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NATIONAL BANKS AND MUTUAL FUNDS: WHERE CAN THEY GO AFTER *INVESTMENT COMPANY INSTITUTE v. CAMP*?

INTRODUCTION

The question of what activities properly constitute the business of commercial banking is one that has recently come under close scrutiny and for the most part, has gone unresolved.[1] At present there can be established no all inclusive definition since the banking industry is still seeking new areas of expansion which are unrelated to the traditional concepts of the role of commercial banking. The popular term which may be attributed to these various activities is full service banking and within recent years banks have sought to extend the scope of this term to its fullest extent. Commercial banks have entered into the fields of insurance, travel agencies, leasing of trucks, automobiles and equipment generally, leasing of computer time and rendering accounting services, underwriting of revenue bonds, issuance of credit cards and the underwriting and distributing of mutual fund shares.[2] In many of these activities the invading banks have been challenged in both the courts[3] and by Congress.[4] This comment will focus on one particular segment of the commercial bank expansion, the incursion into the mutual fund field,[5] through an analysis of the

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[1] Beatty, *What are the legal limits to the expansion of national bank services?*, 86 THE BANKING L.J. 3 (1969); Harfield, *Sermon on Genesis 17:20: Exodus 1:10 (a proposal for testing the propriety of expanding bank services)*, 85 THE BANKING L.J. 565 (1968); Huck, *What is the banking business?*, 21 THE BUSINESS LAWYER 537 (1966); Note, *Diversification by National Banks*, 21 STAN. L. REV. 650 (1969).

[2] *Hearings on Mutual Fund Legislation of 1967 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess., Part 3, at 1249 (1967).

[3] Arnold Tours v. Camp, 408 F.2d 1147 (1st Cir. 1969), *rev'd and remanded* 400 U.S. 45 (1970) (travel agencies); Wingate Corp. v. Industrial National Bank, 408 F.2d 1147 (1st Cir. 1969), *cert. denied* 397 U.S. 987 (1970) (data processing); Assoc. of Data Processing Service Organizations v. Camp, 406 F.2d 837 (8th Cir. 1969), *rev'd and remanded* 397 U.S. 150 (1970) (data processing); Port of N.Y. Authority v. Baker, Watts and Co., 392 F.2d 497 (D.C. Cir. 1968) (revenue bond underwriting).

[4] *Bank Credit-Card and Check-Credit Plans, Hearings Before the Subcom. on Banking and Currency*, 89th Cong., 2d Sess. (1968); *Hearings on S. 2704 Collective Investment Funds Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. (1966) [hereinafter 1966 *Hearings*]; *Senate Comm. on Banking and Currency, Hearings on Mutual Funds Legislation of 1967*, 90th Cong., 1st Sess. (1967) [hereinafter *1967 Hearings*]; *Hearings on H.R. 8499 and H.R. 9410 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 88th Cong., 2d Sess. (1964) [hereinafter *1964 Hearings*].

[5] Congressional Quarterly Almanac Vol. XXVI, at 891 (1970) defines mutual funds:

> A mutual fund is an investment company in which a number of persons invest money and which re-invests these funds in stocks or other assets. . . .
> The primary attraction of mutual funds is that they offer the

(Continued on next page)

successful battle, both judicial and legislative, to prevent that entry and the prospects for the future.

RECENT DEVELOPMENTS

Prior to 1962 it was certain that commercial banks could not enter the mutual fund field. During that time trust activities of commercial banks were under the control of the Federal Reserve Board which unequivocally maintained that the entrance of commercial banks into the mutual fund field would be a violation of the Glass-Steagell Banking Act of 1933.[6] [hereinafter Banking Act]. However, at the insistance of the banking industry[7] that control was turned over in 1962 to the Comptroller of the Currency[8] who solicited suggestions for improving the regulations applicable to trust activities.[9] The industry responded with suggestions which would allow them to commingle investment monies delivered to them for investment management;[10]

(Footnote continued from preceding page)

advantages of diversified investment in a single company. Shareholders receive the benefits of growth or income, or both, from all assets in a fund's portfolio of investments in different companies or activities. Ordinarily the breadth of the portfolio protects them from severe loss resulting from a drop in value or income of any single investment.

[6] 42 FED. RESERVE BULL. 228 (1956); 41 FED. RESERVE BULL. 142 (1955); 26 FED. RESERVE BULL. 393 (1940). The Board maintained that a bank operating a commingled investment fund would violate Section 16 (12 U.S.C. § 24) and Section 21 (12 U.S.C. § 378) of the Glass-Steagell Banking Act, Section 16 provides in part that:

> . . . The business of dealing in securities and stock by the [national banking] association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock. . . . Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the [national banking] association for its own account of any shares of stock of any corporation. . . .

Section 21 provides in part that:

> [I]t shall be unlawful—(1) For any person, firm, corporation, association, business trust or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of [deposit banking]. . . .

[7] See generally *Hearings on H.R. 12577 and H.R. 12825 Before a Subcomm. of the House Comm. on Banking and Currency*, 87th Cong., 2d Sess. (1962).

[8] 12 U.S.C. § 92(a) (1970). This statute gave the Comptroller of the Currency the power to authorize national banks "to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity 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."

[9] Investment Company Institute v. Camp, 401 U.S. 617 (1971).

[10] Prior to 1963, commercial banks were able to solicit investment funds

(Continued on next page)

the suggestions were in effect, to allow for the operation of a mutual fund. In 1963 the proposed regulations were officially promulgated.[11] Two years later First National City Bank of New York [hereinafter City Bank] submitted for the Comptroller's approval a plan for a commingled investment fund [hereinafter CIF]. The plan was accepted[12] and the fund put into operation, quickly amassing $11 million in fund assets in the first two years of its existence.[13] The solicitation for CIF funds was, however, soon brought to a halt by a decision in federal district court.[14] In a suit by an association of mutual fund dealers the district court agreed that the CIF was in violation of sections 12, 20, 21, and 32 of the Banking Act[15] and enjoined the plans operation. This decision was appealed and on appeal was consolidated with a second suit[16] challenging certain exemptions granted the bank by the Securities and Exchange Commission [hereinafter SEC] from parts of the Investment Company Act of 1940 [hereinafter Investment Act]. The Court of Appeals reversed as to the district court's decision and affirmed as to the SEC's exemptions and gave the go-ahead to the CIF.[17] The bank's victory, however, was short lived as the Supreme Court reversed the circuit court in *Investment Company Institute v. Camp*,[18] basing their decision entirely on provisions of the Banking Act.[19]

(Footnote continued from preceding page)
and to manage them for individual customers but could not commingle them. They could, however, commingle trust assets, and funds held as part of a tax-exempt pension or profit sharing or stock bonus plan of employers for the benefit of employees. See, Regulation F, 12 C.F.R. § 206 (1959 Rev.).

