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NOTES

COMMERCIAL BANK PRIVATE PLACEMENT ACTIVITY: CRACKING GLASS-STEAGALL

The American financial industry¹ is undergoing a metamorphosis of major proportions. Financial institutions of different molds are shedding their traditional roles and diversifying their services in response to changing economic conditions and market demands.² Growing competition between varied types of financial institutions is eroding the artificial barriers which have separated specialized sectors of financial markets.³ The spur

1. The term "financial industry" is used in this article in its broadest sense, encompassing all institutions which serve the financial needs of American consumers, businesses, and governments. These institutions include commercial banks, savings and loan associations, mutual savings banks, credit unions, trust companies, insurance companies, investment companies, and securities underwriters, brokers, and dealers.

2. See, e.g., *Ten Local Credit Unions Start Electronic Banking*, Wash. Post, Nov. 10, 1977, § B, at 3, col. 2; *Credit Unions to Offer VISA Cards*, Wash. Post, Oct. 14, 1977, § B, at 3, col. 4; *Banks Cash in on Capital-Equipment Leasing*, BUS. WEEK, Aug. 8, 1977, at 62; *Merrill Lynch Gears for Banking Entry*, J. OF COMMERCE, July 11, 1977, at 1. See also *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (9th Cir. 1977), cert. denied, 98 S. Ct. 3069 (1978) (upholding motor vehicle leasing activities by national banks); *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972) (denying national banks authority to operate full-scale travel agencies).

The Federal Reserve Board has permitted bank holding companies to engage in a variety of nonbanking activities which are "closely related" to banking. See the Board's Regulation Y, 12 C.F.R. § 225.4 (1977), authorizing bank holding companies and their subsidiaries to act as investment advisers to registered investment companies and to provide leasing, courier, and management consulting services as well as certain kinds of insurance. See also *Alabama Ass'n of Ins. Agents v. Bd. of Governors of the Fed. Reserve Sys.*, 533 F.2d 224 (5th Cir. 1976), cert. denied, 435 U.S. 904 (1978) (upholding portions of § 225.4(a)(9) of Regulation Y).

3. See Lovati, *The Growing Similarities Among Financial Institutions*, 59 FED. RES. BANK OF ST. LOUIS REV. 2 (1977). The report of the President's Commission on Financial Structure and Regulation recommended the abolition of statutorily imposed specialization within the financial industry. PRESIDENT'S COMMISSION ON FINANCIAL STRUCTURE AND REGULATION, THE REPORT 9 (1971). Congress and the federal financial regulatory agencies have also taken several steps in this direction. See, e.g., S. 2684, 95th Cong., 2d Sess. (1978) (a bill introduced by Sen. Proxmire to broaden the lending and investment powers of savings and loan associations), 124 CONG. REC. S3139 (daily ed. Mar. 7, 1978) (remarks of Sen. Proxmire); Act of Oct. 28, 1977, Pub. L. No. 95-147, 91 Stat. 1227 (1977) (authorizing

of competition has promoted greater efficiency and lower costs while stimulating a wide variety of innovative financial services.⁴

One significant aspect of the accelerating trend toward diversification and increased competition in the financial industry is the expansion of commercial banks⁵ into the investment banking⁶ business.⁷ To some observers, this development reflects a natural and healthy evolution of commercial banking in response to competitive forces and the nation's demand for additional capital.⁸ To others, it represents a dangerous attempt by commercial banks to engage in the same kind of speculative activities which led to the 1929 stock market crash and the subsequent collapse of the banking system.⁹ Under either view, the growing involvement of com-

savings and loan associations and credit unions to join commercial banks as depositaries of U.S. Treasury tax and loan accounts); The President's Message on Tax Reduction and Reform, 14 WEEKLY COMP. OF PRES. DOC. 158, 171-72 (Jan. 21, 1978), reprinted in [1978] U.S. CODE CONG. & AD. NEWS 113, 125 (proposing legislation to tax financial institutions on a more equal basis); *Interest-Bearing Checking Accounts—the Ban is Eroding*, N.Y. Times, May 8, 1978, § D, at 1, col. 2; *Thrifits Increasing Share of Checking*, N.Y. Times, Jan. 28, 1978, § 1, at 27, col. 1; *House Panel Votes to Let Some S & L's Offer Check Service*, Wall St. J., June 28, 1978, at 34, col. 1; *Credit Unions Permitted to Grant Mortgages*, Wash. Post, April 4, 1978, § D, at 8, col. 1; *S&L's Quietly Get Right to Issue Credit Cards*, Wash. Star, May 9, 1978, § B, at 5, col. 6; *Credit Unions Surging Into 'Share Draft' Plans*, Wash. Star, March 16, 1978, § B, at 5, col. 5.

4. A variety of new services is available to consumers as a result of increased competition among financial institutions. Increased services include 24-hour cash dispensing services, customer bank communication terminals (CBCT's), automatic stock investment plans, dividend reinvestment plans, travel services, insurance, automobile leasing services, automated teller facilities, interest-bearing (NOW) accounts in some states, and interest-bearing share-draft accounts at credit unions. Many of these innovations have reduced the cost of financial services for consumers.

5. Commercial banks are those institutions chartered by federal and state banking authorities for the purpose of accepting deposits, paying checks, making loans, and performing other activities related to deposit banking. See *Investment Co. Instit. v. Camp*, 401 U.S. 617, 629 (1971).

6. Investment banking has been broadly defined as that business which "serves the users and suppliers of capital by providing the facilities through which savings are channeled into long-term investment," including the origination and merchandising of securities and providing of financial and investment advice. V. CAROSSO, *INVESTMENT BANKING IN AMERICA* ix-x (1970).

7. See *Cracks in Glass-Steagall? Do the Banks Want to Gobble Up Wall Street?*, FORBES, Sept. 16, 1975, at 59; *Banks: Taking on Wall Street*, NEWSWEEK, Sept. 6, 1976, at 45; *Banks Get Into Brokerage Business: Chemical Bank Tests the Water*, 116 TR. & EST. 31 (1977); *Citicorp Forms Securities Firm*, Wall St. J., Sept. 16, 1977, at 5, col. 2.

8. See, e.g., Address by W. Wriston, *Glass, Steagall and the Benchley Principle*, before the Reserve City Bankers Association, Jan. 31, 1977, reprinted in *AMERICAN BANKER*, Feb. 8, 1977, at 4; Golembe, *Glass-Steagall: An Anachronism?* FINANCIER, March, 1977, at 25, 26-28; Golembe Associates, *Commercial Banks and Investment Banking* 49 (1976) (a paper prepared for the Economic and Financial Research Division of the American Bankers Association).

9. See, e.g., Keffe, *What Is Wrong With the American Banking System and What to*

mercial banks in investment banking activities raises troublesome legal questions under the Glass-Steagall Act of 1933¹⁰ which sought to remove commercial banks from investment banking. Investment bankers maintain that the Act imposes a hermetic seal between the two financial sectors.¹¹ Commercial bankers, on the other hand, argue that the Act was intended to foreclose only those investment banking activities which threaten safe banking practices.¹² In seeking judicial endorsement of their respective views in recent years,¹³ these powerful banking factions have illuminated both the Act's ambiguities and its questionable relevance to the modern banking system. The enormous economic stakes involved guarantee continued litigation as commercial banks seek to increase their activities in equity markets to accommodate the burgeoning long-term capital needs of American business and government.¹⁴

One almost certain target of attack by investment bankers is commercial bank involvement in the private placement of securities.¹⁵ A private placement is a direct offering of securities to a limited number of sophisticated private investors, which is exempt from the registration requirements of the Securities Act of 1933.¹⁶ Approximately one-third of long-term debt and equity offerings sold by domestic and foreign issuers has been privately placed since the mid-1960's.¹⁷ Ordinarily, a private placement is arranged by a financial intermediary who brings buyer and seller together

Do About It, 36 MD. L. REV. 788 (1977); *Securities Industry Association, Bank Securities Activities: Memorandum for Study and Discussion*, 14 SAN DIEGO L. REV. 751, 790-95 (1977).

10. 12 U.S.C. §§ 24, 78, 377, & 378 (1976).

11. *See Securities Activities of Commercial Banks, Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. 239-43 (1975)* [hereinafter cited as *1975 Bank Securities Activities Hearings*] (remarks of I.W. Burnham II, Chairman of the Board, Securities Industry Assoc.); *id.* at 326 (remarks of Robert L. Augenblick, President, Investment Company Institute).

