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Implementating Comprehensive Banking under SEC Jurisdiction: A Workable Solution to Bank Reform;Note

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IMPLEMENTING COMPREHENSIVE BANKING UNDER SEC JURISDICTION: A WORKABLE SOLUTION TO BANK REFORM

The recent collapse of the savings and loan industry[1] has prompted Congress to reevaluate its decision to continue deregulating the banking industry. Many members of Congress now feel that the loose leash under the Reagan years has led to increased financial woes, instead of creating new and ambitious opportunities. While this skepticism is understandable, it is an insufficient reason for Congress to avoid accepting, at least in theory, the Bush Administration's invitation to lower barriers between commercial and investment banking.[2] Differences between the savings and loan and the national banking industries begin to shed light on the reasons for Congress to reform the Glass-Steagall Act ("the Act"),[3] the barrier between commercial and investment banking. Moreover, sound economic and legal reasons offer Congress the impetus to take the bull by the horns and wrestle down the problems the banking industry faces because of scarcely applied prohibitions under the Act.[4]

Unfortunately, the key issue Congress faces to institute "comprehensive banking"[5] is a political one. The ability of Congress to act before the 1992 presidential election depends, to a large extent, on the Bush Administration's

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1. The problems that stem from the savings and loan failures have had a broad impact on many elements of the financial services industry. Consequently, "securities industry officials say they realize that Congress will not be in the mood to consider a massive reform proposal. Nonetheless, the same officials express frustration with the unwillingness of bank regulators to hold off on regulatory actions that further break down Glass-Steagall barriers." *Congressional Agenda: Stalemate May Derail Comprehensive Banking Reform*, Daily Rep. for Exec. (BNA) No. 13, at S-9 (Jan. 18, 1991) [hereinafter *Stalemate in Reform*]. The Bush Administration, however, has set forth an aggressive agenda of further bank reforms which are designed to spur Congress to enact legislation that treats the ills of the banking industry instead of letting them get worse.

2. DEPARTMENT OF THE TREASURY, MODERNIZING THE FINANCIAL SYSTEM: Recommendations for Safer, More Competitive Banks, Part XVIII (February 1991) [hereinafter TREASURY REPORT]. The Treasury's report addressed a four part problem:

> (1) reduced bank *competitiveness* and financial strength, caused by outdated legal restrictions that have prevented banking organizations from responding to the evolution of financial markets and technology; (2) the *overextension of deposit insurance* [excessively exposing taxpayers] . . .; (3) a *fragmented regulatory system* that has created duplicative rules . . .; and (4) an *undercapitalized deposit insurance fund.*

Id. at ix, Executive Summary (emphasis in original). The first problem, so indicated is the focus of this note: should banks be allowed to engage in currently prohibited capital market activities under the regulatory structure of the SEC.

3. The Glass-Steagall Act [hereinafter the Act] comprises a number of sections of the United States Code in Title 12. The primary sections involve: (1) Section 16, 12 U.S.C. § 24 (Seventh) (1988), (general powers of national banks); (2) Section 20, 12 U.S.C. § 377 (1988), (prohibitions of bank affiliations with securities organizations); (3) Section 21, 12 U.S.C. § 378a (1988), (prohibits securities firms from receiving deposits and carrying on other banking activities); and (4) Section 32, 12 U.S.C. § 78 (1988), (disallows certain persons from being officers, directors or employees of Federal Reserve member banks).

4. *See, e.g.*, Fischer, Gram, Kaufman & Mote, *The Securities Activities of Commercial Banks: A Legal and Economic Analysis*, 51 TENN. L. REV. 467 (1984) [hereinafter Fischer & Mote].