The commingling of trust assets was, however, closely watched by the Federal Reserve Board to ensure that revocable trusts were not being used to attract "individuals seeking investment management of their funds." 42 FED. RESERVE BULL. 228 (1956). At one time the Federal Reserve Board proposed to forbid the use of common trust funds for revocable trusts because of the possibility that they could be used as a commingled investment fund. See, R. MUNDHEIM, MUTUAL FUNDS 8 (1970).

[11] 12 C.F.R. § 9 (1963).

[12] Letter from the Comptroller of the Currency to First National City Bank, May 10, 1964, printed in *1966 Hearings, supra* note 4, at 418-21.

The fund also received authority from the Securities and Exchange Commission, see, S.E.C. Investment Co. Act Release No. 4538 (March 9, 1966, as amended March 14, 1966) printed in *1966 Hearings, supra* note 4, at 81-90.

[13] As of September, 1967, there were 654 participants in the fund and assets of $11,610,682. After the Court of Appeals reversed the lower court's ruling the fund was re-opened and as of November 20, 1969 had 469 participants and fund assets of $11,174,908. N.Y. Times, Nov. 21, 1969, § C at 78, col. 1.

[14] Investment Company Institute v. Camp, 274 F.Supp. 624 (D.D.C. 1967).

[15] 12 U.S.C. §§ 24, 377, 378 and 678 (1970).

[16] The opinions and orders of the SEC are reprinted in the *1966 Hearings, supra* note 4, at 81.

[17] National Ass'n of Security Dealers Inc. v. Securities and Exchange Comm'n, 420 F.2d 83 (D.C. Cir. 1969), *cert. granted* 397 U.S. 986.

[18] 401 U.S. 617 (1971).

[19] Section 16, 12 U.S.C. § 24 (1970), and section 21, 12 U.S.C. § 378 (1970), of the Glass-Steagell Banking Act.

While this judicial battle was taking place the banking industry was also involved in legislative activity where several attempts were made to provide for the approval of a bank operated CIF. The most recent of these attempts was a bill introduced by Senator McIntyre of New Hampshire which would have indirectly amended the Banking Act to give positive approval to a bank operated CIF.[20] Similar legislation was introduced in the House of Representatives but was not reported out of committee,[21] largely because the legislature wished to defer action until the Supreme Court's decision in *Investment Company Institute v. Camp*. The McIntyre Bill was able to pass the Senate but without a House counterpart it was excised in the Joint House-Senate Conference Committee.[22]

THE BANK OPERATED CIF

The CIF put into operation by City Bank is representative of the CIFs under Regulation 9[23] and is said to be the model for all future CIFs. Under that plan the customer tenders to the bank an amount between $10,000 and $500,000 which is added to the fund. In addition the customer authorizes the bank to be his managing agent for the investment of fund assets. In exchange the customer receives a written

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[20] S.2704, A Bill to Amend the Securities Exchange Act of 1934, and the Investment Act of 1940, to Provide for the Regulation of Collective Investment Funds Maintained by Banks, and for Other Purposes.

The McIntyre Amendment would treat the CIF "as an open-end investment company and make such funds subject to the regulatory requirements of the Investment Company Act of 1940 and the registration and other provisions of the Securities Act of 1933. At the same time Federal banking agencies would continue to exercise their general authority to supervise these funds from the standpoint of safe and sound trust and banking practices. Nevertheless the proposed amendment would place the principal regulatory responsibility in the Securities and Exchange Commission, to be exercised under the Federal Securities laws.

Additionally the McIntyre Amendment would unconditionally prohibit such a fund, when maintained by a bank, from including a sales load in the public offering price of any security issued. Thus a CIF operated by a bank would be essentially similar to a no-load mutual fund and would be accorded the same treatment under the 1940 Act." *1967 Hearings, supra* note 4, at 1293.

[21] H.R. 9410 and 8499, 88th Cong., 2d Sess., (1964).

[22] Congressional Quarterly Almanac Vol. XXVI, at 894 (1970); CCH Congressional Index, The Week in Congress, Nov. 27, 1970.

> The Senate passed bill authorized banks and savings and loan associations to operate mutual funds. The House bill left the issue of mutual fund operation by banks and savings and loans institutions to be settled by a case pending before the Supreme Court. But it provided for regulation of CIFs if they were upheld by the Court. Conferees eliminated both House and Senate provisions on the subject.

[23] Regulation 9 is printed in 12 C.F.R. § 9 (1963) and includes the rules governing the operation of a collective investment fund by national banks as set out by the Comptroller of the Currency. These rules are made under the authority of 12 U.S.C. 92(a) (1970). *See supra* note 8.

evidence of his investment, expressing in "units of participation" his proportionate interest in the fund's assets. These units of participation are redeemable by the fund at their net asset value, and are freely transferable to any person who has executed a managing agreement with the bank. The account which is directed by a committee elected annually by the fund's participants, is registered as an investment company under the Investment Act[24] and the "units of participation" are registered under the Securities Act of 1933[25] [hereinafter Securities Act]. The bank through its committee, acts both as investment advisor to the account and statutory underwriter for the "units of participation."[26]

The CIF is the functional equivalent of a mutual fund but the two differ in several respects. As in all banking functions, the bank operated CIF is subject to the supervision of the Comptroller of the Currency.[27] This would include the review of fund investments to insure that they are in accordance with sound fiduciary principles.[28] Additionally banks would be limited to a service charge of ½ of 1% per annum of the average net asset value of the fund.[29] Open-end mutual funds charge a "load charge," which is principally a sales commission, on the amount paid or the amount invested.[30] The final distinction is that banks may advertise their CIF only through their trust department and may not market their "units of participation" through regular channels of public distribution.[31] Mutual funds, however, are not subject to such a limitation and the industry is noted for its aggressive salesmanship.

