan Bank Board (the "FHLBB") issued for comment proposed amendments to its regulations governing permissible activities of savings and loan service corporations [162]. The proposed rules sought to permit service corporations of federally-chartered savings and loan associations to engage in a number of new activities without prior scrutiny and approval by the FHLBB. These newly authorized activities included securities brokerage, organizing and operating mutual funds, and selling mutual fund shares.

3.7.2.2. Application of the Home Owners' Loan Act to S&L service corporation securities activities. The FHLBB asserted that the service corporation statute empowers S&L service corporations to engage in a wide range of activities, including the newly proposed securities activities. According to the General Counsel of the FHLBB:

[I]f Congress had intended to establish some definite standard for the [FHLBB] to apply, we assume that it would have articulated one as it quite clearly did in the Bank Holding Company Act to restrict activities of bank holding company subsidiaries, 12 U.S.C. Section 1843(c) (8), and the Bank Service Corporation Act to limit the bank service corporations [163].

Critics of the FHLBB's proposal, however, argued that S&L service corporations are limited purpose entities, and those purposes do not include engag-

ing in the stock brokerage and mutual fund business [164]. Admittedly, federal savings and loan associations are not expressly authorized to create or operate investment companies or to engage in stock brokerage activities, and the FHLBB's ability to define the powers of S&Ls is limited. Thus, it was argued that the FHLBB may not "by its interpretation of the statute under which it operates increase its power beyond that given by the legislative body" [165].

The legislative history of the S&L service corporation statute indicates that service corporations were to serve specific purposes closely supportive of the basic functions of S&Ls, and that activities of service corporations would be limited to functions "closely related" to the savings and loan business [166]. For example, the S&L service corporations are modelled upon bank service corporations established under the Bank Service Corporation Act [167]. Under that statute, prior to its amendment by the Garn-St. Germain Depository Institutions Act of 1982 [168], bank service corporations could engage only in a limited range of "clerical, bookkeeping, accounting, statistical or similar functions" [169].

3.7.2.3. Application of the Glass-Steagall Act. The FHLBB relied upon footnote 24 in *Board of Governors v. Investment Company Institute* in taking the position that Section 21 of the Glass-Steagall Act – which prohibits certain entities from simultaneously engaging in the securities business and the depository banking business – did not prohibit S&Ls from having service corporations that engage in the activities contemplated by the FHLBB's rule. The FHLBB has asserted that the Supreme Court's decision supports the position "that Section 21 does not prohibit S&L service corporations from engaging in securities activities" [170].

The FHLBB's proposal would have enabled S&Ls to join together to create an S&L service corporation for the purpose of creating and operating an investment company or engaging in stock brokerage – activities arguably prohibited to the S&L directly under Section 21 of the Glass-Steagall Act. Thus, it was urged that the fundamental policies articulated by the Glass-Steagall Act could not be evaded by the nominal separation of prohibited activities in an affiliated service corporation [171]. Opponents of the FHLBB's proposals also argued that Congress, not the FHLBB, should decide whether S&Ls are to be permitted to use service corporations to operate mutual funds, and engage in the stock brokerage business [172].

3.7.2.4. Directive of the Garn-St. Germain Act Conference Report. The FHLBB's effort to facilitate S&L entry into the mutual fund business by S&L's new regulatory authority was halted, however, by Congress with the directive contained in the Conference Report on the Garn-St. Germain Act [173]. The report specifically stated that, by approving certain expanded powers and activities for thrift institutions and by not authorizing the FHLBB

to permit service corporations to engage in any new activities not previously authorized, Congress intended that the FHLBB not approve, in the absence of clear and specific Congressional authorization, any new regulation expanding activities of service corporations other than to permit service corporations to engage in activities permitted for federal thrift institutions [174]. The Conference Report noted that the FHLBB was presently considering proposed regulations that would expand significantly the permitted range of activities for service corporations and that the conferees directed the FHLBB to withdraw and take no further action on the proposed regulations. In response, the FHLBB's service corporation rule-making, whereby S&L service corporations would have been empowered to create, operate, distribute, and advise investment companies, has been withdrawn [175].

3.7.3. *S&L service corporation brokerage joint venture*

However, on May 6, 1982, the FHLBB approved a specific securities brokerage joint venture proposal by a group of federal S&Ls: Coast Federal Savings and Loan Association, California Federal Savings and Loan Association, and Perpetual American Federal Savings and Loan Association [176]. The S&Ls had submitted applications to the FHLBB for permission to establish an S&L service corporation to be called the Savings Association Financial Corporation ("SAFC"). The stock of SAFC would be owned substantially by service corporations owned by each of the three applicant savings and loans (some of the remaining stock would be available for investment by other S&Ls). SAFC would, in turn, own the Savings Association Investment Securities ("SAIS") which proposed to engage in buying and selling stocks, bonds and mutual fund shares for the account of others, providing investment advisory services, including portfolio analysis and valuation, and offering marketing and training to participating S&Ls and providing them with liquidity management advice.

SAIS indicated that it would register with the SEC as a broker-dealer and as a member of the National Association of Securities Dealers, Inc. The applicant S&Ls also indicated that SAIS would function by setting up investment centers in the offices of participating S&Ls. Each center would be separated from the rest of the S&L office by walls, partitions, or plants. At least two individuals would staff each center. S&L branch and assistant branch managers might be registered as broker-dealers and could divide their time between traditional S&L activities and their brokerage duties.

The FHLBB approved the application after concluding that the proposed activities were reasonably related to the activities of federal S&Ls and that the Glass-Steagall Act did not prohibit S&Ls from establishing brokerage firms through subsidiaries. The FHLBB noted that its implementing regulations under the Home Owners' Loan Act required that the activities of S&L service corporations be limited to those reasonably related to the activities of the

parent S&L [177]. The FHLBB then went on to note, however, that the activities in which federal S&Ls may engage have been expanded in recent years, and that, in addition to the powers set out in the statute, the FHLBB had “broad discretion to determine the nature and scope of the incidental powers federal [S&Ls] may exercise in a rapidly changing marketplace and the appropriateness and scope of the ‘reasonably related’ criterion that the [FHLBB] has adopted” [178]. Thus, under this evolving standard, the FHLBB was able to conclude that engaging in brokerage activities was reasonably related to permissible activities of federal S&Ls, and therefore permissible for the S&L service corporations.

The Board also concluded that, while Section 21 of the Glass–Steagall Act may be applicable to S&Ls, the section did not apply to S&L subsidiaries, such as service corporations. The FHLBB again relied on footnote 24 in the Supreme Court’s decision in *Board of Governors*, pointing out that a service corporation is a separate organization which does not receive deposits but is merely related by ownership to a depository institution:

It would not, therefore be subject to the section 21 prohibitions against issuing, underwriting, selling, or distributing securities as interpreted by the Supreme Court in *Board of Governors of the Federal Reserve System v. Investment Company Institute* [179].

The Treasury Department and the Justice Department were critical of the FHLBB’s approval of the S&L service corporation applications to engage in brokerage activities. The Treasury Department, in particular, characterized the approval as “the wrong approach to expansion of securities services by S&Ls and banks” [180]. The Securities Industry Association (the “SIA”) reacted even more strongly and sued the FHLBB over its approval action, alleging that the FHLBB exceeded its statutory authority by permitting S&L service corporations to form a securities brokerage subsidiary [181].

3.7.3.1. Application of the federal securities laws to S&L service corporation brokerage activities. The FHLBB’s approval of the *Coast Federal et al.* service corporation applications was not the final regulatory hurdle for the S&L brokerage joint venture, however. The applicant S&Ls’ brokerage subsidiary, SAIS, also applied to the SEC for a “no-action” letter that the S&Ls participating in the SAIS program would not be required to register as broker-dealers under Section 15(a) (1) of the Exchange Act [182]. SAIS argued that registration was not required because the S&Ls (as opposed to SAIS) would not be engaged in the business of effecting transactions in securities for the account of others; and thus did not fall within the definition of “broker” set forth in Section 3(a) (4) of the Exchange Act [183]. Apparently, since the portfolios of many S&Ls contain low-yielding, illiquid mortgages, had the participating S&Ls been subject to registration as broker-dealers, they would have failed to meet broker-dealers’ net capital requirements [184].

The SAIS position was disputed by the Securities Industry Association. In comments submitted to the SEC, the SIA argued that the participating S&Ls would perform services designed to attract prospective buyers and sellers of securities. The SIA asserted that “in situations involving the ‘channeling’ of business by one person to a particular broker-dealer... the [SEC] staff usually has required that the person register separately as a broker-dealer” [185].