12. *See Letter from Hans H. Angermueller, Senior Vice President and General Counsel, Citibank, to the Board of Governors of the Federal Reserve System (Jan. 7, 1977); New York Clearing House Association, Commercial Bank Private Placement Advisory Services: An Analysis of the Public Policy and Legal Issues 10 (1977).*

13. *See Investment Co. Instit. v. Camp*, 401 U.S. 617 (1971); *New York Stock Exch., Inc. v. Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *rev'd and remanded on other grounds sub nom.*, *New York Stock Exch. v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied sub nom.*, *New York Stock Exch. v. Heimann*, 435 U.S. 942 (1978).

14. New capital needs for the 10-year period from 1976 through 1985 have been projected to be \$4.5 trillion. *BUS. WEEK*, Sept. 22, 1975, at 42.

15. *See Private Placements Pit Wall Street Against Banks*, *N.Y. Times*, Jan. 30, 1978, § D, at 1, col. 1.

16. Securities Act of 1933, § 4(2), 15 U.S.C. § 77d(2) (1976); 17 C.F.R. § 230.146 (1977). For a concise description of private placements, *see R. JENNINGS & H. MARSH, SECURITIES REGULATION 27 (1976).*

17. FEDERAL RESERVE BOARD, *COMMERCIAL BANK PRIVATE PLACEMENT ACTIVITIES 15 (1977)* (staff study) [hereinafter cited as *FED. RES. STUDY*].

and negotiates the terms of the transaction.¹⁸ Commercial banks are uniquely equipped¹⁹ to perform this role and have captured an increasing share of the private placement market in recent years.²⁰ Investment bankers argue that intermediaries involved in private placement negotiations are engaged in securities underwriting,²¹ an activity expressly denied to commercial banks, with limited exceptions, by the Glass-Steagall Act.²² This contention was recently rejected by the Federal Reserve Board in a 1977 study of commercial bank private placement activity.²³ While acknowledging that the legality of such activity is "not free from doubt," the study found it legally permissible under the "better view."²⁴

The Federal Reserve study undoubtedly will heighten the tension between commercial and investment bankers and stimulate Congressional review of the premises underlying the Glass-Steagall Act. This Note will examine the Act and assess its future, focusing on the legality of commercial bank private placement and other securities activities.

18. A commercial banker involved in arranging a private placement typically will provide advice as to the structure the proposed financing should take, including matters such as timing, interest rates, maturity, and other terms and conditions. See New York Clearing House Assoc., Commercial Bank Private Placement Advisory Services, An Analysis of the Public Policy and Legal Issues 7-8 (1977).

19. Because of their frequent contacts with corporate banking customers and because the terms of bank lending arrangements might be affected by the issuance of securities, commercial banks are in a position to learn of a need to raise capital at an early stage.

20. Commercial bank-assisted private placements have increased from \$129 million or 1.8% of the total value of assisted placements in 1972 to \$1.3 billion or 7.3% in 1976. Commercial banks accounted for 11% of the number of assisted private placements in 1976. FED. RES. STUDY, *supra* note 17, at 2, 29-31. A recent unpublished study by the Stanford Research Institute estimated that this share will increase to 15-20% by 1981. Stanford Research Institute, Outlook for the U.S. Securities Industry 102 (1977), cited in Commercial Bank Private Placement Advisory Services, *supra* note 18, at 19.

21. Securities Industry Association, Private Placement Activities of Commercial Banks 12 (1977) (memorandum to the Federal Reserve Board).

22. 12 U.S.C. § 24, seventh (1976).

23. FED. RES. STUDY, *supra* note 17. The study was prepared in response to a request by Congressman Henry S. Reuss, Chairman of the House Committee on Banking, Finance and Urban Affairs. Letter from Henry S. Reuss to Arthur F. Burns, Chairman, Board of Governors, Federal Reserve System, (Dec. 15, 1976), reprinted in *id.*, app. A. Similar requests were made to the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Neither of these agencies conducted a comparable study but endorsed the Federal Reserve Board's study after it was released. [1977] 427 SEC. REG. & L. REP. (BNA) A-7; [1977] 432 SEC. REG. & L. REP. (BNA) A-12. One year after the Federal Reserve Board's study was released, the three bank regulatory agencies jointly issued a follow-up study of commercial bank private placement activity substantially reaffirming the 1977 study. COMPTROLLER OF THE CURRENCY, FED. DEPOSIT INSUR. CORP., FED. RES. BD., COMMERCIAL BANK PRIVATE PLACEMENT ACTIVITIES (June 1, 1978).

24. FED. RES. STUDY, *supra* note 17, at 4-5.

I. THE BANKING ACT OF 1933—REACTION AND REFORM

Glass-Steagall is the popular name for the securities provisions of the omnibus Banking Act of 1933²⁵ which was designed to revamp the collapsed banking system in the wake of the 1929 stock market crash.²⁶ The Act embodies three basic Congressional objectives: to restore public confidence in the banking system, insure economic stability, and forestall potential conflicts of interest between commercial and investment banking operations.²⁷ To aid in the accomplishment of these objectives, the Glass-Steagall provisions prohibit individuals or firms in the investment banking business from engaging simultaneously in deposit banking activities.²⁸ The Act also bars affiliations²⁹ and personnel interlocks³⁰ between commercial and investment banking firms and restricts the securities activities of commercial banks to purchasing and selling upon the order and for the account of customers.³¹ Commercial banks are permitted to purchase investment securities for their own accounts under restrictions prescribed by the Comptroller of the Currency.³² Securities underwriting by commercial banks is prohibited, except for obligations of the United States and state and local governments.³³

The Glass-Steagall prohibitions on commercial bank securities activities were fathered largely by public outrage against bankers and excessive political efforts to restore public confidence in the banking system following the 1929 financial debacle. The securities activities of commercial banks

25. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified in scattered sections of 12 U.S.C.).

26. For a detailed history of the Banking Act of 1933 and the Glass-Steagall provisions, see H. BURNS, *THE AMERICAN BANKING COMMUNITY AND NEW DEAL BANKING REFORMS, 1933-35*, (1974); S. KENNEDY, *THE BANKING CRISIS OF 1933* (1973); Smith, *Glass-Steagall—A History of Its Legislative Origins and Regulatory Construction*, 92 *BANKING L.J.* 38 (1975); Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 *BANKING L.J.* 483 (1971); OFFICE OF CAPITAL MARKETS POLICY, U.S. DEP'T OF TREASURY, *PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES*, app. (1975) [hereinafter referred to as *PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES*].

27. *PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES*, *supra* note 26, at 3-4.

28. Banking Act of 1933, ch. 89, § 21, 48 Stat. 189, *as amended by* 12 U.S.C. § 378 (1976).

29. *Id.*, § 20, 48 Stat. 188, 12 U.S.C. § 377 (1976).

30. *Id.*, § 32, 48 Stat. 194, 12 U.S.C. § 78 (1976).

31. *Id.*, § 16, 48 Stat. 184, 12 U.S.C. § 24 (1976). This section restricts the securities activities of national banks. Identical restrictions are imposed on state member banks of the Federal Reserve System by *id.*, § 5(c), 48 Stat. 165, 12 U.S.C. § 335 (1976).

32. *Id.*, § 16, 48 Stat. 184, *as amended by* 12 U.S.C. § 24 (1976).

33. *Id.* The exception for obligations of state and local governments is limited to general obligations. Commercial banks were prohibited from underwriting municipal revenue bonds—those payable from specified sources of revenue such as tolls, user charges, or designated taxes—after an adverse court decision in *Port of N.Y. Auth. v. Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968).

and their securities affiliates³⁴ were widely believed to have fueled speculation and exaggerated business and monetary fluctuations prior to the stock market crash.³⁵ Sensational congressional hearings focusing on the nation's second largest bank and its securities affiliate revealed manipulative practices and banker self-dealings that were thought to pervade the entire industry.³⁶ Evidence that some banks had diverted deposits into unsound investments by financing perilous underwriting operations of their affiliates tended to confirm the view that bank securities activities were incompatible with safe banking practices.³⁷ Bankers resolutely denied that such abuses were widespread. Their credibility was severely damaged, however, by the failure of over 4,000 banks and numerous indictments of bank officials for fraud during the course of legislative deliberations on Glass-Steagall.³⁸ The failure of the Bank of United States in 1930, widely attributed to that bank's securities activities, was cited as proof that the soundness of the entire banking system had been eroded by bank involvement in the securities markets.³⁹

In addition to inflicting financial losses on millions of depositors and shareholders and inflaming public opinion against bankers, the failures exposed fundamental flaws in the banking system which had fostered its collapse. Most of the banks that failed were small, undercapitalized, and poorly managed. They also lacked membership in the Federal Reserve System which required minimum reserves and offered access to emergency funds.⁴⁰ Many failures had occurred in outlying rural areas which, with the advent of automobile travel and new roads, were being served by more competitive in-town banks.⁴¹ Because of the ban on branch banking in most states, banks which faltered were forced to terminate in bankruptcy

34. Commercial bank securities activities were conducted largely through affiliates prior to 1933. Securities affiliates developed after a Comptroller of the Currency ruling in 1902 interpreting the National Banking Act as disallowing direct bank involvement in underwriting and distribution of equity securities. The Comptroller later recommended legislation to permit national bank underwriting of investment securities but such legislation was not enacted until 1927. PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES, *supra* note 26, at app. 5, 8. See also W.N. PEACH, THE SECURITY AFFILIATES OF NATIONAL BANKS (1941).