It is quite clear why banks would seek entry into the mutual fund field and equally apparent why the mutual fund industry would seek to keep them out. The fantastic rise of the mutual fund industry has been chronicled in numerous publications and has become the envy within the financial world. In 1940 the total assets of all investment companies were approximately $2 billion and mutual fund assets less than $450 million. In 1970 the Investment Company Institute, which comprised 93% of the mutual fund industry, listed 339 mutual funds as members of the Institute with total assets of $45 billion. At that

[24] 15 U.S.C. § 80(a) *et. seq.* (1970).
[25] 15 U.S.C. § 77(a) *et. seq.* (1970).
[26] Investment Company Institute v. Camp, 401 U.S. 617, 622-623 (1971).
[27] 12 C.F.R. § 9.18(b)(1) (1968).
[28] 12 C.F.R. § 9.11(d)(1968).
[29] 12 C.F.R. § 9.18(b)(12) (1968). The charge is set so as not to exceed the sum of the fees charged if the account were managed individually.
[30] Congressional Quarterly Almanac Vol. XXVI, at 891 (1970). Most funds charge a sales fee of 8.5% of the amount paid, or 9.3% of the amount actually invested.
[31] 12 C.F.R. § 9.18(b)(5)(iii) and (iv) (1968).

time Institute members had 10.5 million shareholder accounts and almost one of every six of the 31 million Americans owning stock in 1970 held mutual fund shares.[32] The banking industry has a ready made access to this market, primarily through its association with investors in its trust and investment management departments, but also because of its position at the heart of economic life. Because of these assets banks should make quick and substantial gains in the mutual fund field and it is precisely for that reason that the mutual fund industry has registered such strong opposition. Shortly before City Bank began its CIF it was estimated that banks would capture as much as $2 billion of mutual fund business within the following ten years.[33] Although subsequent judicial decisions have negated that estimate, fifty major banks were ready to start CIFs if the McIntyre legislation became law.[34] However, with the substantial interest of banks in the operation of CIFs and the large amount to be won if they are successful, it is not likely that this issue will end with the demise of the McIntyre legislation and the ruling in *Investment Company Institute v. Camp.*

HISTORY

Before there can be a proper analysis of the reasons for and against bank entry into mutual funds, it is necessary to make mention of the underlying history which caused the separation of investment and commercial banking. During the 19th century American banks followed the financial policy established in England that there must be a sharp dichotomy between institutions involved in investment banking and those involved in commercial banking.[35] American banks had no problem living with this principle since they were unchallenged in their sphere of activities.[36] However, in the latter part of the 19th century trust companies began to emerge as rivals of commercial banks. Although at first these companies were limited to the administration of estates and wills they soon began soliciting deposits from the general public as well as engaging in the preparation and distribution of securities.[37] The banking industry rose to the challenge and, with legislative approval, entered new fields, one of which was the

[32] Congressional Quarterly Almanac, Vol. XXVI, at 891 (1970).
[33] *1964 Hearings, supra* note 4, at 26.
[34] Statement by American Bankers Association in The Wall Street Journal, June 13, 1968, at 3, col. 4.
[35] Perkins, *The Divorce of Commercial and Investment Banking: A History,* 88 THE BANKING L.J. 483, 485 (1971). For an in-depth study of the history of investment banking see, V. CAROSSO, INVESTMENT BANKING IN AMERICA (1970).
[36] Perkins, *supra* note 35, at 486-87.
[37] *Id.* at 487-88.

securities field.[38] By the turn of the 20th century the distinction between banks and trust companies was one of semantics as both offered a full range of services to their customers.[39]

Although there was criticism of bank incursion into other fields, most notably the securities field,[40] it was apparent that there was insufficient regulatory power to solve the problem and little predilection to authorize additional power.[41] The banking industry was in a state of regulatory chaos as forty-nine legislative bodies were imposing varing degrees of supervision on and granting widely dissimilar privileges to banks.[42] Where banks were restrained from directly entering investment banking they often did so by means of a security affiliate.[43] By 1922 sixty-two commercial banks were involved

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[38] *Id.* at 489.

[39] *Id.*

[40] As early as 1912 a Subcommittee of the House Banking and Currency Committee began investigating the concentration of money and credit. The Pujo Committee (so named because Rep. Arsene P. Pujo headed the Committee) took unfavorable notice of the growth of the affiliate phenomenon but its findings went largely unheeded. See PUJO REPORT, MONEY TRUST INVESTIGATION, H.R. REP. No. 1593, 62nd Cong., 3rd Sess. (1913). See also V. Carosso, *supra* note 35, at 137-55.

This fact was again mentioned in 1920 by the Comptroller of the Currency who observed in his annual report to Congress that:

> Some 'securities companies' operating in close connection with, and often officered by, the same men who managed the national banks with which they are allied, have become instruments of speculation and headquarters for promotions of all kinds of financial schemes. Many of the flotations promoted by the 'securities corporations' which are operated as adjuncts to national have proven disastrous to their subscribers, and have in some instances reflected seriously not only upon the credit and the standing of the 'securities companies' by which they are sponsored but also in some cases have damaged the credit and reputation of national banks with which the 'securities companies' are allied.
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> In times of rising prices and active speculation, some of these auxiliary corporations have made large profits through their ventures and syndicate operations, but their losses in other periods have been heavy, and they have become an element of increasing peril to the banks with which they are associated. The business of legitimate banking is entirely separate and distinct from the kind of business conducted by many of the 'securities corporations' and it would be difficult if not impossible for the same set of officers to conduct safely, soundly, and successfully the conservative business of the national banks and at the same time direct and manage the speculative ventures and promotions of the ancillary institutions.

1 Ann. Rep. of the Comptroller of the Currency 55 (1920).

[41] Whitesell, *Is the Glass-Steagell Act Obsolete?*, 87 THE BANKING L.J. 387, 394-95 (1970).

[42] Lehr, *The Affiliation of Commercial Bank and Mutual Fund Personnel,* 10 ST. LOUIS U. L.J. 190, 194 (1965).

[43] V. Carosso, *supra* note 35, at 97-98.

> Security affiliates were state-chartered corporations owned by the stockholders of the national bank that sponsored them. They were 'officered and directed' by the individuals who managed the bank. To make certain that ownership of the affiliate and the bank always remained identical, stockholders could not buy or sell stock in one without also doing so in

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in such activities directly and another ten had security affiliates for the same purpose.[44] Together these banks and their affiliates were able to exercise a powerful influence on the securities market.[45]

The results of this chaotic period were numerous abuses, especially by the larger banks, all of which contributed to the large number of bank failures and the ensuing depression.[46] Banks amassed large sums of money which they invested in speculative securities by offering the high rates of interest on long term deposits. Loans were made to shore-up faltering companies in which the lending bank had a substantial interest or the bank was able to dump its interest in the faltering company onto its security affiliate. Vast sums were made by bank officers and directors at the expense of the public through the manipulation of securities. In short, the banking industry was caught up in a massive conflict of interest for which there was inadequate safeguards and a great deal of abuse.[47]

In the period that followed the failure of the Bank of the United States,[48] the public clamored for remedial legislation.[49] Congress responded with the enactment of three major pieces of legislation, the Glass-Steagell Banking Act of 1933,[50] the Securities Act of 1933[51] and the Investment Company Act of 1940,[52] which were to prevent future abuses.