5. As used hereinafter, the term "comprehensive banking" refers to the merger of commercial and investment banking currently proscribed by the Act. This term has been used by other commentators and the author adopts it as a convenient reference (citations omitted).

willingness to expend enough political capital to pass reforms now.[6] While this element of the equation is uncertain, recent proposals by the Administration, together with Congress' enactment of the Securities Enforcement Remedies Act ("SERA")[7] indicate that the time is ripe for Congress to institute comprehensive banking legislation.[8] While it is necessary to revive the banking industry from the severe blows it took as a result of the savings and loan debacle, it is also critical for the United States' financial industry, as well as the economy as a whole, to resume new growth. This growth should be spurred by a strong and ambitious banking industry which has secured the goodwill of the American public. Thus, comprehensive banking offers the competition and diversity for American banks, as well as the entire financial industry, to trigger new growth and freedom in financial services which will also recapture their role as world players.[9]

The opening of the European Community in 1992 is another impetus for Congress to overhaul the American banking system and allow commercial banks with a substantial capital base to engage in banking and underwriting.[10] The Treasury Report outlines the fact that many EC countries operate under a regulatory structure absent the type of restrictions in the Act.[11] Since activities by world banks will continue to grow in this area, American banks will be at a considerable competitive disadvantage in the world financial market. The consen-

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6. The strength of the opposition in Congress stems from the notion that "[m]any consider Glass-Steagall reform a *fait accompli*, particularly since the [Board] already has approved limited corporate debt and equity powers for [sic] some of the nation's biggest BHCs. Seidman said, in his opinion, the Glass-Steagall issue is one of the least important matters pending in the debate at this point, since regulators already have acted to expand bank securities powers." *See, Stalemate in Reform, supra* note 1 at S-9. It is likely, however, that if Bush pushes hard enough, he should get most of his reform proposals through Congress. *Id.* at S.

7. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (codified as amended in scattered sections of 15 U.S.C.). The full title is the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, but since the Act is divided into two parts, the enforcement part and penny stock reform part, I will only refer to it as the Securities Enforcement Remedies Act.

8. The idea to broaden bank powers has previously been on the blocks. *See* The Proxmire Financial Modernization Act of 1988, S. 1886, 100th Cong., 1st Sess., 134 CONG. REC. 3360-3437 (1988) [hereinafter Proxmire Act]. In the recent proposals for reform, however, the Bush Administration is seeking a wide range of reforms including greatly expanded bank securities powers. *Stalemate in Reform*, supra note 1 at S-5. The Securities Industry Association ("SIA") has also offered a proposal to allow banks into the securities business provided "banks do not use federally insured deposits to subsidize the bank's efforts. *Id.* at S-9. The essence of the SIA proposal is the separate affiliate concept or the separate subsidiary concept currently embraced by the Federal Reserve Board in its recent approvals of some bank holding company subsidiaries securities activities. *See infra* note 16. *See also* SECURUTUES INDUSTRY ASSOCIATION, QUESTIONING EXPANDED BANK POWERS: A Case for Maintaining the Fundamental Separation Between the Banking and Securities Industries (1985) [hereinafter EXPANDED BANK POWERS].

9. J.P. MORGAN & CO., INC., RETHINKING GLASS-STEAGALL 38 (1984) [hereinafter J.P. Morgan].

10. The Securities Act of 1933 [hereinafter '33 Act] defines underwriter to include "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(11) (1990). This definition also includes control persons within those who are issuers. *Id.*

11. TREASURY REPORT, *supra* note 2, at XVIII- 25, citing Am. Bankers A., *International Banking Competitiveness, op. cit.*, 72, 82 (1990).

sus is that "the action the EC has taken [with the Second Banking Directive] would be comparable to the removal of Glass-Steagall, McFadden, the Bank Holding Company Act, and many state laws and regulations in the United States."[12]