35. S. REP. NO. 77, 73d Cong., 1st Sess. 3-10 (1933); 77 CONG. REC. 4028 (1933) (remarks of Rep. Fish).

36. *Hearings on S. Res. No. 71 Before a Subcomm. of the Senate Comm. on Banking & Currency*, 71st Cong., 3d Sess. (1931) [hereinafter cited as *1931 Hearings*]. See S. KENNEDY, *supra* note 26, at 108-28.

37. S. REP. NO. 77, *supra* note 35, at 10.

38. PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES, *supra* note 26, at 4.

39. *1931 Hearings*, *supra* note 36, at 116-17, 1017, 1068.

40. *Id.* at 34, 46, 396.

41. *Id.* at 7, 252-53, 375.

rather than through acquisition by a healthy bank as a going concern.⁴² The power of the Federal Reserve Board and the Comptroller of the Currency to discipline unsafe banking practices was found to be insufficient.⁴³ The Comptroller, for example, lacked power to remove bank officers and had no authority to examine bank security affiliates. The laxity of the Federal Reserve Banks in allowing banks to use the discount window indiscriminately for rediscounting notes that financed securities purchases was found to have aggravated speculation.⁴⁴

The fundamental defects in the banking system were repaired by the Banking Act of 1933, which introduced the federal deposit insurance system among other much-needed reforms.⁴⁵ Public hostility toward bank securities activities aroused by the banking collapse and the exposure of bank misdealings in the stock market, however, spurred Congress to embrace the banking philosophy of Senator Carter Glass.⁴⁶ Architect of the 1913 Federal Reserve Act and other banking legislation for over a quarter of a century, Glass viewed investment banking as alien to the proper and traditional role of commercial banks.⁴⁷ Glass espoused the so-called commercial loan theory that banks should be confined to making short-term loans to finance the production of goods.⁴⁸ Corporate financing through the public securities markets was viewed with suspicion by Glass and others, who distrusted the wisdom of the ordinary investor and believed that securities financing diminished desirable bank control over the allocation of capital.⁴⁹ Many members of Congress shared Glass' view that the tie between commercial and investment banking impaired the ability of commercial banks to function as impartial allocators of credit and disinter-

42. *Id.* at 34.

43. *Id.* at 7, 20, 39, 47-48.

44. *Id.* at 50-51.

45. The Banking Act of 1933, 48 Stat. 162-95 (codified in scattered sections of 12 U.S.C.), prohibited the payment of interest on demand accounts, gave the Comptroller of the Currency and the Federal Reserve Board authority to examine affiliates of banks and to remove bank directors who engaged in unsafe or unsound banking practices, expanded the power of national banks to branch, and provided for more rigid control over capital requirements of federally supervised banks, in addition to other provisions.

46. Senator Glass was chairman of the subcommittee which drafted the Glass-Steagall Act. As former Secretary of the Treasury under President Wilson and Chairman of the Senate Appropriations Committee as well, he wielded considerable power in the Senate. JOINT ECONOMIC COMMITTEE OF CONGRESS, THE FEDERAL RESERVE SYSTEM, 94th Cong., 2d Sess. 115 (Joint Comm. Print 1977). Glass was instrumental in incorporating a provision calling for the divorce of commercial banks from investment banking in the 1932 Democratic platform. Perkins, *supra* note 26, at 518.

47. See PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES, *supra* note 26, at app. 12-15.

48. *Id.*

49. *Id.* at 13-14.

ested investment advisers. A parent bank seeking to promote its underwriting affiliate might favor customers who borrowed funds to purchase securities from the affiliate or extend credit on favorable terms to companies in which its affiliate had invested. Commercial banks might be tempted to promote the sale of unmarketable securities to their unwitting customers or correspondent banks, or even to their own trust accounts.⁵⁰ These hazards, Glass and the Seventy-Third Congress concluded, made it necessary to sever commercial banks from the securities industry.

Two years after the divorce between commercial and investment banking was imposed, however, depressed business conditions prompted second thoughts about the wisdom of such a drastic measure. Senator Glass sought to amend the Glass-Steagall Act to permit commercial banks to underwrite corporate securities to a moderate extent in order to aid the faltering heavy goods industries.⁵¹ In spite of the enactment of the Securities Acts of 1933⁵² and 1934,⁵³ which subjected the securities industry to extensive regulation, a majority of the Congress adhered to the rigid separation of commercial banks from investment banking activities.⁵⁴ Although the statutory line between commercial and investment banking remained firmly fixed, latent ambiguities in the language and purpose of Glass-Steagall persisted. These ambiguities have been illuminated in recent years as commercial banks have innovatively sought to engage in securities activities within the Act's parameters.

II. THROUGH THE JUDICIAL LOOKING GLASS

In 1965, the Comptroller of the Currency endorsed a national bank's plan to offer a mutual investment service.⁵⁵ The plan enabled individual customers to pool their funds to take advantage of the bank's financial expertise developed in the management of large trust accounts. The investment scheme combined three unquestioned legal activities: the pooling

50. *Id.* at 32 & app. 18-21.

51. 79 CONG. REC. 11933 (1935) (remarks of Senator Glass).

52. 15 U.S.C. §§ 77a-aa (1976).

53. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified in scattered sections of 15 U.S.C.).

54. The Glass amendment won Senate endorsement but failed to gain the approval of the House of Representatives. H. CONF. REP. NO. 1822, 74th Cong., 1st Sess. 53 (1935).

55. The plan was approved under 12 C.F.R. § 9.18 (1970). It involved the operation of a mutual fund in which customers who invested were given units of participation. Participation units were freely redeemable and transferable to anyone who had a managing agency account at the bank.

of trust assets,⁵⁶ the management of individual agency accounts,⁵⁷ and the purchase of stock for individual customer accounts.⁵⁸ In *Investment Company Institute v. Camp*,⁵⁹ however, the Supreme Court held this combination invalid under the Glass-Steagall Act. Declaring that the purpose of the Act was to "prohibit commercial banks . . . from going into the investment banking business,"⁶⁰ the Court relied on the underlying Congressional policy that spurred its enactment in testing whether the mutual fund involved a forbidden sale of securities. After identifying the financial hazards which had concerned the Seventy-Third Congress, the Court examined the mutual fund to detect similar dangers. It found that promotional pressures resulting from the bank's "salesman's interest" in the fund could tempt the bank to rescue faltering investments through unsound banking measures. Moreover, the bank's pecuniary and reputational stake in the fund could distort its credit decisions to favor purchasers of interests in the fund or firms in whose securities the fund had invested. Additionally, talent and resources of the bank might be diverted from its commercial banking operations and, if the fund's investments turned sour, the bank would suffer a loss of public confidence and risk insolvency.⁶¹ The Court declined to be influenced by the argument that the hazards of commercial bank involvement in securities activities are outweighed by the benefits of increased competition, convenience, and expertise that they bring to the investment market.⁶² A contrary balance had been struck by Congress forty years earlier, the Court observed. It did not assume the power to reopen the balance, thereby ignoring the impact of subsequent regulatory measures which could have neutralized the effect of the hazards it perceived.⁶³ By focusing on the "more subtle hazards"⁶⁴ which Glass-

56. The legal authority of commercial banks to pool trust assets is generally recognized as a proper and traditional bank activity. *Investment Co. Instit. v. Camp*, 401 U.S. 617, 625 (1971).

57. The management of individual agency accounts is authorized by 12 U.S.C. § 92a (1976).

58. *Id.* § 24 authorizes the purchase of stock for the account of customers.