The Banking Act dealt, in part, with the specific hazards of com-

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(Footnote continued from preceding page)
the other. Usually the same share of stock was used for both, one side bearing the name of the national bank and the other that of the affiliate.

44 Perkins, *supra* note 35, at 492.

45 *Id.* at 495. A specific example of this power was that in 1927 the market share of new bond issue participations of commercial banks was 37% and by 1930 this figure rose to 61%.

46 Lehr, *supra* note 42, at 196.

47 Lehr, *supra* note 42, at 196; V. Carosso, *supra* note 35, at 322-52; Whitesell, *supra* note 41, at 396; Investment Company Institute V. Camp, 401 U.S. 617, 629-34 (1971).

48 Perkins, *supra* note 35, at 496-97.

> A most significant event that incited public opinion against the security affiliate system was the failure of the Bank of the United States in December 1930. The president of the New York bank, Bernard Marcus, had appropriated vast quantities of the bank's funds for his own personal, and highly speculative, business ventures. The eventual financial difficulties of these outside investments made it impossible for Marcus to repay his loans. The bank was finally forced to suspend payment and to close its doors. When it failed, the bank had over $200 million in deposits, many of them owned by immigrants who erroneously believed the bank's name indicated a close connection with the national government. . . . Because this was the largest bank failure in American financial history, the story gained extensive national exposure. . . .

49 Lehr, *supra* note 42, at 198.

50 Ch. 89, 48 Stat. 162 (codified in scattered sections of 12 U.S.C.).

51 15 U.S.C. § 77(a)-aa (1970).

52 15 U.S.C. §§ 80a-1 to 80a-52 (1970).

mercial bank's involvement in the security field. Although the initial response of Congress was to enact a comprehensive regulatory scheme, the increasing number of bank failures and the demands of the public called for a complete divorce,[53] essentially, the act sought to prohibit a commercial bank dealing in securities for its own account. Blessed with the aid of hindsight, it was recognized by Congress that such self-dealing by a bank could jeopardize its solvency if the investments were unsuccessful. An additional hazard which was recognized was that a bank faced with an unprofitable investment in its portfolio might further jeopardize its own solvency by making an unsound loan in the hope of reviving the faltering investment. An equally apparent danger was that a bank might use its position to sell its unproductive stock to its unwary customers.[54] In order to carry out this divorce, the Banking Act was directed at preventing commercial banks from engaging in investment banking either directly or indirectly. Section 20 and 32 effectively blocked the indirect approach through the use of affiliates. Section 20 prohibited the affiliation of commercial banks with business "engaged principally in the issue, flotation, underwriting, public sale or distribution" of securities.[55] Section 21 took the obverse position by prohibiting companies in the business of the "issuing, underwriting, selling or distributing" of securities from engaging in commercial banking.[56] Section 32 additionally prevented the use of affiliates by proscribing any employee of a security organization from being an employee of a commercial bank.[57] This provision was aimed at interlocking directorates between investment companies and commercial banks, a common occurrence in the pre-depression days.[58] Finally, in order to prevent a bank from doing directly what it could not do indirectly, *via* an affiliate, section 16 limited commercial banks to dealing in securities solely for the account of its customers and "in no case for its own account."[59]

The Securities Act was aimed less at the banking industry in particular than at the abuses existing in the securities market gen-

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[53] Perkins, *supra* note 35, at 505. Initially it was not certain whether the affiliate system would be made subject to new regulations or if a complete divorce would be enforced. In fact the preliminary draft of the Banking Act included two sections related to the affiliate question. The first would allow banks to continue operating their affiliates but only if the entire operation of the bank was open to federal or state inspection. The alternative plan called for a complete severance within five years, of commercial banks and their affiliates.

[54] See text accompanying note 47.

[55] 12 U.S.C. § 377 (1970).

[56] 12 U.S.C. § 378 (1970).

[57] 12 U.S.C. § 78 (1970).

[58] Whitesell, *supra* note 41, at 396.

[59] 12 U.S.C. § 24(7) (1970).

erally. Ignorance of the true facts and outright deception were common shortcomings of the pre-depression market. Congress sought to alleviate this problem by providing for full disclosure, by means of a prospectus, for all new issues of securities, offered in interstate commerce.[60] Criminal and civil penalties were provided under sections 17[61] and 12(2)[62] for the fraudulent sale of securities in interstate commerce.

The last major piece of legislation affecting commercial banks, the Investment Act, was designed to prevent those possible abuses that were not adequately provided for by either the Banking Act or the Securities Act. Whereas the function of the Banking Act was to separate commercial banking from investment banking, the Investment Act left intact the primary framework of the investment industry but enacted an extensive regulatory scheme.[63] The evil that the act sought to remedy was the use of the investment company as a vehicle for the private gains of insiders at the expense of the investment company's shareholders.[64] Section 10 accomplished this by providing that a certain percentage of directors must be free of affiliations which would involve a conflict of interest. The percentage under section 10 varies according to the type of affiliation involved.[65]

THE BANKING ACT TODAY

The Supreme Court has finally laid to rest the issue of whether the City Bank plan violates the Banking Act. In so doing the Court held that the issuance of "units of participation" by the bank to its investors constituted an "underwriting, issuing, selling or distributing of securities in violation of sections 16 and 21" of the Act.[66] Furthermore, the Court found that the purpose and intent of the plan clashed with the purpose of the Act since "the potential hazards and abuses that flow from . . . (the City Bank's) entry into the mutual investment business are the same basic hazards and abuses that Congress intended to eliminate forty years ago."[67]

The judicial determination, however, does not, *nor should it*, answer the more basic question of the banking Act's relevancy in today's financial community. Whether that relevancy may still exist

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[60] Note, *Commingled Investment Accounts: Banks & Securities Industry*, 45 NOTRE DAME LAWYER 746, 753-54 (1970).
[61] 48 Stat. 74 (1933), 15 U.S.C. § 77 (1970).
[62] 48 Stat. 74 (1933), 15 U.S.C. § 77(2) (1970).
[63] Lehr, *supra* note 42, at 201.
[64] *Id.* at 200.
[65] *See generally*, Lehr, *supra* note 42, at 203-08.
[66] Investment Company Institute v. Camp, 401 U.S. 617 (1971).
[67] *Id.*

depends on the possibility of a recurrence of the abuses which the Banking Act was designed to prevent. Principally there are four possible abuses:

1) A bank might invest its own assets in frozen or otherwise imprudent stock or security investments.[68] The blunt answer to this is that it is impossible in a CIF under Regulation 9. This is because all purchases are made by the fund for the customers account and at no time may bank assets be used to purchase securities. Regulation 9 makes this quite clear:

> A bank administering a collective investment fund shall not (a) have any interest in such fund other than in its fiduciary capacity or (b) make any loans on the security of a participation in such fund. If because of a creditor relationship or otherwise the bank acquires an interest in a participation in such fund, the participation shall be withdrawn on the first date on which such withdrawal can be effected. . . .[69]

2) Since the CIF is operated by the bank, the public will merge the two so that a poor performance by the fund could endanger the public's confidence in other bank activities.[70] Initially it would take a rather naive and unsophisticated public to fail to perceive the distinction between the management of a commercial bank and the performance of an investment fund.[71] But even so, today banks hold about $250 billion in various fiduciary capacities,[72] a large part of which banks invest and re-invest everyday, and there is no indication that bank stability is judged by its performance in these areas. Actually it is more likely that public confidence in banks is based on the guaranteed protection of their deposits by the FDIC rather than on a bank's investment ability.