Since softening of the Act does not require complete repeal, a carefully drawn regulatory scheme updating the prohibitions will help rejuvenate the banking industry without sacrificing the fundamental goals of the Act: to prevent banks from using their bank assets in "imprudent securities" activities and protect banks from the "subtle hazards" that arise when a commercial bank enters the investment banking forum.[13] But change in the regulation of commercial banks—allowing securities law to govern banks' securities activities and banking law to govern banks' traditional banking activities—represents a fundamental shift in regulatory philosophies. The primary purpose of banking law is to protect the depositor and the bank industry, including the public.[14] Consequently, the regulatory perspective focuses on protection and stability. To allow banks to engage in securities activities on a broad scale would introduce the need for regulation from the point of view of the "equityholder" because the focus is on "encourag[ing] banks to engage in additional risk taking to improve profitability and to diversify activities as a hedge against risk."[15] The Federal Reserve Board ("Board") already operates to some degree in this mindset; as evidence by their recent approvals of bank holding company subsidiaries to engage in limited underwriting.[16] The proper regulatory perspective to channel new competitive banking activities in the capital markets, however, should fall under the jurisdiction of the Securities Exchange Commission ("SEC") since its regulatory point of view is of the "equityholder" or investor.

This note takes the position that comprehensive banking is now appropriate, and demonstrates how such an objective can be achieved through a unique combination of securities and banking laws. Part I provides an historical overview of modern banking law, including an analysis of the Act and why it was written in such a prohibitory manner. Part II discusses recent developments in securities law that strongly suggest both the legal and financial communities' amiableness to comprehensive banking. Furthermore, this part scrutinizes SERA and examines

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12. TREASURY REPORT, *supra* note 2, at XVIII-26, quoting Committee on Banking, Finance and Urban Affairs, *op. cit.*, at 343.

13. *See* Board of Governors v. Investment Co. Inst., 450 U.S. 46, 66 (1981) [hereinafter ICI], and Investment Co. Inst. v. Camp, 401 (U.S. 617, 630-31 (1971) [hereinafter Camp].

14. Garten, *Regulatory Growing Pains: A Perspective on Bank Regulation in a Deregulatory Age*, 57 FORDHAM L. REV. 501, 504 (1989).

15. *Id.* at 505.

16. *See Citicorp, J.P. Morgan & Co. Inc., and Bankers Trust Ne York Corp.*, 73 Fed. Res. Bull. 473, 502-04 (1987) [hereinafter Citicorp/J.P. Morgan/Bankers Trust], *aff'd sub nom.* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys. 839 F.2d 47 (2d Cir. 1988) [hereinafter Citicorp], (approving underwriting and dealing in municipal revenue bonds, mortgage-backed securities, and commercial paper), *J.P. Morgan & Co. Inc., Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 75 Fed. Res. Bull. 192 (1989) [hereinafter Limited Bank Underwriting Decision] (permitting banks through affiliates to engage in limited underwriting of corporate debt and equity securities), *Bankers Trust New York Corp.*, 75 Fed. Res. Bull. 829 (1989) [hereinafter Bankers Trust New York] (approving bank affiliate to act as an agent in the private placement of all types of securities as well as to act as a riskless principal in buying and selling securities).

how the new amendments to the securities acts[17] set the stage for SEC jurisdiction over comprehensive banking activities. It is direct involvement by the SEC that will be the linchpin for comprehensive banking's success. Part III examines why comprehensive banking is right for the current economic climate and how the SEC and the Board must work together to comprehensively regulate private equity and debt underwriting activities of commercial banks. Part IV seeks to gauge the impact on the securities markets and the banking industry, with a special sensitivity toward the historical reasons for separating commercial and investment banking. It is apparent that this separation is not as necessary as Senator Glass perceived,[18] and that the current sophistication of the nation's and world's financial markets permits comprehensive banking in the United States. In conclusion, this note comments on Congress' willingness to act promptly and anticipate the response of the financial and legal worlds in the wake of comprehensive banking legislation of any degree.

I. HISTORY OF MODERN BANKING LAW

The climate that set the stage for today's banking and securities laws was the Great Depression. Because of unregulated speculation by banks with depositors' money, many of the nation's leading banks either collapsed or had to shut their doors to their own depositors.[19] The resulting panic, and later depression,

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17. The Federal securities law comprises mainly the '33 Act, 15 U.S.C. § 77a-aa (1988) [hereinafter the '33 Act] and the Securities and Exchange Act of 1934, 15 U.S.C. § 78a-11 (1988) [hereinafter the '34 Act]. The primary purpose of the '33 Act is to regulate distributions of securities by protecting the investor through special disclosure and antifraud requirements. The primary purpose of the '34 Act is to regulate trading of securities on the nation's exchanges, as well as apply special registration requirements. T. HAZEN, THE LAW OF SECURITIES REGULATION (2d ed. 1990).