59. 401 U.S. 617 (1971).

60. *Id.* at 629.

61. *Id.* at 630-38.

62. *Id.* at 630.

63. Former Comptroller of the Currency, James E. Smith, criticized the Court's analysis as an attempt "to apply a legislative remedy which was fashioned with certain specific abuses committed at a certain period of history to a different service being carried out at a different historical period" which ran the risk of becoming "arbitrary and artificial." *1975 Bank Securities Activities Hearings, supra* note 11, at 193. The plasticity of the Court's test was demonstrated by Justice Blackmun in dissent. Challenging the majority's attempt to distinguish the dangers of commercial bank operation of a mutual investment fund as opposed to a mutual trust fund, he argued that the same possibilities for abuse and threat to bank stability exist in both. 401 U.S. 617, 644 (1971). Blackmun similarly found no basis in the language of the Glass-Steagall Act for the majority's holding that the combination of otherwise lawful commercial bank activities renders them unlawful. *Id.* at 645.

64. *Id.* at 617, 630.

Steagall was designed to expunge, the Court demonstrated the Act's potency. By carefully limiting its decision to the type of mutual fund at issue,⁶⁵ however, the Court invited further commercial bank attempts to devise investment schemes compatible with Glass-Steagall. Commercial banks were not long in responding to the invitation.

In June of 1974, the Comptroller of the Currency approved a national bank's plan to offer an automatic stock investment service—AIS. Plan participants could designate small sums to be deducted automatically from their accounts each month and invested in one of a number of blue-chip securities.⁶⁶ The Investment Company Institute⁶⁷ was joined by the New York Stock Exchange in challenging the alleged intrusion into forbidden investment banking territory. In *New York Stock Exchange, Inc. v. Smith*,⁶⁸ the District Court for the District of Columbia sustained the AIS plan, finding it unobjectionable under either the language or the spirit of Glass-Steagall. The court observed that section 16 of the Act authorizes national banks to purchase and sell securities as agents of their customers if the transaction is without recourse, at the request of customers, and for customer accounts. The AIS plan met each requirement.⁶⁹ The district court did not evaluate the combined legal effect of the bank's activities as the Supreme Court had done in *ICI v. Camp*. It did examine the potential hazards posed by the AIS plan, however, and by detecting subtle differences and relying on existing regulatory reforms as safeguards against potential abuse, it found the activity beyond the reproach of Glass-Steagall.⁷⁰ In the court's view, the most significant factor distinguishing the

65. *Id.* at 638.

66. Funds designated for investment under the plan were held by the bank in a common investment account. The bank had 30 days in which to purchase stocks upon the order of customers, and the stocks were held in the bank's name. When a customer sold his stock, the bank could match the sell order with a buy order from another customer. Unlike the mutual investment fund challenged in *ICI v. Camp*, the AIS made no recommendation as to the merits of any individual stock and each customer made his own securities selection. The only stocks available for investment under the plan were the 25 stocks having the highest aggregate market value of outstanding stock on Standard & Poor's 425 Industrial Index.

67. The Investment Company Institute is an association of open-ended investment companies, advisors, and underwriters.

68. 404 F. Supp. 1091 (D.D.C. 1975), *rev'd and remanded on other grounds sub nom.*, *New York Stock Exch. v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied sub nom.*, *New York Stock Exch. v. Heimann*, 435 U.S. 942 (1978).

69. 404 F. Supp. 1091, 1097 (D.D.C. 1975).

70. In response to the plaintiffs' argument that the AIS plan posed a potential for abuse since the bank could use the AIS funds interest-free during the thirty day float, the court reasoned that customers were fully aware of the potential conflict when they chose to participate and that federal bank examiners would detect any abuse. *Id.* at 1100. In response to the plaintiffs' argument that AIS customers were unprotected under the Securities Investor Protection Act of 1970, 84 Stat. 1636 (1970), (codified in 15 U.S.C. §§ 78 (o), 78 (aaa)-

AIS plan from the mutual fund struck down in *ICI v. Camp* was the absence of any responsibility for investment decisions on the part of the bank which could jeopardize public confidence.⁷¹

III. PRIVATE PLACEMENTS: COMMERCIAL BANKERS STRIKE AGAIN

The Comptroller of the Currency initially took a more cautious approach toward commercial bank private placement activity than toward commercial bank operation of mutual investment funds and AIS plans.⁷² As recently as 1975, the Comptroller's Office viewed commercial bank involvement in private placement negotiations as lying "at the heart of the investment banking business" and of questionable legality under Glass-Steagall.⁷³ Relying on the views of the Comptroller, the Federal Reserve Board in December of 1976 denied permission to the First Arabian Corporation, a newly formed bank holding company, to retain more than a five percent interest in a corporation engaged in the private placement business. Reiterating the Glass-Steagall divorce policy enunciated in *ICI v. Camp*, the Board concluded that the subsidiary corporation's participation in private placement negotiations transgressed too far into investment banking terrain.⁷⁴ Six months thereafter, the Board released a staff study

78(III) (1976)), the court pointed out that such customers are protected by federal deposit insurance. 404 F. Supp. 1091, 1101 (D.D.C. 1975).

71. *Id.* at 1100.

72. National banks were authorized by interpretive ruling to serve as "finders" in making private placements when the bank's activity was limited to introducing the parties and it took no part in the negotiations. 12 C.F.R. § 7.7200 (1977).

73. The Deputy Comptroller of the Currency in early 1975 warned that bankers substantially participating in negotiations between client and purchaser "may well be engaged in underwriting, selling or distributing securities in violation of the Glass-Steagall Act." Bankers who promised to use only their "best efforts" to market a securities issue and accepted a fee contingent upon successful marketing "undoubtedly" were involved in such activity. Letter from Justin T. Watson, Deputy Comptroller of the Currency, to Joe Selby, Regional Administrator of National Banks, (Jan. 15, 1975), reprinted in Securities Industry Association, *Bank Securities Activities: Memorandum for Study and Discussion*, 14 SAN DIEGO L. REV., 751, 811-12 (1977). The Comptroller never took the position that national bank private placement activity in fact violated the Act, however, and in 1976 the Office announced that it was actively reconsidering its former views. AMERICAN BANKER, June 14, 1976, at 1, col. 2.

74. 63 FED. RES. BULL. 68 (1977). Section 225.4(g)(2)(v) of the Board's Regulation Y applies the Glass-Steagall restrictions to bank holding companies. For background and discussion of the application of the Glass-Steagall Act to bank holding companies, see Golembe Associates, Inc., *Bank Holding Companies and the Glass-Steagall Act* (July 24, 1975) (prepared for Ass'n of Registered Bank Holding Companies). The Board's decision provoked an immediate response from the nation's biggest banks protesting its broad sweep. If a bank holding company subsidiary's participation in private placement negotiations violated the strictures of Glass-Steagall, it seemed to follow a fortiori that a national bank's direct involvement in the same activity was unlawful. Securities Industry Assn., *Private Placement Activities of Commercial Banks 18-20* (1977). In a letter to the Board of Gover-

of commercial bank private placement activities which substantially conflicted with its earlier view.⁷⁵ The study concluded that commercial bank private placement activity was not barred by Glass-Steagall and offered appreciable public benefits by increasing competition in the private placement market.⁷⁶

In contrast to the policy-oriented approach of the *ICI v. Camp* and *NYSE v. Smith* opinions, the Federal Reserve Board study's analysis of the legal aspects of commercial bank private placement activity took a definitional approach. It focused on two basic questions: whether commercial bank assistance in private placements constitutes underwriting or selling of securities prohibited by the Act, and whether such activity amounts to engaging in the "business of dealing in securities" which, under the Act, must be confined to purchasing and selling without recourse for the account of customers.⁷⁷ By taking advantage of the absence of clear definitions in the Act and selectively drawing on definitions from the Securities Act of 1933, the study put private placement activities outside the reach of Glass-Steagall.