3) A bank might use, or better yet abuse, its credit facilities in order to bolster a corporation in which the fund has invested.[73] This is a variation of the pre-depression abuse involving the making of loans to a corporation in which the bank had invested for its own

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[68] *Id.* at 630.

[69] 12 C.F.R. § 9.18(8)(i) (1964).

[70] Investment Company Institute v. Camp, 401 U.S. 617, 631 (1971).

[71] *1967 Hearings* at 1224 (letter from William McChesney Martin).

[72] STAFF OF SUBCOMM. ON DOMESTIC FINANCE, HOUSE COMM. ON BANKING AND CURRENCY, 90TH CONG. 2D SESS. COMMERCIAL BANKS AND THEIR TRUST ACTIVITIES: EMERGING INFLUENCE ON THE AMERICAN ECONOMY at 1 (Subcomm. Print 1968) [hereinafter DOMESTIC FINANCE REPORT]. Of this estimated $253.3 billion, $72.9 billion were in employee benefit accounts, $126.2 billion in private trust accounts and $54.2 billion in agency accounts. Since these figures were estimated at the end of 1967 it is apparent that the totals have since increased substantially, however there is no reliable data on present bank holdings.

[73] Investment Company Institute v. Camp, 401 U.S. 617, 631 (1971).

account. Now, rather than protecting its own investment, it is indicated that a bank may do the same in order to protect the fund's performance. There is no denying that this possibility exists but it likewise exists in all of the various banking investment activities including trust management of pension and profit sharing plans. The danger, however, is small considering the lack of abuse associated with bank investments in other capacities.[74]

4) The pecuniary interest of the bank in selling the fund may cause it to use undue pressure to steer customers into the fund.[75] Again the pre-depression abuse, which involved banks dealing in and underwriting securities for its own account and often to the detriment of its customers, differs perceptively from the present situation. Now the possible abuse lies in an over-aggressive policy on the part of the bank to induce customer participation and build up management fees. It has been suggested in this respect, that a bank might even extend credit to a customer with the expectation of investment in the fund.[76] At the heart of this proposition lies the rationale that in order for banks to exist in the highly competitive mutual fund field they must be as aggressive as any of their competitors and that this aggressiveness may lead to unsound practices.[77] It is not a complete answer to say that a bank faces stiff competition in the trust and pension management fields as well since banks have long been established in these fields and the problems of competition are not the same as those faced when just entering the field.[78] There is no question that banks do have subtle powers of persuasion due to their unique position at the center of economic life which are not available to their competitors.[79] Whether banks would use these coercive powers is open to conjecture

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[74] *Supra* note 71.
[75] Investment Company Institute v. Camp, 401 U.S. 617, 630 (1971).
[76] *Id.* at 631.
[77] *1967 Hearings* at 80 (statement of Eugene Rostow).

The trust business of banks, in the nature of things, derives from the banks' relationships with its customers, with lawyers, and with insurance agents. . . . (A) bank's trust accounts . . . do not . . . normally involve the active daily battle for business characteristic of the work of brokers and dealers. One of the purposes of the Glass Steagell Act was to keep the banks out of this market, with its built-in and inescapable conflicts of interest.

[78] *Id.*

In the conduct of a trust department of the classical kind, a bank is under no pressure to sell interests in its own collective investment trust. Its fees and commissions as trustee, guardian, or executor do not depend on whether trust assets are managed in the common trust fund, or in a separate account. But if the law develops to allow for collective investment funds, the banks would have a pecuniary interest in advising their customers to purchase interests in their own collective investment funds.

[79] *Id.* at 1249.

but even should it so desire the limitation of fund advertising to the bank trust department would restrict such activities to a minimum.[80]

PROBLEMS WITH THE INVESTMENT ACT

The Supreme Court's interpretation of the Banking Act made it unnecessary for the Court to answer the issues arising from the exemptions afforded City Bank by the SEC.[81] The bank applied for and received exemptions from several sections of the Investment Act, most notably §§ 10(b)(2), (b)(3) and (c).[82] These exemptions were needed to allow the fund to conform with banking regulations which demanded that the bank have a working majority on the fund's committee.[83] Since a strict interpretation of the Investment Act would prevent such a majority control, the exemptions were sought. Under §§ 10(b)(2) and (b)(3) no principal underwriter of a fund nor any investment banker may be a director, officer or employee of the investment fund unless a majority of the directors were unaffiliated with the underwriter or investment banker. Additionally § 10(c) would specifically prohibit a majority of the board of directors from being officers, directors or employees of any one bank.

Bank exemption was sought under § 6(c) of the Act[84] which empowers the Commission to grant exemptions:

> . . . if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of the investors and the purposes fairly intended by the policy and provisions (of the Act). . . .[85]

The granting of the exemptions allowed the bank fund to operate under the general provisions of § 10(a) which limits directors with outside interests to sixty percent of the board.[86]

When presented with the issue of the justification for these exemptions, the Court of Appeals affirmed the Commission's actions. However, since the Supreme Court has not dealt with this question it is imperative that any final settlement of the CIF question should

[80] *See* text accompanying note 31 *supra.*

[81] Investment Company Institute v. Camp, 401 U.S. 617, 620-21 (1971).

[82] 15 U.S.C. § 80a-10(b)(2), (b)(3) and (c) (1964).

[83] Nat'l Ass'n of Security Dealers v. Sec. and Exch. Comm'n, 420 F.2d 83, 92 (D.C. Cir. 1969).

[84] Originally the bank sought an exemption so as to allow it to operate under section 10(d) of the Investment Company Act. 15 U.S.C. § 80a-10(d) (1964). This section permits certain types of no-load funds to have only one unaffiliated director if they meet specified conditions. The SEC denied the bank's request and the bank did not appeal.

[85] 15 U.S.C. § 80a-6(c) (1964).