18. The Second Circuit noted Senator Glass' concern for the separation of commercial and investment banking in *Citicorp*: Senator Glass remarked: " I want to make it impossible hereafter to have the portfolios of commercial banks filled with useless speculative securities, so that when stringency comes upon the country these banks may not respond to the requirements of commerce." 839 F.2d at 59.

19. *See Camp*, 401 U.S. at 629-30, wherein the Court exposited in great detail Congress' rationale for enacting the Glass-Steagall Act:

> The failure of the Bank of the United States in 1930 was widely attributed to that bank's activities with respect to its numerous securities affiliates. Moreover, Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities. The Glass-Steagall Act reflected a determination that policies of competition, convenience, or expertise which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the 'hazards' and 'financial dangers' that arise when commercial banks engage in the activities proscribed by the Act.

Id.

See also Part IV of the *Camp* opinion, 401 U.S. at 629, for a complete summary, in the Court's view, of why Congress enacted the Act. Some commentators, however, believe that the Act was not precipitated by the financial woes of the Great Depression, but because of a desire to protect big business securities firms from losing too much business to an inevitably large banking industry. Kaufman and Mote, *Glass-Steagall: Repeal by Regulatory and Judicial Reinterpretation*, 107 BANKING L.J. 388, 393-94 (1990). *See also* G.J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING: THE GLASS-STEAGALL ACT REVISITED AND RECONSIDERED (1990) and White, *Before the Glass-Steagall Act: An Analysis of the Investment Banking Activities of National Banks*, 23 Explorations in Econ. Hist., 33-55 (1986) (offering evidence that the failure of securities affiliates did not cause the collapse of a single bank).

led Congress to pass tough regulatory laws with the simple goal of never having such a disaster again.[20] Ultimately, these laws were designed to separate one industry fraught with risk and devoid of public confidence, with another industry, the banking industry, which should be the backbone of the American economic system and which the public should never doubt. The Court, in *Camp*, delineated Congress' intent to ensure a stable and permanent banking system:

> Congress acted to keep commercial banks out of the investment banking business . . . because . . . the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system.[21]

The *Camp* majority also recognized several "subtle hazards" as well as the obvious hazard of a bank using depositor money to make "imprudent stock or security investments."[22] The hazards the Court outlined are part of the bank-affiliate relationship where the bank begins to act as a player in the market instead of just a "fiduciary or managing agent."[23] The subtle hazards Congress was concerned with involved "promotional and other pressures on the bank" which could impair public confidence in the bank,[24] losses investors might suffer from relying on a bank affiliate's involvement with a issue of securities, improper lending to a corporate client where the bank affiliate has become too deeply involved, bank loans to preferred customers for the purpose of purchasing securities, and conflicts of interest between the "promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice."[25] Thus, these primary concerns and subtle hazards motivated Congress to erect the "Glass-Steagall wall" between investment and commercial banking. They continue to permeate Congress while the courts and the Board have recognized the banking industry's evolution.[26]

A. The Glass-Steagall Act: Sections 16, 20, 21, and 32

The Glass-Steagall Act is a conglomeration of sections throughout the Banking Act of 1933[27] designed to separate commercial and investment banking. Section 16[28] delineates the basic powers of the national banks and their limited involvement in the securities business.[29] It seeks to keep commercial banking