The study used tortuous reasoning to escape the conclusion that commercial banks engage in underwriting when performing an intermediary role in private placements.⁷⁸ In this role, the study correctly asserted, banks do not act as "firm commitment" underwriters since they do not purchase securities for resale to third parties. Their role does bear a disturbing resemblance to "best efforts" underwriting, however, which entails

nors, the Senior Vice President and General Counsel of Citibank pointed out that the only feasible way of financing certain major financial transactions in order to meet the capital needs of industry is through multi-bank loan syndicates combined with long-term debt obligations placed directly with institutional investors. Moreover, such a definitive interpretation at a time when the Comptroller and other federal agencies, including the Board itself, were studying the private placement question at the request of Congress was inappropriate. Letter from Hans A. Angermueller, Senior Vice President and General Counsel, Citibank, New York, to the Board of Governors of the Federal Reserve System (Jan. 7, 1977). Two days prior to the issuance of the First Arabian decision, Chairman Henry Reuss of the House Banking Committee had written to the three federal bank regulatory agencies requesting each to study and report on the private placement activity of commercial banks within six months. The Board subsequently issued a letter stating that it had not intended the First Arabian decision to apply to national banks and that such a determination of the issue would be premature in light of ongoing study. [1973-78 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 82,300.

75. FED. RES. STUDY, *supra* note 17.

76. *Id.* at 4-5. In addition to the legal aspects of commercial bank private placement activity, the study examined the nature of the private placement market, available data sources concerning private placements, the effect of commercial bank private placement activity on competition and concentration within the investment banking industry, and related regulatory issues.

77. *Id.* at 81.

78. *Id.* at 87-89.

selling securities as an agent rather than as a dealer.⁷⁹ The 1933 Securities Act definition of "underwriter" includes best efforts underwriters.⁸⁰ The study conceded that commercial bank involvement in private placement negotiations for a contingent fee could be construed as best efforts underwriting.⁸¹ But "even if" it were deemed to be such, the study argued, that would not necessarily put it within the forbidden zone of Glass-Steagall. The Securities Act definition of underwriter applies only to persons involved with public, as opposed to private, offerings of securities. Neither best efforts nor firm commitment underwriters whose activities are confined to private placements are considered underwriters for purposes of that Act, the study pointed out.⁸² Parenthetically, it added that the Securities Act definition is not controlling for Glass-Steagall purposes.⁸³ Without that concession, under the study's reasoning a commercial bank could engage in firm commitment underwriting without violating the Glass-Steagall Act as long as there was no public offering.

The study's analysis of whether commercial bank private placement activity amounts to "selling" securities within the meaning of the Glass-Steagall Act was equally tortured.⁸⁴ The study conceded that under the Securities Act a bank which solicits parties or actively participates in arranging a private placement is arguably engaged in selling securities. But "even if" such activity were selling, the study detected a possible escape hatch in the Glass-Steagall provision allowing commercial banks to sell securities for the account of customers. One plausible interpretation of the term "customer," however, would confine it to persons having a pre-existing relationship with the bank unrelated to its private placement services. The study hurdled this question by concluding that private placement activity does not expose a commercial bank to the risks of fluctuating securities values at which Glass-Steagall was aimed, and thus can claim the customer exemption irrespective of any definitional conflict.⁸⁵

79. L. LOSS, *SECURITIES REGULATION* 171-72 (student ed. 1961).

80. Section 2(1) of the Securities Act of 1933 broadly defines as an underwriter "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking . . ." 15 U.S.C. § 77b(1) (1976). See *Dale v. Rosenfeld*, 229 F.2d 855 (2d Cir. 1956).

81. FED. RES. STUDY, *supra* note 17, at 88.

82. *Id.* at 89.

83. See Miller, *The Participation of National Banks in Private Placements of Corporate Securities*, 13 N. ENG. L. REV. 63, 76-81 (1977), rejecting a definitional analysis of commercial bank private placement activity based on the Securities Act of 1933.

84. FED. RES. STUDY, *supra* note 17, at 93-99.

85. *Id.* at 95-99.

In addition to its definitional analysis, the Federal Reserve study also examined whether commercial bank private placement activity created other hazards of the type that Glass-Steagall was designed to forestall. It found that commercial banks have handled relatively secure private placements, that bank supervisory and regulatory agencies are able to detect and correct any possible conflicts of interest or self-dealing, and that private placements account for a small, albeit growing, portion of commercial banking business.⁸⁶ To qualify for the private offering exemption under the Securities Act of 1933, the study emphasized, buyers in private placement transactions must have sufficient knowledge and sophistication to evaluate the risks and merits of a particular investment without depending on the advice of a commercial bank.⁸⁷ Finally, no bank funds are placed directly at risk in a private placement since the role of the bank is limited to that of an intermediary.⁸⁸ While a bank might extend credit to a firm in exchange for its private placement business, the study found no evidence of such practice.⁸⁹

Whether the policy considerations enumerated by the Federal Reserve study should be sufficient to overcome the definitional difficulties of commercial bank compliance with the language of Glass-Steagall in negotiating private placements is questionable. The study's reliance on reforms post-dating or contemporaneous with the Glass-Steagall Act as safeguards against commercial bank abuse in facilitating private placements is at odds with the approach of *ICI v. Camp*. To the extent that regulation of the banking and securities industries has eliminated threats to bank soundness and conflicts of interest associated with commercial bank involvement in investment banking activity, the study implicitly questions the current relevance of Glass-Steagall. Such questioning raises the fundamental legal issue of whether subsequent reforms can legitimately be used to render an unrepealed statute impotent. While the Federal Reserve study and the *NYSE v. Smith* opinion suggest an affirmative answer, the Supreme Court has declined to endorse this position. Any expansion of commercial bank securities activities may thus have to proceed on a course charted by Congress.

86. *Id.* at 63-77.

87. *See* Securities Act of 1933, Rule 146, 17 C.F.R. § 230.146 (1977); *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); *SEC v. Continental Tobacco*, 463 F.2d 137 (5th Cir. 1972); *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971).

88. FED. RES. STUDY, *supra* note 17, at 76.

89. The study did disclose, however, that almost one quarter of commercial bank assisted private placements entailed some bank financing. *Id.* at 2 and 74.

IV. REDEFINING THE ROLES OF COMMERCIAL AND INVESTMENT BANKERS

Commercial and investment banking institutions have come under increasing Congressional scrutiny in recent years.⁹⁰ The Congressional consensus generally endorses a relaxation of artificial barriers within both industries in order to enhance competition and economic efficiency.⁹¹ Legislation authorizing broader commercial bank involvement in certain realms of the securities markets has been introduced and considered.⁹² Incorporation of investment banking subsidiaries abroad by U.S. commercial banks in recent years without Congressional interference evidences a growing tolerance of commercial bank securities activities.⁹³ The rigid separation policy of Glass-Steagall thus appears to have little chance of

90. See *The Safe Banking Act of 1977, Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation & Insurance of the House Comm. on Banking, Finance & Urban Affairs*, 95th Cong., 1st Sess. (1977); *Federal Bank Commission Act, Hearings on S. 2298 Before the Senate Comm. on Banking, Housing & Urban Affairs*, 94th Cong., 2d Sess. (1976); *Financial Institutions and the Nation's Economy, Discussion Principles: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation & Insurance of the House Comm. on Banking, Currency & Housing*, 94th Cong., 1st Sess. (1975); *Securities Activities of Commercial Banks, Hearings on the Expansion of Commercial Banks' Securities Operations and the Elimination of Barriers between the Banking and Securities Industries Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs*, 94th Cong., 1st Sess. (1975); SUBCOMM. ON SECURITIES OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, SECURITIES INDUSTRY STUDY, S. DOC. NO. 93-13, 93d Cong., 1st Sess. (1973); STAFF OF THE SUBCOMM. ON DOMESTIC FINANCE OF THE HOUSE COMM. ON BANKING & CURRENCY, FINANCIAL INSTITUTIONS: REFORM AND THE PUBLIC INTEREST, 93d Cong., 1st Sess. (1973); SENATE COMM. ON BANKING, HOUSING & URBAN AFFAIRS, 93rd Cong., 1st Sess., REPORT OF THE PRESIDENT'S COMMISSION ON FINANCIAL STRUCTURE AND REGULATION (Comm. Print 1973).

91. See, e.g., SENATE BANKING, HOUSING AND URBAN AFFAIRS COMM., SECURITIES ACT AMENDMENTS OF 1975, S. REP. NO. 94-75, 94th Cong., 1st Sess. (1975), reprinted in [1975] U.S. CODE CONG. & AD. NEWS 179, 181.