[86] 15 U.S.C. § 80a-10(a) (1964).

answer the issues arising from these exemptions. Specifically, the issue is whether the bank plan, with the exemptions, provides for sufficient protection of investors against conflicts of interest on the part of the fund's committee. Former Chairman of the SEC, William L. Cary, has indicated that the exemptions create four danger areas:[87]

1) The bank might retain an unwarranted portion of the fund's assets in deposits, the bank being able to use the deposits for its own profit or in meeting cash reserve requirements of the Federal Reserve.[88] Although it is a real possibility that a bank may find that the interest received from loans is, at a particular time, more lucrative than the management fee from the fund, there are sufficient safeguards to limit the likelihood of such action.[89] Under the Securities Act and the Investment Act participants in the fund would receive a prospectus which includes a specific statement of the fund's defined investment policy and the fees and other charges payable to the fund.[90] Moreover the participants would receive periodic reports and, as soon as possible, a balance sheet and income statement for a recent period and a list of the fund's securities. The form of the information required to be given to the participants is under the control of the SEC and, if the Commission so desires, may be in such a form as to allow a comparison with other investment media.[91] In addition to the protection that disclosure provides, the requirement of a 40% unaffiliated committee allows for an insider's scrutiny of the majority's activities.[92] Further barriers to abuse are erected by Regulation 9 which provides that funds held in a CIF "shall not be held uninvested or undistributed any longer than is reasonable for the proper management of the account."[93] Adherence would be maintained through the periodic

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[87] See *Hearing on Common Trust Funds—Overlapping Responsibility and Conflict in Regulations, Before a Subcomm. of the House Comm. on Gov't Operations,* 83d Cong., 1st Sess., 11-12 (1963) (statement of William L. Cary).

[88] The parties' briefs can be found in the *1966 Hearings, supra* note 4, at 187-579.

[89] The Court of Appeals dismissed this point by relying on the Commission's argument that:

> the temptation to leave funds uninvested would be contrary to the Account's stated policy of investment for long-term growth of capital and income, and to the Bank's interest in having the fund's assets increase. The interest in increasing the assets in the fund dictates not only that funds already held be invested in growth securities, but also, as we have seen, creates pressure to increase the number of participants. The undisputed fact that the Account will compete with the mutual fund industry can be expected to inhibit retention of its income-producing assets in the form of lopsided cash deposits.

Nat'l Ass'n of Security Dealers v. Sec. & Exch. Comm'n, 420 F.2d 83, 93 (1969).

[90] *1966 Hearings, supra* note 4, at 207-08 (brief of First Nat'l City Bank).

[91] *Id.*

[92] 15 U.S.C. § 80a-10(a) (1964).

[93] 12 C.F.R. § 9.10(a) (1964).

examinations of bank trust departments which occur at least three times every two years.[94]

2) A bank might make a bad investment for the fund in order to shore-up an unsound loan. This is opposite to the argument, previously discussed, that a bank might be inclined to make a bad loan in order to aid a faltering company in which the fund had invested. The discussion of that point applies equally well here. As stated by William McChesney Martin, Chairman of the Federal Reserve Board:

> Although such conflicts of interest and consequent misconduct are not impossible, this area of risk is not regarded as significant. For many years banks have participated in the management of employee-benefit funds and other fiduciary accounts that hold stocks and other securities in an aggregate amount far exceeding those held by the entire mutual fund industry. The examinations conducted by bank supervisory agencies have disclosed practically no such misuse by banks of their investment advisory and management functions. In the case of managing agency funds, an additional safeguard is the prophylactic restrictions and requirements of the Investment Company Act of 1940, particularly publicity of the financial transactions of registered investment companies, which almost inevitably would expose such malfeasance. A further deterrent would be the adverse impact on a collective fund's performance—its comparative financial record—if any of its resources were used to make unprofitable investments; the detrimental effect on sales of participations might outweigh any benefits the bank could reasonably expect from its breach of fiduciary duty.[95]

3) The fund might be used as a dumping ground for securities underwritten by the bank. This is the problem to which § 10(b)(3) of the Investment Act was specifically addressed, where a majority of the board of the investment company would be both underwriting and purchasing securities. The present situation, however, is a substantial change from the activities that gave rise to section 10(b)(3) in which investment banks used their controlled investment companies as a dumping ground for underwritten security issues. Today, a commercial bank's involvement in underwriting securities is limited to its participation in syndicates which underwrite government securities.[96] This situation bears little resemblance to the underwriting of highly speculative securities which occurred in the pre-depression years.[97] There is, however, the additional protection afforded by Regu-

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[94] 12 U.S.C. § 481 (1964).

[95] *1967 Hearings*, *supra* note 4, at 1224.

[96] Nat'l Ass'n of Sec. Dealers v. Sec. & Exch. Comm'n, 420 F.2d 83, 94 (D.C. Cir. 1969).

[97] Note, *supra* note 60, at 794-95.

lation 9 against self-dealing that was noted in the discussion of possible abuses to protect outstanding loans.[98]

4) A bank fund may use a broker that reciprocates by giving the bank its business rather than seeking the best broker in terms of cost and service. This is a more subtle conflict of interest and commensurate with its subtlety, less likely to be subject to scrutiny. The Court of Appeals recognized this and commented that it was not entirely satisfied with the assertion in the fund's prospectus that the objectives in placing orders are to obtain the most favorable prices and executions of orders and also, to deal with brokers who provide supplementary research and statistical information or market quotations.[99] The Court, however, concluded that the same problem arises with trust accounts and since Congress exempted commingled trust accounts from the operation of the Act that the danger should be considered minimal.[100] It must also be remembered that economical management of the fund's account is in the bank's best interest as well as the participants' since the management fee is computed on fund assets.[101] Whether it would be more profitable for the bank to abuse the fund rather than manage it economically is doubtful but, in any case, the "Watch dog" operation of the unaffiliated members of the committee would exercise a prophylactic effect on possible abuse.[102]

ADDITIONAL PROBLEMS

Concentration

This comment, primarily has analyzed the hazards of a bank operated CIF as they exist in a vacuum, that is, without regard to the cumulative effect when combined with other banking activities. A more complex problem arises when the scope of inquiry is extended beyond the singular issue of bank participation in mutual funds and into the dangers of concentration of wealth and power of banks in general. Existing data shows that, at the conclusion of 1967, of the $1 trillion in assets held by all institutions in the United States, banks held more than $600 billion, $250 billion of which were held in trust.[103]

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[98] *See supra* note 93 and accompanying text.

[99] Nat'l Ass'n of Sec. Dealers v. Sec. & Exch. Comm'n, 420 F.2d 83, 95 (D.C. Cir. 1969).