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20. *Camp*, 401 U.S. at 629-30. *See also* Smith, *Glass-Steagall Act—A History of Its Legislative Origins and Regulatory Construction*, 92 BANKING L.J. 38 (1975) (discussing the legislative history and initial regulatory construction the Board and Comptroller of the Currency gave to the Act).
21. *Camp*, 401 U.S. at 634.
22. *Id.* at 630.
23. *Id.*
24. *Id.* at 630-31.
25. *Id.* at 633.
26. The Board has liberalized its view of the Glass-Steagall restrictions on commercial banks underwriting securities and the courts have generally afforded the Board great deference in their decisions. *See e.g.* Board of Governors v. Investment Co. Inst., 450 U.S. 46, 68 (1981) and *Camp*, 401 U.S. at 626-27 (giving deference to the Comptroller of the Currency's decision since he has the duty to enforce the banking laws).
27. 12 U.S.C. § 21-531 (1988).
28. 12 U.S.C. § 24 (Seventh) (1988).
29. The relevant text of section 16 reads as follows:
> The business of dealing in securities and stock by the association shall be limited to

separate from investment banking by limiting commercial banking powers to traditional bank business, such as dealing in promissory notes and other types of debt instruments, as well as a limited purchasing role for the "account" of its customers.[30] In addition to this limited role, national banks also have the power to deal in municipal securities.[31] This power includes not only purchasing for the account of the bank's customer, but also involves general underwriting and other activities that are otherwise precluded by the Act with regards to equity and debt securities because they carry an attendant riskier investment.[32] The exception to the general prohibition of underwriting and dealing in securities is accompanied by other significant exceptions; exceptions which many commentators argue requires Congress to abandon the Act, or at the very least, to overhaul it.[33] The general prohibitions, however, still remain in force, albeit somewhat eroded, and continue to impede the evolution of commercial banking.

To deal with institutions that are active in the securities markets, section 21 prohibits those persons who participate in the securities business from underwriting, dealing or selling "to engage at the same time to *any extent whatever* in the business of receiving deposits subject to check or repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor . . . ."[34] This prohibition closes both ends of the spectrum of commercial and investment banking. Consequently, institutions that are either national banks, as perceived by section 16, or securities firms, as perceived by section 21, may not engage in the business of the other, subject to a number of exceptions.[35] The primary wall between commercial banking and investment banking is thus compromised of these two sections.

Both sections 16 and 21 on their face exclude certain "investment securities," subject to approval of the Comptroller of the Currency ("Comptroller").[36] This leaves open the ability of banks to deal in these investment securities for their own account. The availability of investment securities, however, is limited by the

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> 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 stock: *Provided*, [t]hat the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24 (Seventh) (1988) (emphasis in original). While the definitions of various terms in the Glass-Steagall Act have come under considerable debate, such as "security," "issuer," and "underwrite," the securities acts have been relied on to help define these terms in their relevant contexts. *See, e.g., Camp*, 401 U.S. at 635-36, where the Court defines "security" for purposes of the Glass-Steagall Act to encompass a wide variety of investment instruments to protect against inventive bankers seeking to sidestep the Act's prohibitions.

30. 12 U.S.c. § 24 (Seventh) (1988).

31. *Id.* Within the context of Section 16, "selling a security" on the order of customers, and without recourse to the bank means that upon the specific order of the customer, the bank may act as the customer's agent and purchase securities for that customer. M. CAPATIDES, A GUIDE TO THE CAPITAL MARKET ACTIVITIES OF BANKS AND BANK HOLDING COMPANIES 6 (1990).

32. "The limitations and restrictions herein . . . shall not apply to obligations of the United States, or general obligations of any [s]tate or of any political subdivision thereof . . . ." 12 U.S.C. § 24 (Seventh) (1988).

33. Kaufman and Mote, *supra* note 19, at 418.

34. 12 U.S.C. § 378(a)(1) (1988) (emphasis added).

35. *See infra* notes 36-38 and accompanying text.

36. H. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 1.07, at 9 (1900-91 ed.).

Comptroller to "marketable debt securities" bearing a low level of risk and, thereby, a lower return vis-a-vis higher risk instruments.[37] Furthermore, as provided for on the face of the statute, commercial banks are allowed to underwrite municipal securities in the form of general obligations of the United States and the states or any political subdivision.[38] This ability to underwrite government bonds, and other securities backed by the goodwill of the government, has given commercial banks relatively good experience in underwriting financial instruments, albeit instruments with a low level of risk. The underlying rationale for allowing commercial banks to underwrite these government securities is the fact that they are backed by the goodwill of the government.