Despite objections by the SIA, the “no-action” letter was approved by the full Securities and Exchange Commission [186]. The letter indicated, however, that the SEC did not necessarily agree with the contention that the participating S&Ls would not be deemed “brokers” under Section 3(a) (4), and concluded that there were “substantial arguments to the contrary given the structural and financial relationship between the participating S&Ls and SAIS”. Nevertheless, because SAIS would be a registered broker-dealer and all participating S&L employees involved in securities activities would be fully subject to SEC and self-regulatory organization requirements, the SEC concluded that investor protection would not be enhanced by requiring the participant S&Ls to register as broker-dealers, and that enforcement action would not be recommended if the S&Ls themselves did not register.

Under different circumstances, therefore, the SEC could well require registration of the savings and loan association on whose premises another firm’s brokerage services were to be provided. In fact, shortly after issuing the SAIS “no-action” letter, the SEC declined to issue a similar letter to Home Federal Savings and Loan Association in connection with Home Federal’s plan to offer brokerage services to be provided by Fidelity Brokerage Services. The SEC contended that Home Federal must also register as a broker-dealer, pointing to, among other factors, the operating relationship between Home Federal and Fidelity and the fact that Home Federal and Fidelity planned to split commissions on securities transactions [187].

Home Federal subsequently revamped its compensation arrangements with Fidelity, so that Home Federal would receive only a fixed monthly fee, and limited the extent to which Home Federal employees could answer questions concerning different types of brokerage accounts. Following these and other changes, the SEC issued a “no-action” letter to Home Federal [188].

4. Legal issues presented by banking-related activities of securities firms

Just as the banking industry has sought to develop new products and services to compete with the financial products and services available from securities industry firms, so have securities industry firms – and other commercial enterprises – sought to acquire banking institutions and provide services resembling bank services. These efforts epitomize the increasingly blurred distinctions between banking and commerce.

4.1. Money market mutual funds

Money market mutual funds ("MMFs") developed by securities industry firms have proved to be attractive investment vehicles. MMFs generally are organized as corporations or business trusts, usually by an existing company engaged in the business of providing investment management services such as a brokerage firm or an investment adviser. Shares sold by a MMF to the public represent equity ownership interests in the fund.

The capital raised from the sale of fund shares is invested by the fund in money market instruments (generally short-term securities which pay attractive market rates of interest) and the return from these investments, net of fund expenses, is distributed to shareholders in the form of dividends. While a typical mutual fund invests its assets in equity securities and distributes its net earnings on a quarterly basis, the typical MMF distributes net earnings in the form of dividends which are declared daily and reinvested in additional shares of the MMF [189].

Although MMFs resemble equity investment companies, they generally provide an expedited means for effecting purchases and redemptions of MMF shares. By wiring funds to a money market fund prior to a specified time, an investor can have his money invested and earning dividends almost immediately. Investors can also remain fully invested until the precise time they require the use of the invested money by effecting redemptions by telephone and having the proceeds wired by the MMF to a predesignated bank account [190].

Another means of redemption generally offered by MMFs is redemption of MMF shares by means of drafts ("check writing"). This feature of MMFs has led critics to question whether MMFs are, impermissibly, engaged in depository banking, by receiving deposits subject to check. Since MMFs obviously are in the business of "issuing... selling [and] distributing" securities, namely the MMF shares, if a MMF were found to be engaged also in "receiving deposits subject to check", the fund would be engaged in a combination of activities prohibited by Section 21 of the Glass-Steagall Act.

Although the MMF draft redemption procedure superficially resembles a checking account, the redemption feature actually operates quite differently. A shareholder generally must expressly indicate that he wishes to avail himself of the draft writing redemption feature in the application form submitted for the purchase of fund shares. Then, if the shareholder wishes to redeem his shares, he writes a draft drawn on the bank account of the fund maintained at the fund's custodian bank (or a bank account established at that bank by the fund for each of its shareholders). When the draft is presented for payment, the transfer agent determines whether the shareholder has a sufficient investment in the fund to cover the draft. If sufficient monies are available, the transfer agent, acting as agent for the redeeming shareholder, effects the redemption of

a sufficient number of the shareholder's shares to generate the money necessary to honor the draft. The bank then makes payment on the draft from cash in the MMF's account with the bank.

In most cases, the fund will have sufficient cash available in its custodial account with its custodian bank so that redemptions through the draft writing privilege are merely an offset against cash available for reinvestment by the fund. However, where there is insufficient cash held by the custodian bank to cover such redemptions, the fund liquidates portfolio securities or takes other steps to meet redemptions [191].

MMFs generally impose certain restrictions or limitations on draft writing. For example, MMFs usually require that the investor meet certain minimum investment requirements in order to initially purchase shares of the fund. In addition, investors are usually limited to a specific minimum amount for which a draft check can be written. Frequently, this minimum is \$500.

The MMF draft writing feature was scrutinized by the Justice Department, which determined that the redemption procedure did not cause a MMF to be engaged in the business of banking. The Department of Justice concluded that:

Availability of particular mechanisms for an investor to transfer his ownership is a mere formality and serves in no way to alter the substance of his status as owner. As between him and the fund, the potential for capital gain or loss on his investment remains unaffected by the means he may select to realize his investment and he is not by his selection of the mechanism of a combined order to sell and pay over (check) to realize his investment, converted into a mere creditor of the fund with no expectation of capital gain or loss from the fund upon realization [192].

This conclusion subsequently was reaffirmed by the Department of Justice [193].

4.2. "Cash management" accounts

4.2.1. Description of "CMA"-type accounts

The "Cash Management Account" ("CMA") offered by Merrill Lynch, Pierce Fenner & Smith, the largest U.S. brokerage firm, was the pioneer of the "cash management" type accounts now offered by many of the major securities brokerage houses. These accounts combine a securities brokerage account, a choice of several money market funds, a checking account with a bank, and a debit card issued by the bank which enables an account holder to have ready access to his funds [194]. Money coming into an account through a deposit, sale of stock, or the payment of the dividend or interest is swept on a daily basis into a money market fund specified by the customer. When the customer purchases securities, writes a check on the account, or uses his debit card, the appropriate amount of money is automatically withdrawn from the money market fund until the customer's MMF account is exhausted. After that point, additional money may be loaned by the bank to the customer using securities

in the customer's brokerage account as security for the loan. To open the Merrill Lynch CMA, a minimum investment of \$20,000 in cash and/or securities currently is required.

4.2.2. Application of the McFadden Act

The nationwide scope of cash management accounts – for example, the firms offering the accounts have offices in many states and a customer may trigger a margin loan from any location – prompted questions whether offering such accounts constitutes an interstate banking impermissible under the McFadden Act.

The McFadden Act permits banks to establish “branches” across state lines only to the extent that state statutes permit their state banks to branch across state lines. Since only five states allow any type of interstate banking, the McFadden Act effectively places severe limitations on the ability of banks to operate on an interstate basis [195].

The term “branch” is statutorily defined to include any branch bank, branch office, branch agency, additional office, or any branch place of business where deposits are received, checks paid out, or money lent [196]. In an interpretative ruling, the Comptroller of the Currency has also specifically addressed the question of what constitutes “lending money”. The ruling excluded from the definition of “lending money”:

origination of loans by employees or agents of the national bank or a subsidiary corporation at locations other than the main office or a branch office...[provided] that the loans are approved and made at main office or a branch of the bank or at an office of the subsidiary location on the premises of or contiguous to the main office or branch of the bank [197].

In connection with the application by Security Pacific National Bank to conduct discount brokerage activities through a new subsidiary corporation, the Comptroller concluded that it was permissible for Security Pacific's new discount brokerage subsidiary to interview and counsel customers on loan rates and terms, aid customers in completing margin loan applications, and then transmit loan applications to an authorized branch office where they would be processed and from which office credit would actually be extended. The Comptroller reasoned that the performance of solicitation and origination activities in connection with the extension of margin credit which then actually took place at an authorized branch office would not constitute lending money within the meaning of the McFadden Act [198].

These precedents would also appear to distinguish cash management-type accounts from impermissible “lending” activities. For example, in the case of the Merrill Lynch CMA, the actual extension of margin credit is done by Bank One, a duly authorized bank located in Ohio. In fact, Merrill submitted its CMA plan to the Federal Reserve Board for scrutiny before the plan was

offered to the public, and the Board advised Merrill Lynch that nothing in existing law or regulations prevented the introduction of that kind of account [199].