92. See, e.g., S. 2674, 95th Cong., 2d Sess. (1978) (a bill introduced by Senator William Proxmire to permit commercial banks to underwrite municipal revenue bonds). The Senate passed similar legislation in 1967 and 1974 but the bank underwriting provision was dropped in conference with the House. S. 3838, 93d Cong., 2d Sess., 120 CONG. REC. 30625-30 (1974); H. CONF. REPT. NO. 93-1440, 93rd Cong., 2d Sess. (1974), reprinted in 120 CONG. REC. 34427, 34428 (1974). Numerous exceptions to the Glass-Steagall ban on commercial bank underwriting activities have been adopted since its enactment, generally to permit banks to underwrite new housing or international agency obligations. See Rogowski, *Commercial Banks and Municipal Revenue Bonds*, 95 BANKING L.J. 155, 162 (1978). The House Committee on Banking, Housing and Urban Affairs recently approved legislation that would retain the present exemption from the Glass-Steagall Act for foreign banks operating in the United States. H.R. 7325, 95th Cong., 2d Sess. (1978). The President's Commission on Financial Structure and Regulation recommended legislation to permit banks to manage and sell mutual investment funds and to give them limited equity investment authority. REPORT OF THE PRESIDENT'S COMMISSION ON FINANCIAL STRUCTURE AND REGULATION 42-43 (1971).

93. *Merchant Banking: Is the U.S. Ready for It?*, BUS. WEEK, April 19, 1976, at 54.

long-term survival. Although Congressional concern about potential conflicts of interest remains alive,⁹⁴ a trend toward regulation, rather than restriction, of commercial bank investment activities is emerging.⁹⁵ How far this trend will go and what it means for the future of Glass-Steagall cannot easily be predicted.⁹⁶ As commercial banks are given increased entry into investment banking, investment bankers undoubtedly will demand liberalized entry into commercial banking activities.⁹⁷ Reexamination by Congress of the entire philosophical framework of the Glass-Steagall Act appears to be an inevitable necessity.⁹⁸

Congressional timidity in considering the complete removal of the Glass-Steagall yoke from commercial and investment banks is unwar-

94. See, e.g., Letter from Henry S. Reuss, Chairman of the House Banking, Finance, and Urban Affairs Committee, to John G. Heimann, Comptroller of the Currency, (Dec. 19, 1977).

95. See, e.g., S. 2131, 95th Cong., 1st Sess., 123 CONG. REC. S15371-74 (1977) (a bill introduced by Senator Williams, Chairman of the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, directing the federal bank regulatory agencies to promulgate rules and regulations governing the brokerage and dealer activities of commercial banks).

96. The Act's ban on firm commitment underwriting by commercial banks is one provision likely to survive the current reform movement. In its 1975 hearings on bank securities activities, the Senate Subcommittee on Securities viewed the provision as largely unquestioned. In testimony before the Subcommittee, however, former Securities and Exchange Commission Chairman Roderick Hills pointed out that if increasing commercial bank competition in other areas of the securities industry weakened the industry's underwriting capacity, commercial banks might be needed to supplant that capacity. *1975 Bank Securities Activities Hearings*, supra note 11, at 139. See Plotkin, *What Meaning Does Glass-Steagall Have for Today's Financial World?*, 95 BANKING L.J. 404, 418 (1978).

97. That this is more than a mere possibility was demonstrated by the introduction in 1977 of the "cash management account" by Merrill Lynch, Pierce, Fenner & Smith. The fund enables brokerage customers to borrow, write checks, make VISA card purchases, deposit funds, and earn interest on funds held in their margin accounts. *Merrill Lynch: The Bull in Banking's Shop*, BUS. WEEK, Aug. 8, 1977, at 50; *Merrill Lynch Takes on the Banks*, Wash. Post, July 3, 1977, § G at 1, col. 3. The Federal Reserve Board has told Merrill Lynch that it is "concerned" about possible ramifications of the new account. Deferring to the Justice Department for enforcement of the Glass-Steagall Act, however, the Board stated that the account "doesn't appear to violate" any laws within its authority. The Justice Department has raised no objection to the Merrill Lynch plan. Wall St. J., July 20, 1977, at 4, col. 2. The state banking authorities of Colorado and Oregon, however, have barred the service as an unauthorized intrusion into commercial banking. Wall St. J., May 30, 1978, at 13; June 2, 1978, at 11.

98. Comptroller of the Currency John Heimann recently called for a "thorough review" of the Glass-Steagall Act. Wash. Post, April 18, 1978, § D at 11, col. 3. The Securities Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs currently is conducting an extensive study of bank brokerage-related and investment advisory services, but does not plan to review the Glass-Steagall ban on commercial bank underwriting of corporate securities. SUBCOMM. ON SECURITIES OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94th Cong., 1st Sess., THE SECURITIES ACTIVITIES OF COMMERCIAL BANKS, STUDY OUTLINE IV (Comm. Print 1975).

ranted. There is nothing sacrosanct about maintaining a locked door between the two banking sectors. Many economically stable European countries have successfully blended commercial and investment banking without jeopardizing the health of their banking systems. In Germany, for example, so-called "universal banks" are permitted to accept deposits, underwrite corporate bonds, effect securities transactions, and invest in equities for their own account all under one roof.⁹⁹ Switzerland, Belgium, Luxembourg, and the Netherlands have similar banking systems. In France, investment banks are permitted to accept deposits, and in Great Britain, commercial banks operate investment banking subsidiaries.¹⁰⁰

The economic benefits offered by commercial bank entry into the investment banking business are substantial. Commercial bank securities investment services have already demonstrated the ability of banks to attract many small investors who would not enter the securities markets otherwise and to lower transactional costs for individual investors.¹⁰¹ Commercial bank entry into the underwriting business would drive down the price of underwriting fees¹⁰² and thus increase the number of businesses that could afford to tap public and private capital markets. Companies too small to get the attention of investment bankers and too big to rely on bank credit for all their financing would be the primary beneficiaries.¹⁰³ Senator William Proxmire acknowledged the competitive benefits of commercial bank underwriting activities in urging support for a bill to permit banks to underwrite municipal revenue bonds. "The availability of bank underwriting," he said, "has enabled municipalities to secure the most favorable rate on their general obligation borrowing By

99. *Merchant Banking: Is the U.S. Ready for It? The German Example*, BUS. WEEK, April 19, 1976, at 89; Mülhaupt, *In Defense of Universal Banks*, THE BANKER 775 (July 1976).

100. H. Terrell, *Activities Permitted to Commercial Banks in Selected Foreign Countries* (1972) (unpublished paper prepared for the Division of International Finance, Federal Reserve Board).

101. *The Legality of Bank-Sponsored Investment Services*, 84 YALE L.J. 1477, 1480-83 (1975). *But see Market Place: Banks as Stockbrokers: Little Success*, N.Y. Times, Nov. 25, 1977, § D, at 2, col. 3.

102. An investment analyst at Merrill Lynch, Pierce, Fenner & Smith indicated in a telephone conversation that the firm's commissions on corporate underwritings, where it does not face bank competition, were substantially higher than its commissions on municipal general obligation bond underwriting, where it does compete with banks. A number of studies have concluded that bank competition in the underwriting of government revenue securities would lower interest costs and ultimately benefit the public. *See e.g.*, S. REP. NO. 93-1120, 93d Cong., 2d Sess. (1974).

103. *Merchant Banking: Is the U.S. Ready for It?*, *supra* note 98, at 69. According to a survey by the Senate Select Committee on Small Business, major Wall Street firms will not underwrite firms with less than \$1 million in profits. Wash. Post, Feb. 11, 1978, § C, at 8, col. 2.

excluding commercial banks from the revenue bond underwriting market, the Glass-Steagall Act stifles competition in this market and causes municipalities to pay a higher rate of interest on their revenue bond issues."¹⁰⁴ Publicly held and private companies should be allowed to benefit from commercial bank underwriting as well.

Current economic circumstances justify a reappraisal of the costs of excluding commercial banks from investment banking. American business and governments are making unprecedented demands for capital, and many economic forecasters predict capital shortages in the next decade.¹⁰⁵ The ability of the securities industry to satisfy these capital demands has been questioned.¹⁰⁶ Commercial banks, through their extensive branch networks and expertise, could play an important role in raising new capital and allocating it efficiently if the fetish of Glass-Steagall were discarded.

Far-reaching reform of the regulatory environment in which commercial and investment bankers operate has answered many of the concerns which prompted Glass-Steagall. Public confidence in the banking system is assured by federal deposit insurance, which protects depositors against bank failure up to \$40,000 per account.¹⁰⁷ Bank supervision and examinations are more comprehensive and are designed to detect incipient departures into unsafe banking practices.¹⁰⁸ The quality of bank investment portfolios is closely monitored by bank examiners,¹⁰⁹ who now have the authority to examine bank affiliates.¹¹⁰ Transactions between commercial banks and their affiliates are strictly regulated.¹¹¹ Unduly speculative

104. 119 CONG. REC. 17738 (1973).