Section 20[39] of the Act "precludes an affiliate of a bank from being 'engaged principally' in the securities activities prohibited to a bank under section 21."[40] This section covers "issue, floatation, underwriting, public sale or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities . . . ."[41] Congress intended this section to apply to any affiliate of a bank to ensure a complete divorce of commercial and investment banking. Although the Board has recently approved some bank holding companies' applications to underwrite securities that banks, in their own capacity, were precluded from underwriting, the Board has insisted on keeping the parent bank holding companies and their subsidiaries under the same rules.[42] Thus, the impenetrable wall has weakened. Further action by Congress to open the doors to allow a closer relationship by banks and their subsidiaries engaged in the securities underwriting business is warranted. The ability for national commercial banks with robust financial health to expand their capital generating bases into the securities industry under the jurisdiction of the SEC, through well protected subsidiaries, separated from the funds of the parent bank, is necessary for American banks to continue to grow and diversify and reclaim a stake in modern investment markets.

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37. *Id.* The Comptroller has developed three categories of investment securities pursuant to his rule making authority. 12 C.F.R. § 1.3(c)-(e) (1990). The regulations divide the types of securities activities into three categories. "Type I securit[ies]" are those "a bank may deal in, underwrite, purchase and sell for its own account without limitation." 12 C.F.R. § 1.3(c). These generally include government securities as outlined in section 16, 12 U.S.C. § 24 (Seventh) (1988). "Type II securit[ies]" refer to securities a bank may market in similar fashion as with "Type I" securities, "subject to a 10-percent limitation." 12 C.F.R. § 1.3(d). These include specialized securities, such as those of the Tennessee Valley Authority or securities issued by a state or political subdivision. "Type III securit[ies]" are those "which a bank may purchase and sell for its own account, subject to a 10-percent limitation, but may neither deal in not underwrite." BLOOMENTHAL, *supra* note 36, § 1.07, at 9.

38. 12 U.S.C. § 24 (Seventh) (1988).

39. 12 U.S.C. § 377 (1988).

40. H. BLOOMTHAL, *supra* note 36, at 9 (emphasis added).

41. M. CAPATIDES, *supra* note 31, at 7, (quoting 12 U.S.C. § 377 (1988)).

42. *Id.* Some commentators have argued that the Board's interpretation of "engaged principally" has weakened the Glass-Steagall wall between commercial and investment banking through the parent/subsidiary relationship. *See infra* notes 72-81 and accompanying text. Additionally, while some activities by the subsidiary fall under the securities laws, the scope of the securities laws is limited somewhat as compared to a nonbank performing the same function. For instance, section 3(a)(2) of the '33 Act exempt securities "issued or guaranteed" by banks from registration. 15 U.S.C. § 77c(a) (1988). *See also* T. HAZEN, supra note 17, § 4.3, at 129. Moreover, section 12(i) permits publically held banks to file disclosure and other information documents, that are similar to those required by the SEC, with bank regulators instead of with the SEC. 15 U.S.C. § 781(i) (1988).

The last relevant section of the Act is section 32.[43] This section, similar in purpose and design to section 20,[44] prohibits "'interlocking'" directors, officers, or employees between any organization engaged in underwriting securities and a member bank of the Federal Reserve System.[45] Notwithstanding that this section was an additional attempt to close the door on the union between commercial and investment banking, the Board has discretion to allow sharing of directors if "it would not unduly influence the investment policies of such member bank[s] or the advice it gives its customers regarding investments."[46] This power gives the Board the responsibility to remove the prohibition on those entities which establish a degree of separateness in their activities, and which would not leave any indicia of unfair investment practices.[47]

B. Securities Activities Allowed by Banks and Bank Holding Companies

The ability of banks to engage in securities activities is very much a part of modern banking practice.[48] The Act has explicit terms prohibiting investment banking by commercial banks. It addresses bank underwriting of securities, bank purchase of securities for its customers, and bank purchase of securities for its own account.[49] The creativity of commercial banks to find loopholes in the law and the willingness of the Board and Comptroller to go along with such activities, however, has left many types of securities transactions open to commercial banks.[50] The primary proscription that still remains, however, involves underwriting by commercial banks of publically issued corporate debt and equity securities.[51] This bastion is the last real restriction that has not been substantially diminished.