4.3. Marketing of bank accounts and certificates of deposit

Securities industry firms also have developed cooperative relationships with banks and S&Ls whereby brokerage firms market debt instruments issued by particular banks and S&Ls to the brokerage firms' wider customer base. The first such arrangement involved "All Savers" certificates, whereby customers of certain major brokerage firms located across the United States could purchase "All Savers" certificates issued by various S&Ls [200]. As the marketing of "All Savers" certificates was the first joint marketing effort, it was also the first to be attacked under state banking laws as an authorized banking activity. In none of the relevant cases, however, has securities firms' marketing of "All Savers" certificates been found to be impermissible [201].

The involvement of brokerage houses in the marketing of "All Savers" certificates proved to be a prelude to even more extensive activity by brokerage firms in creating a retail market for bank certificates of deposit. For example, Merrill Lynch has created a secondary market for certain certificates of deposit and has begun to market CDs issued by certain banks and S&Ls [202]. Other firms have announced an intention to engage in similar activities. As a result, a person interested in purchasing (insured) CDs may do so through his stockbroker. Moreover, since certain firms have indicated their willingness to create a secondary market in CDs, if the customer ever wants to sell the CD the brokerage firm will repurchase the CD at the prevailing secondary market rate.

A new opportunity for securities firms to market a type of bank deposit also appears to be presented by the money market deposit account authorized by the Garn-St. Germain Depository Institutions Act of 1982. Indeed, one securities firm will even handle switching its customers' money from one of its funds into a money market account at a bank. The securities firm handles the transaction and the bank pays it a fee.

In another variation of securities firms' marketing bank deposits, the Federal Home Loan Bank Board recently issued an opinion, in response to a request by Merrill Lynch, that the Federal Savings and Loan Insurance Corporation ("FSLIC"), the FHLBB's insurance arm, would consider a participation in a jumbo certificate of deposit issued by a savings and loan association to be the same as an account at the savings and loan for the purposes of federal deposit insurance [203]. (A similar opinion has also been expressed by the FDIC.) The FHLBB's position thus would enable a brokerage firm to purchase very large face value certificates of deposit and sell interests in the certificates with interests to be covered by deposit insurance.

Under Merrill Lynch's plan, as described in the FHLBB's opinion, CDs would be purchased by a dealer in CDs, who would resell the CDs to a broker-dealer. The broker-dealer, in turn, would sell participation interests in particular CDs to individual investors. After the sale of the participation interests, the broker-dealer would continue to hold the CDs as agent or nominee for the participation holders, and the issuing institution's records would reflect this fact.

However, the Securities and Exchange Commission declined to issue a "no-action" letter to Merrill Lynch that participations in the proposed portfolio of certificates of deposit were not securities requiring registration under the Securities Act, or that the trust which would hold the portfolio of CDs was not an investment company requiring registration under the Investment Company Act of 1940 [204]. The Commission staff found the participations to constitute "securities" under the Investment Company Act, because the participations constituted certificates of interest or participation in a profit-sharing agreement, transferable shares, and investment contracts.

Despite the SEC's refusal to issue a "no-action" letter, Merrill Lynch appears to have taken the steps necessary to proceed with its plan to market participations in CDs. The firm recently announced that it was offering "Six Month Insured CD Participations".

4.4. Acquisitions of "non-bank" banks

Another recent phenomenon in the financial industry has been the acquisition by securities firms or other non-banks of state chartered trust companies and newly restructured "non-bank" banks. Generally, the Bank Holding Company Act requires that any company owning a "bank" must divest itself of its non-banking business and limit its business and that of its affiliates to banking activities and other activities deemed to be closely related to banking [205]. The acquisition of non-banks is premised on the BHCA's definition of a "bank", which provides that a bank is an institution that *both* accepts demand deposits *and* makes commercial loans [206]. Thus, if a depository institution does not make commercial loans, or discontinues its commercial loan business, the depository institution becomes a so-called "non-bank" bank, arguably not subject to the provisions of the Bank Holding Company Act.

One example of a corporation owning both a securities brokerage firm and a "non-bank" bank is American Express, which owns both Shearson/American Express, a major securities brokerage house, and the Boston Safe Deposit and Trust Company [207]. Similarly, the Fidelity Group of securities firms recently created a trust company [208].

In related developments, non-financial companies have also acquired "non-banks", *i.e.* institutions that accept demand deposits but do not make commercial loans. For example, Gulf & Western Corporation acquired Fidelity Na-

tional Bank of Concord, California [209]. Fidelity divested its commercial loan portfolio and ceased its commercial lending activities. It thereby became a "consumer bank" outside the definition of the term "bank" under the BHCA. However, Gulf & Western did have to notify the Comptroller of the Currency before acquiring Fidelity, since Fidelity *did* meet the definition of "bank" set forth in the Change in Bank Control Act [210].

Similarly, Household International, Inc., a major finance company, acquired Valley National Bank in Salinas, California, after Valley spun-off its commercial loan portfolio and ceased to be a BHCA "bank" [211]. Citizens National Bank of Tilden, New Hampshire, also spun-off its commercial loan portfolio to enable it to be acquired by the Parker Pen Company [212]. Chrysler Corporation has also established Automotive Financial Services Company, Inc., a limited purpose state-chartered bank designed to act as Chrysler's bank of initial deposits [213]. In this case, the Federal Reserve Board concluded that the limited purpose bank was not a "bank" under the BHCA, provided that its investment activities were restricted as indicated.

The Federal Reserve Board has attempted to halt the trend of acquisitions of "non-bank" banks, however, using the acquisition of Lincoln State Bank by Dreyfus Corporation as the vehicle to close an apparent loophole in the Bank Holding Company Act. The Board stated that:

Dreyfus' proposed acquisition of Lincoln Bank is the latest example of a recent trend by nonbanking organizations to acquire commercial banks and to transform such banks into so-called "nonbank banks" by divesting the bank's commercial loan portfolio in an effort to avoid the prohibitions of the BHCC Act [214].

The Board's letter noted that the acquisition of "non-bank banks" by non-banking organizations such as Dreyfus was predicated upon an amendment to the definition of "bank" in the BHCA in 1970, which added to the demand deposit test in the BHCA the requirement that the institution also be engaged in the business of making commercial loans. The Board asserted that the legislative history of the BHCA showed that this amendment was designed for a limited and special situation involving a single trust company and that the amendment was to be narrowly applied by the Board [215].

According to the Board, between 1970 and 1981 the exemption remained within the narrow confines intended by Congress, and the Board's apparent acquiescence in other acquisitions of non-bank banks was consistent with this restrictive approach.

The Board asserted that during the past year it had noted the large number of acquisitions of "non-bank banks" by non-banking organizations, and had considered the potential for evasion of the purposes of the BHCA that was present in the combination of such banking and non-banking organizations. In particular, the Board was concerned that the proliferation of such acquisitions

would allow for the expansion of banking across state lines without either state authorization or Congressional approval.

Accordingly, the Board concluded that action was necessary to confine the so-called “non-bank bank” exception to the scope originally intended by Congress. The Board asserted that Dreyfus could not lawfully acquire shares of Lincoln Bank without obtaining the Board’s prior approval. Accordingly, the Board requested that the FDIC advise Dreyfus that Dreyfus’ notice with respect to its proposed acquisition of Lincoln Bank was, as a matter of law, improperly filed under the Change in Bank Control Act, because of the Board’s formal determination that the proposed bank acquisition was subject to the Bank Holding Company Act and that Dreyfus could not consummate its proposed acquisition in reliance on the Change in Bank Control Act. The Board indicated further, that if Dreyfus attempted to proceed with the acquisition, the Board would issue an order blocking the transaction. However, the FDIC elected to approve the acquisition under the Change in Bank Control Act, and Dreyfus consummated the acquisition, leaving the next move up to the Board, which has yet to take further action to attempt to block Dreyfus.

4.5. Creation of a bank by a securities firm

4.5.1. Dreyfus National Bank

Perhaps the most aggressive effort by a securities firm to engage in banking activities is the recent application by the Dreyfus Corporation, to the Comptroller of the Currency, for permission to form its own national bank, Dreyfus National Bank and Trust Company [216].

Dreyfus recognized that the ownership of a national bank by a major securities firm would present problems under the Glass–Steagall Act and, in its application to the Comptroller, Dreyfus argued that Sections 20 and 32 of the Act were inapplicable, because the income derived by Dreyfus from activities covered by Sections 20 and 32 was minuscule [217]. Dreyfus also contended that, under the *Board of Governors* decision, the prohibitions imposed by Section 21 of the Glass–Steagall Act were applicable *only* to a single corporation which engages *both* in commercial banking and investment banking [218].