105. See note 14, *supra*.

106. See [1975] U.S. CODE CONG. & AD. NEWS, *supra* note 91, at 180; J. STONE, ONE WAY FOR WALL STREET; A VIEW OF THE FUTURE OF THE SECURITIES INDUSTRY (1975).

107. 12 U.S.C. § 1813(m) (1976).

108. National banks are examined at least three times every two years by the Comptroller of the Currency and are also subject to examination by the Federal Reserve Board and the Federal Deposit Insurance Corporation. State member banks of the Federal Reserve System are examined periodically by the Federal Reserve Board, the FDIC, and state banking authorities. Insured non-member banks are examined by the FDIC and state banking authorities. 12 U.S.C. §§ 481, 483, 325, & 1820 (1976). See COMPTROLLER OF THE CURRENCY, THE COMPTROLLER'S HANDBOOK FOR NATIONAL BANK EXAMINERS (1977); COMPTROLLER GENERAL, FEDERAL SUPERVISION OF STATE AND NATIONAL BANKS 7-1 through 7-25 (Jan. 1977).

109. See 12 C.F.R. §§ 1.1-1.12 (1977); Remarks by O. Carney, *New Approach to Investment Portfolio Examinations*, American Bankers Association Bank Investments Conference, (Feb. 9, 1978).

110. 12 U.S.C. § 481 (1976).

111. Section 23A of the Federal Reserve Act, enacted as part of the Banking Act of 1933, limits a bank's transactions with a single affiliate to no more than 10% of the bank's capital and surplus and limits transactions with all affiliates to no more than 20% of the bank's capital and surplus. 12 U.S.C. § 371c (1976).

bank investments are curbed by federal and state laws which impose strict fiduciary standards on bank management of trust funds. At the same time, securities investors are protected by an array of disclosure and anti-fraud statutes designed to eliminate self-dealing and undisclosed conflicts of interest. The Securities Act of 1933 prohibits false or misleading information disseminated in connection with the offer and sale of securities.¹¹² The Securities Exchange Act of 1934 condemns manipulative practices in securities markets¹¹³ and strictly regulates the extension of credit for the purchase of securities.¹¹⁴ Rules promulgated by the Securities and Exchange Commission require brokers and dealers to consider their customers' financial situation and needs in recommending particular securities.¹¹⁵ Exchange rules require brokers to use "due diligence" in executing market orders at the best price available.¹¹⁶ Investors are protected against broker-dealer insolvency by the Securities Investor Protection Act,¹¹⁷ which provides the functional equivalent of federal deposit insurance. Although commercial banks currently are exempt from SEC enforcement of all but the anti-fraud provisions of the securities laws,¹¹⁸ they are subject to similar regulations enforced by the bank regulatory agencies.¹¹⁹

112. Securities Act of 1933, §§ 11, 12, & 17, 15 U.S.C. §§ 77k, 77l, 77q (1976).

113. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j (1976); Rule 10b-5, 17 C.F.R. § 240.10b-5 (1977).

114. Securities Exchange Act of 1934, § 7, 15 U.S.C. § 78g (1976).

115. *Id.*, § 15b, 15 U.S.C. § 78o (1976), Rule 15b10-3; 17 C.F.R. § 240.15b10-3 (1977).

116. NYSE Rule 123, 2 NYSE GUIDE (CCH) ¶ 2123 (1976); Amex Rule 156, 2 AMEX GUIDE (CCH) ¶ 9156 (1976).

117. 15 U.S.C. §§ 78aaa-iii (1976). The Securities Investor Protection Corporation (SIPC) is a nonprofit insurance corporation whose members are all registered brokers and dealers. Customers' securities are insured by SIPC up to \$50,000.

118. Securities Act of 1933, § 3(a)(2), 15 U.S.C. § 77c(a)(2) (1976); Securities Exchange Act of 1934, §§ 3(a)(4) & (5), 15 U.S.C. §§ 78c(a)(4) & (5); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, *reh. denied*, 407 U.S. 916, 408 U.S. 931 (1972); *Carroll v. First Nat'l Bank of Lincolnwood*, 413 F.2d 353 (7th Cir. 1969), *cert. denied*, 396 U.S. 1003 (1970).

119. The Securities Act Amendments of 1975 require bank regulatory agencies to issue substantially similar regulations to those administered by the SEC in effectuating the registration, reporting, and proxy requirements of §§ 12, 13, and 14 of the Securities Exchange Act of 1934. 15 U.S.C. §§ 78(i) (1976). The bank agencies' regulations may deviate from the SEC's only if similar regulations are "not necessary or appropriate in the public interest or for protection of investors." Whether the bank exemption from SEC jurisdiction should continue is a much discussed question. See Butera, *Bank Exemption From the 1933 Securities Act*, 93 BANKING L.J. 432 (1976); Evans, *Regulation of Bank Securities Activities*, 91 BANKING L.J. 611 (1974); Garrett, *SEC and its Concern With Bank Trust Activities*, 113 TRUST & ESTATES 280 (1974); Greenberg, *Banks and the Federal Securities Laws: Some Recent Developments*, 49 So. CALIF. L. REV. 665 (1976). Legislation has been introduced to subject certain bank securities activities to SEC regulation, e.g., S. 2707, 93d Cong., 1st Sess. (1973) (a bill by Senator Brooke to subject commercial bank automatic stock investment plans to SEC jurisdiction). In a recent study of bank securities activities, the SEC officially recommended the retention of the bank exemption from the definition of "broker" and

These statutory reforms have not eliminated all investment risks. They have insulated the small depositor from the hazards of commercial bank failures, however, and insured that investment decisions made by banks and individuals will be intelligent and untainted by self-dealing or hidden conflicts of interest. That Glass-Steagall contains an ambiguous view of financial risks assumed by commercial banks is clear in any event. The Act blesses commercial bank underwriting of municipal securities, such as New York City bonds,¹²⁰ while condemning less risky investments such as AT&T or Exxon bonds. Commercial banks were unencumbered by Glass-Steagall in making risky loans to foreign countries¹²¹ and offering financial and other support to Real Estate Investment Trusts—REIT's¹²²—in recent years. These bank risks have not undermined public confidence in the general health of the banking system.¹²³ A degree of risk is present in all bank investments.¹²⁴ Political attempts to minimize risk-taking tend to entrench large and healthy businesses, forestall new entrants, and hinder the rehabilitation of faltering competitors.¹²⁵ If Congress remains fearful that unforeseen hazards might emerge by an

“dealer” under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78c(a)(4) & (5) (1976). The SEC also recommended, however, that federal bank regulatory agencies be mandated to enact and enforce specific regulations governing bank brokerage and dealer activities comparable to those enforced by the SEC with respect to non-bank institutions. SECURITIES AND EXCHANGE COMMISSION, FINAL REPORT ON BANK SECURITIES ACTIVITIES, reprinted in SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, REPORTS ON BANK SECURITIES ACTIVITIES OF THE SECURITIES AND EXCHANGE COMMISSION 289, 307-08 (Comm. Print 1977).

120. See *New York Financial Crisis, Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. 568-639 (1975) (statements by federal bank regulators concerning bank exposure to a default by New York City on its municipal obligations).

121. E.g., *Peru Appears on the Verge of Defaulting on Foreign Loans*, Wash. Post, Mar. 14, 1978, at A10, col. 1.

122. See *REITs: More Casualties Ahead*, BUS. WEEK, June 13, 1977, at 106.

123. A 1976 Gallup poll showed that 93% of those interviewed had confidence in the basic health of the banking system. *Wall St. J.*, April 30, 1976, at 4, col. 3.

124. Banks incur risks when they make loans in the ordinary course of business. Twenty-six banks which made loans to W.T. Grant & Co., for example, lost approximately \$500 million when that company went bankrupt. *Wash. Post*, February 28, 1978, § D, at 8, col. 3.