The Act does not, however, exclude all capital market activities which may involve a commercial bank performing as an underwriter,[52] as evidence by the Act's permissibility of bank underwriting of government securities.[53] This category

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43. 12 U.S.C. § 78 (1988).

44. The Court noted in Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 219 (1983), a case under section 4(c)(8) of the Bank Holding Company Act of 1956, that section 20 and 32 "contain identical language, were enacted for similar purposes, and are part of the same statute, . . ." *Id.*

45. M. CAPATIDES, *supra* note 31, at 7-8.

46. 12 U.S.C. § 78 (1988).

47. *See* Board of Governors v. Agnew, 329 U.S. 441, 445-49 (1947) (partnership held primarily engaged in underwriting and dealing securities within the meaning of section 32 of the Act and therefore, its employees were prohibited from serving on the board of directors of a member bank of the Federal Reserve System).

48. As a general matter, securities practice includes underwriting and dealing or brokeraging corporate and government securities and advisory services on investment strategies for the institutional or individual investor. Banks are allowed to engage in most securities activities, except underwriting and dealing because of the prohibitions in Glass-Steagall.

49. V. DILORENZO, W. SCHLICHTING, & J. COOPER 5 BANKING LAW *Banks and Securities Laws* § 96.02(2) (1987) [hereinafter V. DILORENZO & J. COOPER].

50. *Id* § 96.02(3), at 96-26.1.

51. Some commentators believe that this prohibition remains only regarding firm commitment underwriter which involves the actual purchase by the underwriting of the security in issue, and then reselling such security. M. CAPATIDES, *supra* note 31, at 20.

52. This availability, however, is subject to the "exercise of prudent banking judgment," which requires the bank to examine a particular obligor's credit and ability to make all required payments connected with the obligation. M. CAPATIDES, *supra* note 31, at 21, n.39.

53. This category of government securities also includes "general obligation municipal bonds, agency-guaranteed mortgage-backed securities, and certain kinds of municipal revenue bonds." TREASURY REPORT, *supra* note 2, at XVIII-15.

of "unlimited"[54] underwriting has expanded into many creative financial instruments.[55] Banks may also underwrite some nongovernment instruments, such as mortgage pass-through certificates, since such activity is deemed "within the 'business of banking' under [section 16], and therefore . . . not prohibited by the Act.[56]

In addition to the ability of banks to engage in the underwriting of general government obligations and other special instruments which fall within the business of banking, commercial banks may purchase and sell instruments which are within the "traditional" practice of banks. This power, granted by the Act in section 16, and formally recognized by the Court in *Securities Indus. Ass'n v. Board of Governor*,[57] allows banks to purchase and sell such instruments as certificates of deposit, bank investment contracts, brokered deposits, banker's acceptances, commercial paper backed by a letter of credit, loan sales, and repurchase agreements.[58] These instruments are the capital market activities which banks have a special interest in dealing in because they involve a bank's traditional function of dealing in business inextricably linked with the business of banking; which is taking care of a depositor's money and generating capital for the bank's own use. In addition, these practices delineate the wall between the activities traditionally handled by the banking industry and those activities where securities firms have a special expertise.[59]

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54. M. CAPATIDES, *supra* note 31, at 20-1.

55. *Id.* at 366-73. Capatides diagrams the myriad of securities and other financial instruments which comprise the allowable capital market activities of banks. While many of these instruments are useful to the practitioner, they involve extremely specialized analysis of the requirements, which has been omitted here.