Dreyfus attempted to avoid the reach of Sections 20 and 32 by arguing that only a minor portion of its income was derived from the types of activities covered by these sections. Dreyfus used Federal Reserve Board Staff Opinions as a measure of the percentage of income that constitutes being “principally” and “primarily” involved in activities subject to Sections 20 and 32. According to these Staff Opinions, a securities firm that receives 10% of its gross income from activities described in Section 32 is generally deemed to be “primarily engaged” within the meaning of that section [219], and the term “principally engaged” for the purposes of Section 20 is deemed to be satisfied if 25% of a firm’s total revenue is derived from the activities described in that section [220].

The Federal Reserve Board reacted adversely to Dreyfus' effort to gain a national bank charter. In a letter to the Comptroller of the Currency, the Board opposed the Dreyfus application, asserting that the proposed Dreyfus Bank would violate the Glass-Steagall Act [221]. In the Board's view, the creation of Dreyfus National Bank would be in direct contravention of Section 20 as interpreted by the Board, since Dreyfus National Bank would clearly be a member bank, and from the information available, it was evident that Dreyfus had established the mutual funds it manages, that it directs such funds' operations, and that Dreyfus exercises a pervasive and dominant influence over the funds and thus controls them for purposes of Section 20.

The Board also asserted that, since a mutual fund is "primarily engaged in the issue" of securities for purposes of Section 32 of the Act, a director, officer, or employee of a member bank may not serve in a similar capacity with a mutual fund [222]. Moreover, the Board noted that it had ruled that Section 32 prohibits a management interlock between a member bank and an investment advisory firm that manages a mutual fund (like Dreyfus), even if the advisory company itself is not engaged in any securities activity [223]. Based on the close functional and structural relationship between the advisory company and the mutual fund being managed, the Board found that the advisory company and the fund constituted a single entity for purposes of Section 32 [224]. Thus, according to the Board, if Dreyfus established any management interlocks between Dreyfus National Bank and itself, or any of the Dreyfus-managed mutual funds, such interlock also would violate Section 32.

The Comptroller of the Currency rejected the Board's arguments that the Dreyfus National Bank would violate either the Bank Holding Company Act or the Glass-Steagall Act, however, and approved the charter for the Dreyfus National Bank & Trust Company [225]. The Comptroller concluded that the Bank Holding Company Act posed no impediment to the Dreyfus National Bank because the bank would neither accept demand deposits *nor* make commercial loans – the two criteria which make a financial institution a "bank" for the purposes of the BHCA. The Comptroller rejected the expanded definition of commercial loan activities which the Federal Reserve Board had advanced, and cited previous opinions of the Board which the Comptroller claimed to be inconsistent with the Board's new, expanded definition of a commercial loan. The Comptroller's decision also reviewed the legislative history of the BHCA and found no support in the language or purpose of the BHCA for the Board's attempted new interpretation of the activities that constituted commercial lending.

The Comptroller also concluded that the creation and operation of the Dreyfus National Bank was not prohibited by the Glass-Steagall Act. The Comptroller asserted that the relationship between Dreyfus and Dreyfus National Bank would not constitute an impermissible affiliation between a bank and an entity which is "engaged principally in the issue, flotation,

underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities..." under Section 20 of the Act because, under the Comptroller's "single entity" theory, the consolidated Dreyfus entity derived less than 1% of its total revenues from Section 20 activities. Under the Comptroller's "single entity" theory, Dreyfus Corp. and its subsidiaries, which distribute and advise the Dreyfus family of mutual funds, as well as other funds, were treated as a single entity, essentially because the subsidiaries' activities are performed on behalf of Dreyfus Corp. The Comptroller declined to include Dreyfus-advised *funds* in the "single entity", however, thereby rejecting the more inclusive "single entity" analysis advanced by the Board.

In particular, the Comptroller looked to the independent director requirements imposed by the Investment Company Act on mutual fund boards of directors, and concluded that Dreyfus' mutual fund advisory activities did not result in Dreyfus controlling the mutual funds it advised. The Comptroller's analysis, and his reference to and reliance upon Investment Company Act standards to limit the scope of the pertinent "single entity", followed the reasoning first articulated only days before in the Comptroller's decision in connection with approval of the national bank charter for J&W Seligman Trust Company, N.A., a non-bank bank created by an investment adviser to a family of mutual funds [226]. Finding that an investment adviser did not control the funds it advises, the Comptroller therefore did not include Dreyfus-advised funds in the Dreyfus "single entity" – an approach which would have produced a Glass–Steagall problem, since the Dreyfus National Bank would then have been impermissibly affiliated with an entity "principally engaged" in Section 20 activities.

4.6. The Comptroller's "moratorium" on new non-bank banks

The Comptroller's decisions in the cases of J&W Seligman Trust Co. and Dreyfus National Bank brought the Comptroller's office squarely into conflict with the Federal Reserve Board on two issues critical to the extent to which non-banking entities, particularly securities industry firms, may conduct a banking business. First, the two agencies disagreed on the meaning of a "commercial loan" for the purposes of the Bank Holding Company Act; second, the agencies also disagreed on the question of what entity controls a mutual fund for Glass–Steagall Act purposes [227].

Following the Comptroller's grant of a national bank charter to J&W Seligman Trust Co. – over the objections of the Federal Reserve Board – the New York Federal Reserve Bank signaled to Seligman that the Federal Reserve Board did not intend to give up on its opposition to the Seligman Trust Co. The Federal Reserve Bank pointed out the requirement that national banks, such as the Seligman Trust Co., purchase Federal Reserve stock from

their appropriate Federal Reserve Bank – in this case the New York Federal Reserve Bank – in order to operate, and then informed Seligman that if Seligman purchased such stock, it could be liable for damages up to \$1,000 per day it remained in business, since its business, in the Federal Reserve Bank's view, would constitute a violation of Section 20 of the Glass-Steagall Act [228].

The Comptroller promptly wrote to Seligman and told the firm to ignore the Federal Reserve Bank. The Comptroller stated that its decision to grant a national bank charter to Seligman "is entitled to great weight and isn't subject to review by another agency after the fact". "Irrespective of the Federal Reserve's threat", wrote the Comptroller, the new bank had the "complete support of the Office of the Comptroller to the Currency [229]". Shortly after the Comptroller wrote to Seligman, Seligman proceeded to purchase the Federal Reserve stock it needed to begin operations and opened for business [230]. Before the Federal Reserve Board reacted, however, the Comptroller was able to effect a truce with the Federal Reserve Board by declaring a moratorium, through 1983, on *new* non-bank banks.

The Comptroller's moratorium on new national bank charters for non-bank banks is scheduled to last through 1983. In announcing the moratorium, effectively a temporary truce with the Federal Reserve Board, the Comptroller indicated that the freeze on non-bank banks was intended to "help foster free and open debate" on financial industry restructuring, and "reduce the pressure of escalating marketplace innovation at the national level that could outpace Congressional deliberation" [231]. To date, however, neither the Federal Deposit Insurance Corporation nor the Federal Home Loan Bank Board have indicated that they will adopt a freeze on acquisitions or new charters for depository institutions subject to their respective jurisdictions, where the depository institution would be owned, by a non-banking or non-thrift firm, respectively.

Thus, the main benefit of the Comptroller's moratorium is expected to be a resumption of negotiations between the Federal Reserve Board and the Comptroller concerning amendments to the Bank Holding Company Act's definition of "bank", with a view toward closing non-bank bank loophole [232].

5. Conclusion

In this article we have reviewed the developments in the financial services industry which have arisen in connection with efforts of banking institutions to enter the securities field and, conversely, efforts by securities firms to offer various banking and near-banking services. At times, existing legislation has seemed inconsistent with these efforts, and courts, regulatory agencies, and participants in the financial services industry have struggled to come to grips

with the rapid pace of these changes, many of which run counter to the historical premises and statutory framework within which the American financial industry has operated.

At present, we are witnessing pressures for the restructuring of both the financial services industry *and* the regulatory framework within which that business is conducted. Sometimes this pressure is relieved by new regulatory approaches or court decisions, sometimes with the aid of sympathetic regulators (without the attendant necessity of obtaining legislative change). As Securities and Exchange Commission Chairman John Shad recently put it: “the financial services industries have outgrown their suits of regulatory armor. They are bursting at the seams” [233].

Notes

[1] Banking Act of 1933, ch. 89, 48 Stat. 184 (1933), codified at various sections of 12 U.S.C., including 12 U.S.C. §§24, 78, 335, 377, 378.

[2] Speech by Securities and Exchange Commissioner Longstreth, "Current Issues Facing the Securities Industry and the SEC", May 4, 1982 (address to Securities Industry Association Conference).

[3] 13 Stat. L. Ch. CVI, §8 (1864).