[100] *Id.* Common trust funds are exempted by reason of 15 U.S.C. § 80a-3(c)(3).

[101] 12 C.F.R. § 9.18 (12) (1964).

[102] The use of brokerage to receive reciprocal benefits is a type of self-dealing which is prohibited by 12 C.F.R. § 9.12(a) (1964). The use of unaffiliated directors under the Investment Act has been the most effective deterrent to this type of self-dealing. *See generally* Lehr, *supra* note 42, at 203-08.

[103] *Domestic Finance Report* at 1.

The 100 largest banks held more than 82% of this $1/4 trillion, a good portion of which was invested in voting stock of other corporations.[104] A survey of forty-nine banks holding $135 billion in trust assets showed 8,019 director interlocks between the banks and non-banking corporations.[105] The more significant issue then is to what extent the additional acquisition of capital by banks through the assets of their CIF will work a disservice to the public interest.

Bank control of non-bank corporations can arise out of two entirely distinct functions and for entirely separate purposes. Firstly, a bank may own the non-bank corporation through the use of a holding company which owns the bank as well as the non-banking interests. Here the purpose of the control is outright ownership, much the same as a conglomerate seeks diversification in non-related activities. This type of domination has been severely restricted by the passage of the One Bank Holding Company Act of 1970.[106] This legislation together with the Bank Holding Company Act of 1956[107] provides for registration of all bank holding companies with the Federal Reserve Board which exercises regulatory control over the holding company. The Act does not prohibit bank holding companies but demands that the Federal Reserve Board must approve any new acquisitions of banks by the holding company. The Act further limits the kinds of businesses that the holding company may engage in and the investments which it can make in non-banking organizations. The purpose underlying the holding company legislation is to increase competition among banks by limiting concentration of bank ownership and to prevent dangers arising from bank activity in non-banking industries.[108]

The second type of domination involves concentration arising indirectly from banks which make investments while in their fiduciary role. Immediately it can be seen that the purpose underlying this activity greatly differs from the situation where outright ownership is sought. In fact a bank acting in its fiduciary capacity may not want to gain control because of the problems of being "locked into" a corpora-

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104 *Id.*
105 *Id.*
106 12 U.S.C. § 1841 *et. seq.* (1971 Supp.).
107 12 U.S.C. § 1841 *et. seq.* (1964).
108 *See generally* 3 U.S. Code Cong. & Ad. News at 5520-22 (1970-71). The 1956 Bank Holding Company Act was designed to limit bank holding companies to the ownership and management of banks. In addition it limited the size of the holding company and prevented them from controlling non-banking assets. However the 1956 Act exempted all holding companies which controlled only one bank. Thus a method of avoiding the 1956 Act was to obtain control of more than one bank but with ownership of less than 25% of the bank's stock, 25% being the definition of ownership under the Act. The 1970 legislation brought one bank holding company within the scope of the 1956 Act and shut off the 25% exemption.

tion which may eventually become an unprofitable investment. However, as previously indicated, banks, because of their fiduciary activities, do exercise a limited, if not absolute, control in many non-banking corporations. It is this domination that concerns opponents of the bank operated CIF. Congress has not undertaken to discuss this issue in any detail in any of the congressional hearings on CIF legislation. This is understandable since the potential problem was raised only in a general manner by mutual fund spokesmen who made vague references to the danger of concentration without attempting to substantiate their claims.[109] Because of the notable absence of interest concerning this issue it becomes a highly speculative endeavor to predict the amount of new assets which will be funneled into bank activities by the addition of CIFs. It has been estimated that as much as $2 billion will be garnered by bank operated CIFs in the first ten years of operation[110] but changing investment patterns and limitations on CIF advertising may well prove this figure to be exaggerated.[111] But even if the estimate proves true the growth of CIF assets would represent only a miniscule addition to the more than $1/4 trillion of already existing trust assets. It is more likely that any real growth will come from management of pension and profit-sharing plans rather than from

[109] *1967 Hearings, supra* note 4, at 1248 (statement of Robert Augenblick).

[110] *1964 Hearings, supra* note 4, at 26.

[111] It appears that the heady bull market days of the late 1960's are over for the Mutual Fund Industry. According to recent data:

> . . . The funds have just completed their worst net sales year since 1954 and simultaneously are immersed in a sea of other problems ranging from low profits to new legal and ethical questions.
>
> In no fewer than four months in 1971, fund stockholders actually cashed in more shares than they bought for the first time since 1940, when industry records begin. In fact, the industry would have run on a net redemption basis for all of 1971 except for its practice of counting reinvested dividends on fund shares as new sales. Industry sources estimate 1971 net sales at $600 million, reinvested dividends at $800 million. And it's not that there hasn't been investment money. Bonds, new closed-end funds and real-estate-investment trusts—though they recently took a licking—have had big successes this year. 'This is money that could have gone into mutual funds,' laments Harry B. Freeman, Jr., president of the Channing Funds.

NEWSWEEK, Jan. 10, 1972, at 54.

On the other hand no-load mutual funds, which are similar to the First City fund, have fared better than the load funds.

> Quick business quiz: how does a group of companies sell its product if it has no salesmen? Answer: by making that fact a virtue—indeed, the main merchandising point.
>
> Whatever marketing professors might think of that reply, it describes the strategy of the little known 'no-load' mutual funds. Four years ago, there were 65 no-load funds. Now there are 160 with 1.4 million shareholder accounts, a fourfold increase. Last year, when mutual funds as a whole suffered an excess of redemptions over sales, the no-loads went on registering increases in net sales.

TIME, March 6, 1972, at 66.

CIFs. Whatever the amount that eventually will be amassed by CIFs there is a further control beyond this fiduciary obligation to diversify that will limit increased domination of non-banking industries. The combined effect of Regulation 9[112] and section 5 of the Investment Company Act[113] will be to limit fund ownership of any corporation to 10% of the outstanding stock of the corporation or 5% of fund assets. Although it would still be possible to exercise some degree of control with 10% of the outstanding stock when considered against the nature of the banking activity the dangers seem minimal.

The more pervasive question of whether bank domination has reached a point that it should be legislatively reduced is, of course, beyond the scope of this paper. It appears that to a large extent the issue was raised in relation to CIF legislation as a catch all by mutual fund spokesmen in the hope of appropriating whatever support there is for a reduction of bank growth. If legislation is needed to restrict bank power it should not be applied piecemeal at the insistence of a special interest group but only after proper investigation shows that limitation would be in the public interest.