125. The “prudent man” rule of the 1974 Pension Reform Act, 29 U.S.C. § 1104 (1976), for example, has operated to artificially confine the investment of pension funds in blue chip securities to the disadvantage of new and innovative smaller companies. Recent hearings by the Senate Select Committee on Small Business revealed that the number of companies making their first public offering—mostly new, small enterprises—dropped from 62% of all issues offered in 1972, to 16% in 1976. *Wash. Post*, Feb. 11, 1978, § C, at 8, col. 2. The social and economic utility of risk capital was recognized by the introduction of legislation in 1977 to permit pension managers to invest a portion of the \$200 billion of private pension assets in small and medium size companies which pose a higher than normal degree of risk. S. 285, 95th Cong., 1st Sess. (1977); 123 CONG. REC. S864 (daily ed., Jan. 18, 1977).

immediate emancipation of commercial banks from Glass-Steagall, it could reduce the Act's prohibitions gradually to afford itself time to evaluate the results. As interim measures to safeguard against excessive risk-taking, Congress could limit bank underwriting to a specified percentage of total bank capital, circumscribe the types of securities eligible for bank underwriting, or levy FDIC fees according to the risk exposure of individual banks, rather than continue the uniform fee system now in effect.¹²⁶

Opponents of commercial bank entry into investment banking claim that it would have destructive effects on the competitive structure of the financial industry.¹²⁷ They assert that the initial benefits from increased competition would be offset in the long run by industry domination by a few big banks and the disappearance of all but a few large investment banking firms which would be driven into the commercial banking business in order to remain competitive. That view, however, ignores the already highly concentrated structure of the securities industry.¹²⁸ It also fails to take into account the antitrust restraints on commercial and investment banks that prohibit anti-competitive mergers,¹²⁹ predatory practices,¹³⁰ monopolization and attempts to monopolize,¹³¹ tying arrangements,¹³² and exclusive dealing.¹³³ Additional competitive safeguards could easily be adapted to insure the maintenance of healthy competition in investment banking if the barrier of Glass-Steagall were

126. See Scott & Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform*, 23 STAN. L. REV. 857, 886 (1971).

127. H. Angermueller & M. Taylor, *Commercial vs. Investment Bankers*, 55 HARV. BUS. REV. 132, 141-43 (1977); Securities Industry Association, *Bank Securities Activities: Memorandum for Study and Discussion*, 14 SAN DIEGO L. REV. 751, 784-88 (1977).

128. An estimated 7% of New York Stock Exchange firms account for well over one-half of the securities business conducted with the public, according to the Securities Industry Association. *SIA Officials Gloomy Over Merger Trend*, Wash. Post, Dec. 1, 1977, § F, at 13. See also *The Shakeout on Wall Street Isn't Over Yet*, FORTUNE, May 22, 1978, at 59.

129. Clayton Act, § 7, 15 U.S.C. § 18 (1976); Bank Merger Act, 12 U.S.C. § 1828 (1976); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963). But see *United States v. Marine Bancorporation*, 418 U.S. 602 (1974); *United States v. Connecticut Nat'l Bank*, 418 U.S. 656 (1974); *No Litigation by Justice to Contest Bank Mergers*, Legal Times of Wash., June 5, 1978, at 23.

130. Sherman Act, § 1, 15 U.S.C. § 1 (1976); Robinson-Patman Act, § 3, 15 U.S.C. § 13a (1976).

131. Sherman Act, § 2, 15 U.S.C. § 2 (1976); *United States v. First Nat'l Bank & Trust Co. of Lexington*, 376 U.S. 665 (1964).

132. Sherman Act, § 1, 15 U.S.C. § 1 (1976); *Fortner Enterprises, Inc. v. United States Steel*, 394 U.S. 495 (1969); Bank Holding Company Act Amendments of 1970, § 106, 12 U.S.C. § 1972 (1976).

133. Clayton Act, § 3, 15 U.S.C. § 14 (1976); *Standard Oil of Calif. v. United States*, 337 U.S. 293 (1949).

lifted.¹³⁴ Congress might require, for example, that all commercial bank entry into investment banking be by de novo expansion rather than by acquisition of existing firms.¹³⁵

Investment bankers nevertheless point to economic advantages possessed by commercial banks which would make competition between the two unfair.¹³⁶ Commercial banks have direct access to low cost capital, they claim, while investment bankers must borrow at high interest rates, often from banks, to finance their operations.¹³⁷ This argument, however, supports liberalized entry into commercial banking by investment bankers, not adherence to artificial barriers which insulate both sectors from the beneficial spur of competition.

The threat of conflicts of interest arising from commercial bank entry into investment banking remains a concern of many observers.¹³⁸ Such speculative threats do not outweigh the proven economic benefits of commercial bank participation in securities markets, however, and can be avoided without the blunderbuss approach of Glass-Steagall.¹³⁹ Congress has tolerated potential conflicts of interest in commercial banking when their elimination would destroy public benefits. Banks may be tempted to use inside information acquired in their loan departments to make investment decisions in their trust departments, for example, yet the law does not condemn the offering of both activities in one institution.¹⁴⁰ The likelihood of abuse is limited by regulations requiring loan and trust operations to be conducted separately and by the antifraud provisions of the securities laws.¹⁴¹ Congress could adopt similar safeguards against potential conflicts in the investment banking operations of commercial banks. Banks

134. See, e.g., *Competition in Banking Act of 1976, Hearings Before the Senate Committee on Banking, Housing and Urban Affairs on S. 2721, 94th Cong., 2d Sess.* (1976).

135. PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES, *supra* note 26, at 31-32.

136. *Commercial vs. Investment Bankers, supra* note 127, at 139-40; *Bank Securities Activities, supra* note 127, at 777-84.

137. Broker-dealers owed large New York City banks \$4 billion as of June 30, 1975. 62 FED. RES. BULL., Feb. 1976, at app. 16.

138. See, e.g., 120 CONG. REC. 30634-35 (1974) (remarks of Sen. Hart).

139. For a rebuttal of the conflicts of interest argument against commercial bank involvement in private placement activities, see New York Clearing House Association, *Commercial Bank Private Placement Advisory Services, An Analysis of the Public Policy and Legal Issues*, at 25-26.

140. 12 U.S.C. § 92a (1976).

141. The Comptroller of the Currency recently issued a ruling requiring national banks to adopt written policies and procedures to ensure that their trust departments do not make any recommendations to purchase or sell any security on the basis of material inside information. 43 FED. REG. 6759 (Feb. 16, 1978). See also the Federal Reserve Board's policy statement declaring the use of material inside information by state member banks in connection with any decision to purchase or sell securities to be an unsafe and unsound banking practice. 46 U.S.L.W. 2515 (April 4, 1978).

also could be prohibited from selling securities underwritten or dealt in by them to any of their trust accounts. Sales of securities by a bank to any of its depositors, borrowers, or correspondent banks could be accompanied by a mandatory statement disclosing the fact that the bank is acting as an underwriter or dealer in the securities.¹⁴² Other potential conflicts of interest could similarly be dealt with through disclosure.¹⁴³

V. CONCLUSION

The Glass-Steagall Act was the offspring of public hostility against bankers and a legitimate concern for bank safety following the collapse of a fundamentally flawed banking system in the wake of the 1929 stock market crash. Its attempt to define the proper role of commercial and investment banks imposed an artificial barrier between the two sectors which has impeded the ability of the financial industry to efficiently service the nation's growing capital needs. Neither the courts nor the federal bank regulatory agencies have discovered a satisfactory way to remain faithful to the Act's language and purposes while permitting commercial banking practices that promise to yield substantial public benefits. The definitional gymnastics performed by the Federal Reserve Board's study in seeking to legitimize commercial bank private placement services under Glass-Steagall stretched the Act's language to the breaking point and demonstrated the need for Congressional review of its philosophical underpinnings.

Comprehensive regulation of commercial and investment banking institutions has made the Glass-Steagall Act's concern over bank safety and potential abuses largely irrelevant. Existing regulatory vehicles could easily be adapted to answer any new concerns over commercial bank participation in investment banking. Rising capital demands and the inability of all but the largest businesses to tap capital markets makes additional competition in the financial markets increasingly imperative. Congress should permit a remarriage of commercial and investment banking as one step in

142. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) (SEC may obtain injunction compelling investment adviser to disclose to his client a practice of purchasing shares of a security for his own account shortly before recommending that security for long-term investment and then immediately selling his own shares at a profit upon the rise in market price following the recommendation).

143. See *Overdrafts and Correspondent Banking Practices, Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 95th Cong., 1st Sess. 415-19 (1977) (statement of Roy A. Schotland, Georgetown University Law Center, urging greater disclosure requirements for banking institutions). See generally *Financial Disclosure By Banks and Bank Holding Companies, Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. (1975).

the removal of artificial barriers to the financial industry's ability to meet the nation's economic needs.

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* During the writing of this article, the author was employed as a law clerk in the Office of the Comptroller of the Currency. The views expressed herein are those of the author and do not reflect the position of that Office.