[4] See, e.g., Department of the Treasury, Public Policy Aspects of Bank Securities Activities: An Issues Paper (1975).

[5] See Hearings Pursuant to S. Res. No. 71, Before a Subcommittee of the Senate Committee on Banking and Currency, 71st Cong., 3rd Sess., Part 1 (1931).

[6] *Id.*

[7] 12 U.S.C. §24 (Seventh).

[8] 12 U.S.C. §335.

[9] 12 U.S.C. §378a.

[10] 12 U.S.C. §377.

[11] 12 U.S.C. §78.

[12] Pub. L. No. 43-6, §11(k), 38 Stat. 251 (1913) (the current version is codified at 12 U.S.C. Sec. 92(a)).

[13] 1 Fed. Res. Bull. 43 (1915).

[14] See, e.g., Marni, *Common Trust Funds – Development of Federal Regulation*, 83 Banking L.J. 565 (1966).

[15] *Brooklyn Trust Co. v. Commissioner of Internal Revenue*, 80 F.2d 865 (2nd Cir.), cert. denied, 298 U.S. 659 (1936).

[16] Ch. 690, §169, 49 Stat. 1708 (1936), now codified at U.S.C. §584.

[17] 2 Fed. Reg. 2976 (1937).

[18] 2 Fed. Reg. 3440–3441 (1937). See also 24 Fed. Res. Bull. 4 (1938).

[19] 26 Fed. Res. Bull. 393 (1940).

[20] 10 Fed. Reg. 8953 (1945), 12 C.F.R. §206.17(a) (3).

[21] See Common Trust Fund Publicity, 92 Trusts and Estates, at 319–320 (May, 1953). In a February 1953 interpretation, the Board again stated its views concerning the merchandising of investment funds, emphasizing that "the common trust fund is not to be regarded as an investment entity to be popularized in and of itself". 41 Fed. Res. Bull. 142 (1953). The Board stated that any publicity by banks concerning their common trust fund services "should be directed toward demonstrating the desirability of and need for corporate fiduciary services". *Id.*

[22] Pub. L. No. 87-722, 76 Stat. 668.

[23] See 12 C.F.R. §§9.18(b)(5) (iv) and (b)(5)(v).

[24] 15 U.S.C. §§80a–1 et seq.

[25] 15 U.S.C. §77a et seq.

[26] See, e.g., Hacker & Rotunda, *The SEC's Ectoplasmic Theory of an Issuer Applied to Educational and Charitable Institutions, Bank Trustees, and Other Exempt Issuers*, 65 Calif. L. Rev. 1181 (1977); see also *Prudential Insurance Company of America v. SEC*, 326 F.2d 383 (1st Cir., 1964), cert. denied, 377 U.S. 953.

[27] 15 U.S.C. §77c(2) (2).

[28] 15 U.S.C. §80a–3(c) (3).

[29] *Hearings on Common Trust Funds – Overlapping Responsibility and Conflict in Regulation*, Before a Subcommittee of the House Committee on Government Operations, 88th Cong., 1st Sess. 4 (Statement of SEC Chairman Cary), cited in *United Missouri Bank of Kansas City, N.A.* (avail. Dec. 1, 1981).

[30] See, e.g., *United Missouri Bank of Kansas City, N.A.*, supra note 29; *Mechanics Bank* (avail.

Jan. 5, 1981); *William C. Connelly* (avail. May 1, 1980); *The Howard Savings Bank* (avail. Aug 13, 1979); *Genesee Merchants Bank & Trust* (avail. June 19, 1976); *BanCal Capital Management Corp.* (avail. Dec. 4, 1974); *Bank of Delaware* (avail. Jan 7, 1973); *Madison Bank & Trust Co.* (avail. May 27, 1972). Thus, the promotion or advertising of a common trust fund will jeopardize the availability of the exemptions. See e.g., *BanCal Capital Management Corp.*, *supra*; *First City Bancorp. of Texas* (avail. Feb 3, 1978); *Texas Commerce Bank* (avail. Jan. 26, 1978).

[31] See, e.g., *The Howard Savings Bank*, *supra* note 30; *Genesee Merchants Bank & Trust*, *supra* note 30; *Madison Bank & Trust*, *supra* note 30.

[32] *Id.*

[33] See, e.g., *Genesee Merchants Bank and Trust*, *supra* note 30.

[34] 20 Fed. Reg. 3305 (1955), 12 C.F.R. §206.10(c).

[35] Pub. L. No. 87-722, 76 Stat. 668 (1962).

[36] 12 C.F.R. §9.18.

[37] 401 U.S. 617 (1971).

[38] 12 C.F.R. §9.18(a) (1).

[39] 12 C.F.R. §9.18(a) (2).

[40] See, e.g., Wade, *Bank-Sponsored Collective Investment Funds: An Analysis of Applicable Federal Banking and Securities Laws*, 35 Bus. Law. 361 (1980).

[41] Pub. L. No. 91-547, 84 Stat. 1413.

[42] *Id.*

[43] See, e.g., *Nat'l. Bank of Fairfax* (avail. Dec. 29, 1976); *Mechanics Nat'l Bank of Worcester* (reconsideration avail. July. 21, 1975); *Texarkana Nat'l Bank* (avail. Apr. 11, 1975); *First Nat'l Bank of Brunswick* (avail. May 19, 1971).

[44] See, e.g., *Millikin Nat'l Bank of Decatur* (avail. Mar. 31, 1979); *Gary-Wheaton Bank* (avail. Dec. 1, 1975).

[45] But see Securities Act Release No. 5450, 1 CCH Fed. Sec. L. Rep. ¶2340, (January 7, 1974) where the SEC indicated that the staff would consider requests for "no-action" positions on the availability of the intrastate offering exemption "only on an infrequent basis and in the most compelling circumstances".

[46] See *United Missouri Bank of Kansas City, N.A.* (Avail. Dec. 1, 1981); *Owensboro National Bank* (avail. July 19, 1981); *Citytrust* (avail. March 9, 1980); *Continental Illinois National Bank and Trust Co. of Chicago* (avail. April 28, 1975), (reconsideration denied, avail Jan. 19, 1976). But see *Fiduciary Trust Company of New York* (avail. Nov. 9, 1981) (particular type of IRA authorized under §401 rather than §408).

[47] *Decision of the Comptroller of the Currency on the Application by Citibank, N.A.*, [Current] Fed. Banking L. Rep. (CCH) ¶99,339 (October 21, 1982).

[48] Registration was necessary because IRAs are tax-exempt under Section 401 rather than Section 408 of the Internal Revenue Code, and thus do not qualify for the ICA and Securities Act exemptions discussed above.

[49] 401 U.S. 617 (1971).

[50] 401 U.S. at 624.

[50a] *Decision of the Comptroller of the Currency on the Application by Citibank, N.A.*, *supra* note 47.

[50b] See *Investment Company Institute v. Conover* (D.D.C. No. 83-0549, Complaint filed February 24, 1983).

[51] 12 C.F.R. §218.101.

[52] 450 U.S. 46 (1981).

[53] 450 U.S. at 58-59, n. 24.

[54] See, e.g., *Whitney National Bank v. Bank of New Orleans & Trust Co.*, 323 F.2d 290 (D.C. Cir., 1963), *rev'd on other grounds*, 379 U.S. 411 (1965); *Casanova Guns, Inc. v. Connally*, 454 F.2d 1320 (7th Cir.), *cert. denied* 409 U.S. 845 (1972); *P.F. Collier & Son Corp. v. FTC*, 427 F.2d 261 (6th Cir., 1970); *Valley Finance Inc. v. U.S.*, 629 F.2d 162 (D.C. Cir., 1980); *Allied industrial*

Cartage Co. v. C.I.R., 647 F.2d 73 (C.A. 6, 1981); *Kersh et al. v. General Council of the Assemblies of God*, No. C-81-2734 (N.D. Calif. Mar. 11, 1982); see also 12 C.F.R. §218.108, 218.111, 218.113 and 218.114.

[55] See, e.g., *Investment Company Institute Asks FDIC to Halt Bank's Mutual Fund*, 14 Sec. Reg. & L. Rep. 656 (April 16, 1982); *Bank's Entry Into Mutual Fund Field Opposed*, Legal Times, April 19, 1982, at 4; *Bid By Boston Savings Bank to Run Funds Under Attack From ICI*, Securities Week, April 19, 1982, at 4; *SEC 'Freezes' Ranking Bids for Money Funds*, American Banker, July 8, 1982 at 1. Mr. Pitt is counsel to entities interested in issues presented by these actions.