CIF Personnel

An additional danger which, strictly speaking, does not arise under either the Investment Act or the Banking Act, is the shortage of experienced mutual fund and bank management personnel. The problem has arisen because the numerical growth of qualified personnel has not kept pace with the rapid expansion of mutual funds and the increase in bank management activities.[114] The resulting possibility is that bank CIFs might not be able to obtain the knowledgeable personnel necessary to adequately protect fund assets. Although this problem may be characterized as a temporary one which will be solved as the public's interest in mutual funds levels off, it should not be dismissed as merely a cyclical difficulty. Billions of dollars are entrusted to mutual fund and bank management personnel and a failure to properly invest these funds, even for a short period of time, could

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[112] 12 C.F.R. § 9.18(b)(9)(ii) (1964).
No investment for a collective investment fund shall be made in stocks, bonds or other obligations of any one person, firm or corporation if as a result of such investment the total amount invested in stocks, bonds or other obligations issued or guaranteed by such person, firm or corporation would aggregate in excess of ten per cent of the then market value of the fund: *Provided,* That this limitation shall not apply to investments in direct obligations of the United States or other obligations fully guaranteed by the United States as to principal and interest.

[113] 15 U.S.C. § 80a-5(b)(1) (1964).

[114] Lehr, *supra* note 42, at 191-94.

bring a sufficiently adverse public reaction as to dry up a much needed source of capital for industry. The real crux of the matter is the extent to which bank operated CIFs would add to the expansion of mutual funds and further deplete the pool of experienced personnel. There is no exact answer to this question but it is likely that bank participation will, to some extent, add to this imbalance of fund growth versus experienced personnel. On the other hand since 93% of mutual fund investors in 1967 invested less than $10,000[115] it may be that banks, with their $10,000 minimum, will have less of an impact than expected, at least as to new money brought into funds. Unfortunately this potential danger has been largely ignored in congressional hearings on CIF legislation. It is known, however, that lack of competent personnel has been a contributing factor to an increasing number of bank mergers within the last several years.[116] Since it is the public's interest, not the banking industry's, which lies at the heart of any proposed legislation, it is fundamental that any question as to fund management be closely analyzed to protect the fund's investors.

BENEFITS

The previous discussion may be considered the negative side of a bank operated CIF but, as in most cases, there is a corresponding positive side. The load charge received by most mutual fund companies is a problem that has received recent congressional attention. It is apparent that the closely knit mutual fund industry has spawned a service charge that is excessive, being the result of a lack of meaningful competition. The Investment Company Act of 1970[117] has attempted to reduce the load charge by self-regulation through the National Association of Securities Dealers under the watchful eye of the SEC. It is hoped that fees will be reduced in this manner rather than by regulatory decree, but it seems more in keeping with time honored American tradition that rates be set by competition in the marketplace rather than by legislation. Banks offer that competition. The bank service charge of ½% per annum on fund assets will compare favorably with the 7½-8% load charge now offered by most mutual funds. At a time when brokerage charges are on the increase the small investor is in need of this competition to allow him the most economical avenue to the market.

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[115] *Hearings on H.R. 9510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess. at 155 (1967).

[116] Lehr, *supra* note 42, at 191-92.

[117] Act of Dec. 14, 1970, Pub. L. No. 91-547, 84 Stat. 1413.

Bankers have consistently argued that a bank operated CIF is in keeping with traditional banking services and that it represents no more than a combination of the commingled trust account and the managing agency account, both of which it is presently entitled to operate.[118] A contrary argument is that the combination of these functions represents something entirely new, that "differences of degree become differences of kind."[119] The semantics of this may be argued indefinitely but within a practical context the managing agency account as now operated allows a bank to invest and re-invest the assets of an individual for the sole purpose of appreciation of capital, much the same as it would do for a group of individuals under a CIF. However where the minimum amount for an individual managing agency account is $200,000[120] the minimum for entry into a CIF will be $10,000. This will allow many small investors to be able to have the full range of their financial needs taken care of under one roof. The benefit to the public is a more convenient and more consistent handling of their financial affairs.

As previously stated, the entry of banks into mutual funds can not be viewed in a vacuum but must be examined within the totality of bank activities. If banks are denied access to an activity which is so closely akin to their present day functions it is likely that the banking industry has reached the last of its expansionist activities and will be harnessed in its present situation for some time to come. Bankers argue that to prevent the natural growth of dynamic banking will work to stultify the industry, thus resulting in a decrease in the imaginative personnel now operating banks with a corresponding danger that a banking industry unduly restricted to activities of the past will cease to be an innovative factor in the growth of our economy.[121] The history

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[118] R. Mundheim, *supra* note 10, at 14; *see also, 1967 Hearings* at 1228 (statement of Dean Miller).

> The pooling by banks of small fiduciary accounts into more economically manageable units, however one chooses to label it, is nothing more than the combination of two financial services which banks have made available to their customers for many years. These are the management of investment portfolios for their customers, and the operation of commingled funds for the more economical investment of monies held as a fiduciary.

[119] *1966 Hearings* at 80 (statement of Eugene Rostow).

> The present proposal is justified as a modest enlargement of existing practice and the common trust fund exemption from securities statutes. But the CIF proposals represent something quite different, and quite new. They would permit the banks to act as investment advisers and managers on a novel scale, going far beyond the historic limits of their fiduciary services. Here, as is often the case, differences of degree become differences in kind.

[120] *1966 Hearings, supra* note 4, at 200-01 (brief of First National City Bank Before the SEC).

[121] *See generally* Harfield, *supra* note 1, at 578-79.

of bank services has been one that has constantly grown with the needs of the public it serves. Whether it be the management of trusts or the introduction of bank credit cards, banks have been at the forefront of providing service to the expanding needs of the public. It is undeniable that the availability of bank capital and expertise in these areas has had a beneficial result in the nation's economic expansion. Whether as a nation we can afford the price of a static banking industry is conjectural but the final decision on bank operated CIFs may well set the tenor for bank activity for years to come.

CONCLUSION

The attempt to approve bank operated CIFs has been described as "the kind of situation the doctor faces in confronting a medical problem he thought was solved fifty years ago, and he does not recognize the symptoms."[122] To a large extent this attitude underlies much of the opposition to bank entry into mutual funds. It is thinking born in the dreary days of the depression and nurtured through the years, either consciously or subconsciously, but it has no application when applied to bank operated CIFs. The abuses of the 20's and 30's are simply not relevant within this context. There is no denying that some abuse is possible but nothing would ever be gained if absolute freedom from abuse was the criterion. When applied to the CIF, the possibility of abuse is just not sufficient to prevent an activity that will benefit the investing public.

With the overshadowing spectre of judicial activity now gone, the issue is squarely before Congress. Legislation should again be introduced to allow bank operated CIFs and this time, approval should be granted.

James G. Woltermann

[122] R. Mundheim, *supra* note 10, at 15-16.