[56] FDIC News Release PR-72-82, 47 Fed. Reg. 38,984 (Sept. 1, 1982). See *FDIC Approves, Delays GlassSteagall Statement*, Legal Times, August 30, 1982, at 1.

[57] See note 55, *supra*.

[58] 15 U.S.C. §77h(a).

[59] See Letter from George Fitzsimmons, Secretary, Securities and Exchange Commission, to Hon. William M. Isaac, Chairman, Federal Deposit Insurance Corporation, July 16, 1982.

[60] *Id.*

[61] *Id.*; see also, e.g., *SEC 'Freezes' Banking Bids for Money Funds*, American Banker, July 8, 1982 at 1; *Securities Activities Cleared*, Legal Times, September 6, 1982, at 9; *FDIC to Consider SEC Request for Glass-Steagall Advice*, Securities Week, August 23, 1982, at 5.

[62] See, e.g., *SEC Reconsiders Delay on Bank-Related Money Funds; Original Decision Had Angered Confused Registrants*, American Banker, September 1, 1982, at 1; *SEC Lifts Freeze on Filings for Bank-Tied Money Funds*, American Banker, September 2, 1982, at 1.

[63] *Id.*

[64] 15 U.S.C. §80a-17.

[65] 15 U.S.C. §80a-6(c).

[66] 15 U.S.C. §80a-12(d) (3).

[67] 15 U.S.C. §80a-17(d).

[68] See, e.g., Testimony of Hon. John S. R. Shad, *Financial Institutions Restructuring and Services Act of 1981, Hearings Before the Senate Committee on Banking, Housing and Urban Affairs*, Part II, 97th Cong., 1st Sess. 884 (1981).

[69] 15 U.S.C. §80a-34(d).

[70] 12 U.S.C. §§3501 et seq.

[71] 12 C.F.R. §§217.3, 217.7.

[72] P.L. 97-320 (1982).

[73] 12 U.S.C. §3503(c).

[74] 47 Fed. Reg. 56,320 (Dec. 16, 1982).

[75] 12 U.S.C. §1818.

[76] See e.g., *Independent Bankers Association v. Heimann*, 613 F.2d 1164, 1168-1169 (D.C. Cir. 1979); *Gulf Federal Savings and Loan Association v. Federal Home Loan Bank Board*, 651 F.2d 259, 264 (5th Cir., 1981); *First National Bank of Lamarque v. Smith*, 610 F.2d 1258, 1265 (5th Cir., 1980); *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610, 611, n. 2 (8th Cir., 1978).

[77] 47 Fed. Reg. 42121 (Sept. 24, 1982).

[78] 4 U.S.C. §57a.

[79] See 41 Fed. Reg. 44361-62 (Oct. 8, 1976); 12 C.F.R. §§227.1, 227.2.

[80] 12 C.F.R. §333.2.

[81] See 15 Fed. Reg. 7730 (Nov. 14, 1950).

[82] See e.g., *Checking Accounts With Money Funds*, New York Times, May 23, 1982, at 15; *The Banker's Dilemma; To Sweep or Not to Sweep*, American Banker, June 9, 1982, at 4; *Banks Linking with 3rd Parties for Money Funds*, American Banker, June 14, 1982 at 1; *Chase Introduces Sweep Account With Choice of Money Market Funds*, Washington Financial Reports, May 10, 1982, at A-19.

- [83] See, e.g., *Marine Midland Unveils Two Funds*, American Banker, June 11, 1982, at 1; *Crocker Creates Own Version of Money Fund*, American Banker, April 23, 1982, at 3; *Crocker National Bank To Offer Money Market Fund*, Washington Financial Reports, May 3, 1982 at A-14; *Crocker Markets One-Stop Financial Shopping, Taking Aim at Merrill*, Securities Week, May 3, 1982, at 3; *Detroit Bank Sets Agency Client Money Fund*, American Banker, May 13, 1982, at 3; *Lehman Sponsors Private Label MMFS for Marine Midland*, Wall Street Letter, June 21, 1982, at 3; *Union Planters Offers Checking Account with Money Market Rates*, American Banker, July 6, 1982, at 2.
- [84] See, e.g., *SEC Approves 2 Bank Money Funds*, American Banker, March 8, 1982, at 1; *SEC Okays Mastercard Funds, But Stalls VISA Bid*, Securities Week, March 8, 1982, at 2.
- [85] 404 F.Supp. 1091 (D.D.C. 1975), *vacated and remanded sub nom. New York Stock Exchange v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977).
- [86] See e.g., *Banking Organizations and Money Market Funds – Relationships and Issues*, Banking Expansion Reporter, May 3, 1982, at 1; *Money Market Fund Adviser Qualifies for Intrastate Registration Exemption*, 14 Sec. Reg. & L. Rep., May 7, 1982, at 806; *Banks Linking With 3d Parties for Money Funds*, American Banker, June 14, 1982, at 1.
- [87] See, e.g., *SEC Approves 2 Bank Money Funds*, American Banker; *SEC Okays Mastercard Fund, But Stalls VISA Bid*, Securities Week, March 8, 1982, at 2; *VISA Launches All-or-Nothing Drive for Fund*, American Banker, May 13, 1982 at 3.
- [88] See e.g., Letter from Matthew P. Fink, General Counsel, Investment Company Institute, to Joel H. Goldberg, Director, Division of Investment Management, January 5, 1982.
- [89] See Securities Act Release No. 6415 (July 9, 1982).
- [90] 15 U.S.C. §80a-35(a).
- [91] 15 U.S.C. §80a-2(a) (40).
- [92] 15 U.S.C. §80a-12(d) (3).
- [93] 17 C.F.R. §240.12b-1.
- [94] 12 U.S.C. §24.
- [95] *Baker, Watts & Co., v. Saxon* 392 F.2d 497 (D.C. Cir. 1968).
- [95a] 12 U.S.C. §1843(c) (8).
- [96] See *United Oklahoma Bancshares Inc.*, 65 Fed. Res. Bull. 363 (1979); *United Bancorp.*, 64 Fed. Res. Bull. 222 (1978); *Stepp, Inc.*, 64 Fed. Res. Bull. 223 (1978).
- [97] See Federal Reserve Board Staff Study, *Commercial Bank Private Placement Activities 27 (1977) (Private Placement Study)*.
- [98] *Id.* at 91 n.10.
- [99] *First Arabian Corporation*, 63, Fed. Res. Bull. 66 (1977).
- [100] *Private Placement Study supra* note 97, at 81.
- [101] *Id.* at 87–89.
- [102] *Id.* at 89.
- [103] *Id.* at 90. See also Miller, *The Participation of National Banks in Private Placements of Corporate Securities*, 13 New England L. Rev. 63 (1977); Note, *Commercial Bank Private Placement Activity: Cracking Glass–Steagall*, 27 Cath. U. L. Rev. 743 (1978).
- [104] [1978–1979 Decisions] CCH Fed. Banking L. Rep. ¶85,107.
- [105] See Letter from the Comptroller of Currency, Letter No. 212, July 2, 1981 [1981 Decisions] CCH Fed. Banking L. Rep. ¶85, 293.
- [106] *A.G. Becker Incorporated v. Board of Governors of the Federal Reserve System*, 519 F.Supp. 602 (D.D.C. 1981).
- [107] *Id.*
- [108] *A.G. Becker Incorporated v. Board of Governors of the Federal Reserve System*, 693 F.2d 136 (D.C. Cir. 1982) *petition for a writ of certiorari pending*.
- [109] See e.g., *Securities and Exchange Commission v. Miller*, 495 F. Supp. 465 (S.D.N.Y. 1980) (economic reality of a repurchase transaction is that of a collateralized or secured borrowing);

Union Planter National Bank of Memphis v. United States F.2d 115 (6th Cir., 1970) (no "sale" took place in a repurchase transaction).

[110] See Securities Act Release No. 6351 (Sept. 25, 1981).

[111] 15 U.S.C. §§77c(a) (2) and 77c(a) (3).

[112] 15 U.S.C. §77ddd(a) (4) (A).

[113] See *Investment Company Institute v. Camp*, *supra* note 37.

[114] Securities Act Release No. 6351 (Sept. 25, 1981).

[115] See Securities Exchange Act Release No. 18927 (July 30, 1982).

[116] See Retail Repurchase Agreements, Comptroller of the Currency Banking circular No. 157 (May 13, 1981); Federal Home Loan Bank Board, Office of Examinations and Supervision, Memorandum No. R 51 (May 8, 1981). The FHLBB's Memorandum was substantially revised and reissued four months later. See Federal Home Loan Bank Board, Memorandum R 51a (September 9, 1981). Thereafter, in October, 1981, the FDIC issued its Policy Statement concerning retail repos. See Federal Deposit Insurance Corporation, Statement of Policy on Retail Repurchase Agreements (October 6, 1981).

[117] See Comptroller of the Currency, Banking Circular No. 157.

[118] 47 Fed. Reg. 23140 (May 27, 1982) (FHLBB); FDIC Release, August 16, 1982; 47 Fed. Reg. 37879 (Aug. 27, 1982) (FRB).

[119] See, e.g., *Proposed FDIC Rule would Grant New Powers to Banks*, Legal Times, August 16, 1982, at 1; *Fed. Liberalizes Regulations D, Q, To Help Banks Compete With MMF's*, Washington Financial Reports, August 30, 1982, at 367.

[120] Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982); 12 U.S.C. §3503(c) (1).

[121] 12 C.F.R. §§1204, 1220.

[122] 47 Fed. Reg. 56320 (Dec. 16, 1982).

[123] See, e.g., Study Outline and Hearings on Securities Activities of Commercial Banks, Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., 99 (1975) at 193. See also Securities and Exchange Commission Initial Report on Bank Securities Activities, reprinted in Reports on Banks Securities Activities of the Securities and Exchange Commission, Senate Committee on Banking, Housing and Urban Affairs, (95th Cong., 1st Sess. at 23-42 (Banks Securities Activities Reports)).

[124] See Frankel, 1 The Regulation of Money Managers 80, 81 (1978).

[125] See, e.g., *New York Stock Exchange v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977); *New York Stock Exchange v. Smith*, 404 F. Supp. 1091 (D.D.C. 1975).

[126] See, e.g., *SIA Says BankAmerica's Purchase of Schwab not Shown to be Closely Related to Banking*, 14 Sec. Reg. & L. Rep., June 4, 1982, at 1009-1010.

[127] See, e.g., *Comptroller Approves L.A. Bank's Plan to Offer Discount Brokerage*, Washington Financial Reports, August 30, 1982, at 378.

[128] See, e.g., *Union Planters Wants to Buy Discount Brokerage in Memphis*, American Banker, March 5, 1982 at 1.

[129] See, e.g., *Fidelity Group Unit Speeds Banks' Entry into Discount Stock Brokerage*, Wall Street Journal, June 16, 1982, at 12; *Federated Forms Discount Brokerage Unit to Serve Banks*, American Banker, May 24, 1982, at 3; *California S&L Holding Company to Form Securities Brokerage Unit*, American Banker, Sept. 9, 1982, at 1.

[130] 12 U.S.C. §24 (Seventh).

[131] *Hearings on H.R. 5357 Before The House Committee on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935).

[132] *Hearings on H.R. 7852 and 8720 Before the House Committee On Interstate and Foreign Commerce*, 73rd Cong., 2nd Sess. 86 (1934).

[133] See 1 Bulletin of the Comptroller of the Currency, No. 2 (October 26, 1936) at 2-3.

[134] Comptroller of the Currency, Digest of Opinions, ¶220 (1948).

- [135] See, Comptroller of the Currency, Digest of Opinions, ¶220A (1957).
- [136] See, e.g., Bank Automatic Investment Services [1973–1974 Decisions] CCH Fed. Sec. L. Rep. ¶79,817.
- [137] Letter from Comptroller James E. Smith to G. Duane Vieth, June 10, 1974.
- [138] *Id.*
- [139] See e.g., Luse and Olsen, *Glass–Steagall does not bar banks as brokers*, Legal Times, May 10, 1982, at 18.
- [140] 329 U.S. at 445 n.3.
- [141] 450 U.S. at 63 (emphasis supplied).
- [142] 329 U.S. at 447–449.
- [143] Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary to be known as Security Pacific Discount Brokerage Services, Inc., August 26, 1982.
- [144] 516 F.2d 1229 (D.C. Cir. 1975).
- [145] *Id.*
- [146] 12 U.S.C. §1843(c) (8).
- [147] *Bank America Corp.*, 69 Fed. Res. Bull. (January 7, 1983).
- [147a] See *Securities Industry Association v. Board of Governors of the Federal Reserve System* (C.A. 2, No. 83-4019, Petition filed March 16, 1983).
- [148] See 15 U.S.C. §78o-4.
- [149] See 3 CCH Fed. Sec. L. Rep. ¶25,944.
- [150] See *Industrial Development Bonds*, Owen Carney, *Comptroller of the Currency Office* (avail. July 11, 1982); see also *Comptroller's Office Advised on Bank Participation in IDB Private Placement*, Washington Financial Reports, July 26, 1982, at 149–150.
- [151] See *J.P. Morgan & Co.*, 68 Fed. Res. Bull. 514 (1982); *Bankers Trust Company*, 68 Fed. Res. Bull. 651 (1982); *Citicorp*, 68 Fed. Res. Bull. 776 (1982).
- [152] See *J.P. Morgan & Co.*, *supra* note 151.
- [153] 47 Fed. Reg. 30872 (July 15, 1982).
- [154] See *Futures Commission Merchant Decision is Limited*, Banking Expansion Reporter, July 19, 1982, at 3.
- [155] 450 U.S. at 55.
- [156] 450 U.S. at 52 n.11.
- [157] 12 C.F.R. §224.125.
- [158] P.L. No. 95-369 (1978).
- [159] 12 U.S.C. §3106.
- [160] *Id.*
- [161] See, e.g., Legal Opinion by Thomas P. Vartanian, General Counsel, Federal Home Loan Bank Board, May 6, 1982.
- [162] See 47 Fed. Reg. 9855 (March 8, 1982).
- [163] Letter from Thomas P. Vartanian, General Counsel, Federal Home Loan Bank Board, to Rep. John E. Dingell, May 26, 1982 (*reprinted in Vartanian's Argument for Service Corporation Regs.*, Legal Times, June 7, 1982, at 27-28).
- [164] See, e.g., Comments of the Investment Company Institute submitted to the FHLBB, May 3, 1982.
- [165] *Id.*
- [166] See *House Committee on Banking and Currency, Housing Act of 1964*, H.R. Rep. No. 1703, 98th Cong., 2nd Sess. (1964).
- [167] 12 U.S.C. §§1861-1865.
- [168] Pub. L. No. 97-320, 96 Stat. 1469 (1982).
- [169] 12 U.S.C. Section 1861(b). See *Senate Committee on Banking and Currency, Bank Service Corporation Act*, S. Rep. No. 2015, 87th Cong., 2nd Sess. (1962); see also *Senate Committee on*

Banking and Currency, Housing Act of 1964, S. Rep. No. 1265, 88th Cong., 2nd Sess. at 55 (1964).

[170] See Letter from Thomas P. Vartanian to Rep. John D. Dingell, *supra*:

First, in that case, the Supreme Court stated that section 21 applies only to banks and not to bank holding companies [citations omitted]. Secondly, the Supreme Court also took a narrow view of the scope of section 21... Because federal S&L service corporations "do not receive deposits," and because they must be maintained as "separate organizations" (i.e., legally distinct corporations) from their parent S&L's by regulation, 12 C.F.R. §§563.37, 570.10, it would appear that language of section 21 should not be read to apply to such corporations, notwithstanding the fact that they are "related by ownership with [an S&L] which does receive deposits."

[171] See Comments of the Investment Company Institute, *supra* note 164. Amendments made to the service corporation provisions by the Depository Institutions Deregulation Act in 1980 increased from 1 to 3% of an S&L's assets the amount of funds that an S&L was permitted to invest in a service corporation, and authorized S&L's to invest in share of mutual funds.

[172] See, e.g., Letter from Rep. John D. Dingell to Hon. Richard T. Pratt, Chairman, FHLBB, February 22, 1982: "What you propose to do is patently illegal under both the Glass-Steagall Act [citation omitted], and the various statutes creating and defining the role of federal S&Ls."

[173] See H.R. Conf. Rep. No. 899, 97th Cong., 2nd Sess. (1982).

[174] *Id.*

[175] 47 Fed. Reg. 49663 (Nov. 2, 1982).

[176] See Legal Opinion by Thomas P. Vartanian, General Counsel, FHLBB, May 6, 1982 (Vartanian Opinion).

[177] *Id.*

[178] *Id.*

[179] *Id.*

[180] See Statement by R.T. McNamar, Deputy Secretary of the Treasury, May 7, 1982.

[181] See *Securities Industry Association v. FHLBB* (D.D.C., No. 82-1920, Complaint filed July 12, 1982).

[182] 15 U.S.C. §78o(a) (1).

[183] See Letter from SAIS Counsel to SEC Staff, January 12, 1982.

[184] See *S&L's Fear SEC Registration could Scuttle Plans for Brokerage*, *Securities Week*, June 7, 1982, at 1.

[185] See Letter from Donald L. Crawford to Douglas Scarff, June 16, 1982.

[186] See *Savings Association Investment Securities, Inc.*, (avail. July 8, 1982. See also *SEC Issues No-Action Position to S&Ls Using Service Subsidiaries Broker*, 14 *Securities Reg. & L. Rep.*, July 16, 1982, at 1306.

[187] See *SEC Halts Home Federal Plan to Offer Discount Brokerage*, *Washington Financial Reports*, August 30, 1982, at 377.

[188] *Home Federal Savings and Loan Association* (avail. Sept. 24, 1982); see also *Home Federal Wins SEC Approval to Offer Discount Brokerage Service*, *Washington Financial Reports*, October 4, 1982, at 559.

[189] Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission on the Regulation of Money Market Funds, May 13, 1981, *reprinted in* *Competition and Conditions in the Financial System: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, Part II*, 97th Cong., 1st Sess. 978 (1981).

[190] *Id.*

[191] See, e.g., Testimony of David Silver, President, Investment Company Institute, *Competition and Conditions in the Financial System: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, Part II*, 97th Cong., 1st Sess. 1177 (1981).

[192] Letter dated December 18, 1979, from Philip B. Heymann, Assistant Attorney General,

Criminal Division, United States Department of Justice, to Martin Lybecker, Associate Director, Division of Investment Management, United States Securities and Exchange Commission.

[193] Letter dated April 30, 1982, from D. Lowell Jensen, Assistant Attorney General, Criminal Division, to David Silver, President, Investment Company Institute.

[194] See, e.g., Arief, *Merrill Lynch Bullishly Promotes Licensing Deal*, Legal Times, Sept. 13, 1982, at 4; Mayer, *Merrill Lynch Quacks Like a Bank*, Fortune, Oct. 20, 1980, at 134.

[195] The five states that allow some degree of interstate banking are: Delaware, 63 Del. Laws, ch. 2 §803 (Feb. 18, 1981); South Dakota, S.D. Codified Laws Ann. §§51-16-40, -41 (1980); Maine, Me. Rev. Stat. Ann. title 9-B, §1013(2) (1980); Iowa, Ia. Code Ann. 524-1805; Alaska, Alaska Stat. §06.050235(e) (1982); and New York, 1982 New York Laws, Chap. 417 (enacted July 29, 1982).

[196] 12 U.S.C. §36(f).

[197] 12 C.F.R. §7.7380.

[198] Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known As Security Pacific Discount Brokerage Services, Inc., August 26, 1982.

[199] Mayer, *supra* note 194.

[200] Schroeder, *Merrill, Fidelity will Sell All-Savers Offered by Thrifts; Plans May Be Trend of Cooperative Marketing*, American Banker, Sept. 1, 1981; Schroeder, *DIDC Agrees to Broker-Bank Link to Market All-Savers; Some Firms Are Already Offering the Certificates*, American Banker, Oct. 2, 1981; Matthews, *Court Upholds Joint Offering of All-Savers*, American Banker, Oct. 2, 1981.

[201] *State of Iowa v. Shearson/American Express, Inc.*, Equity No. CE 16-9079 (D. Iowa, Oct. 1981); Complaint, *State of Minnesota v. Bache, Halsey, Stuart, Shields, Inc.*, (D. Minn., Nov. 9, 1981); *Home Federal Savings and Loan Association of the South v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 81-G-1569-S (N.D. Alabama, Oct. 20, 1981).

[202] See, e.g., *In a Wall Street First Merrill Selling CDs for Retail Investors*, Securities Week, June 14, 1982, at 1.

[203] See, e.g., *Merrill Lynch's Insured CD Approved*, Legal Times, November 29, 1982, at 1.

[204] *Merrill, Lynch, Pierce, Fenner & Smith, Inc.* (avail. Oct. 28, 1982).

[205] 12 U.S.C. §1841(a).

[206] 12 U.S.C. §1841(c).

[207] *Shearson Merges Boston Company*, American Banker, Sept. 29, 1981, at 2.

[208] See *In Re Fidelity Management Trust Company*, Order of Board of the FDIC, December 22, 1980.

[209] Letters from the Federal Reserve Board dated March 11, 1981.

[210] 12 U.S.C. §1813(h).

[211] See, e.g., *Household Finance Parent to Enter Banking by Acquisition*, American Banker, July 13, 1981, at 1.

[212] Mulcahy, *Parker Pen Affiliate Buys Small New Hampshire Bank; Move into Financial Services Field Follows Lead of Other Nonbanking Companies*, American Banker, Oct. 30, 1981, at 3.

[213] Letter from the Federal Reserve Board to Chrysler dated May 28, 1981.

[214] Letter dated December 10, 1982 from William Wiles, Secretary Fed. Reserve Board, to William Isaac, Chairman of the FDIC.

[215] One-Bank Holding Company Legislation of 1970: Hearings Before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess., 137-37 (1970).

[216] Application to form Dreyfus National Bank and Trust Company filed with the Comptroller of the Currency on September 3, 1982.

[217] *Id.*

[218] *Id.*

[219] Staff Opinion 3-939, Federal Reserve Regulatory Service, Vol. I, p. 389 (Dec. 13, 1981).

[220] Application to form Dreyfus National Bank and Trust Company filed with the Comptroller of the Currency on September 3, 1982.

[221] Letter from William W. Wiles, Secretary to the Board, to C.T. Conover, Comptroller of the Currency, December 14, 1982.

[222] 12 C.F.R. §218.101.

[223] 12 C.F.R. §218.113(h).

[224] 12 C.F.R. §218.107(f).

[225] See, e.g., *Decision of the Comptroller of the Currency to Charter Dreyfus National Bank & Trust Company*, February 4, 1983; *Dreyfus Wins Approval to Set Up Bank As Comptroller Spurns Fed's Objections*, Wall Street Journal, February 8, 1983, at 2.

[226] See *Decision of the Comptroller of the Currency on the Application to Charter J&W Seligman Trust Company, N.A.*, February 1, 1983. The Comptroller's Seligman decision articulated a new and important reference to Investment Company Act standards, established a predicate for the Comptroller's Dreyfus National Bank decision, and set a precedent for the establishment of non-bank banks by mutual fund investment advisers. In particular, the Comptroller found that mutual funds advised by Seligman would be permissible affiliates of the new bank under the Glass-Steagall Act because Seligman did not control the funds, because the Investment Company Act required that a mutual fund's board have disinterested directors to assure the fund's independence from its investment adviser. After reviewing the history and purposes of the independent director requirements of the Investment Company Act, the Comptroller asserted that the Seligman-advised funds should not be viewed as part of the Seligman entity for Glass-Steagall Act purposes because each mutual fund advised by Seligman was directed by the fund's own directors and had a majority of disinterested directors, consistent with the requirements of the Investment Company Act.

[227] See, e.g., *OCC Challenges Fed On Nonbank Bankers*, Banking Expansion Reporter, February 21, 1983, at 2.

[228] See, e.g., *Fed Threatens to Challenge Bank Owned by Fund Manager*, American Banker, April 6, 1983, at 1; *Fed Finds New Method To Prevent Mutual Funds From Operating Banks*, Legal Times, April 4, 1983, at 1.

[229] See, e.g., *Comptroller Tells Firm It Needn't Heed the Fed*, Wall Street Journal, April 7, 1983, at 3; *OCC Backs Company Threatened With Glass-Steagall Prosecution*, Washington Financial Reports, April 11, 1983, at 758.

[230] See, e.g., *Seligman Trust Opens Despite Threats from Fed*, American Banker, April 8, 1983, at 1.

[231] See, e.g., *Comptroller Moratorium Apparently Cuts Off Fed*, Legal Times, April 11, 1983, at 1; *Non-Banks Face 1983 Moratorium By Comptroller*, Wall Street Journal, April 6, 1983, at 4; *Comptroller Imposes Moratorium on Non-Bank Bank Charters*, Washington Financial Reports, April 11, 1983, at 750.

[232] See, e.g., *Volcker Hails Move to Bar Non-Banks*, American Banker, April 13, 1983, at 1; *Regan Supports Non-Bank Bank-Charter Moratorium, Removal of Rate Ceilings*, Washington Financial Reports, April 11, 1983, at 749; *Regan Applauds Ban On "Non-Bank Banks"*, Washington Post, April 7, 1983, at D1.

[233] Testimony of John S.R. Shad, Chairman, Securities and Exchange Commission, Financial Institutions Restructuring and Services Act of 1981, Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong., 1st Sess. 884 (1981).

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