56. Securities Indus. Ass'n v. Clarke, 885 F.2d 1034, 1052 (2d Cir. 1989). Mortgage pass-through certificates are interests in a pool of mortgage loans which the bank has pooled and which is under the control of a trust. The certificates represent a "fractional undivided interest in the pool of mortgage loans[,] [and] . . . may then be sold publicly or privately." *Id.* at 1036. The court concluded that the "threshold question [is] whether [an] activity . . . constitutes 'the business of banking' or, instead, the 'business of dealing in securities and stock.'" *Id.* at 1048 (quoting 12 U.S.C. § 24 (Seventh) (1988)). Consequently, underwriting only becomes an issue if a bank activity constitutes the business dealing in securities. If not, then Glass-Steagall prohibitions do not apply. *Id.*

57. 468 U.S. 137 (1984) [hereinafter Becker]. *See also* M. CAPATIDES, *supra* note 31, at 37 (citing *Becker* which "recognized a distinction for Glass-Steagall purposes between financial instruments traditionally handled by the banking industry and those traditionally handled by the securities industry." *Id.*). *See Becker*, 468 U.S. at 149-154.

58. M. CAPATIDES, *supra* note 31, at 36-80. Certificates of deposit, deemed not a security by the Court in Marine Bank v. Weaver, 455 U.S. 551 (1982) are well within the power of a commercial bank's capital activity. Bank investment contracts are agreements between the bank and an investor "whereby the investor deposits funds with the bank and the bank agrees to repay those funds at a specified rate of interest on a specified date or over a period of time." *Id.* at 46. These investment contracts have been traditionally used by banks and are considered a traditional banking activity under the Act. Brokered deposits are deposits "received from a third party-who is not the beneficial owner of the deposit-that pay an interest rate typically in excess of retail CD [sic] rates in the relevant market." *Id.* at 51. Bankers' acceptances are a "signed promise by the drawee of a draft that the draft will be honored at its maturity." *Id.* at 56. Drafts are writings that operate similarly to checks, and are used by investors to "facilitate the acquisition of goods" based on the credit of the bank. *Id.* Commercial paper, backed by a letter of credit, while deemed a security for section 16, is not precluded from being underwritten, as long as its is backed by a letter of credit. *Id.* at 60. "A repurchase agreement . . . is an agreement between two parties to exchange securities, for cash and/or securities for a specified period of time." *Id.* at 73. These repurchase agreements usually involve government backed obligations and thus fall under one of the traditional activities allowed by section 16 of the Act.

59. M. CAPATIDES, *supra* note 31, at 37.

These activities represent a somewhat diversified practice by banks in light of the restrictions of the Act. The courts have, for the most part, approved these activities under challenge by the Securities Industry Association ("SIA") which attempts to have the courts strictly apply the Act.[60] Two recent cases, that evidence the crumbling of the Glass-Steagall wall between investment and commercial banking, have supported the Board's approval of expanded securities activities by highly capitalized commercial banks.[61] In *Citicorp*,[62] the Second Circuit paved the way for bank holding company affiliates[63] to underwrite and deal in limited securities activities.[64] While the affiliates of the holding companies were engaged in underwriting and dealing in U.S. government, agency, and state securities, they additionally sought underwriting in "municipal revenue bonds, mortgage related securities, consumer receivables related securities, and commercial paper."[65] The case focused on the issue of what is a security for purposes of the Act and what does "engaged principally" mean under section 20 of the Act.

The court first determined that Congress was primarily concerned with bank affiliates underwriting "bank-ineligible"[66] securities. This concern comprises investment securities which are highly speculative in nature and not securities of "undoubted character," such as securities of the United States and the states.[67] Thus, as the court continued, the use of "securities" in section 20 refers only to bank-ineligible securities.[68] Consequently, the activities which the Board had earlier approved were upheld by the court, which explained that "[b]ecause underwriting and dealing in government securities pose no hazards to banks themselves, *a foritori* bank affiliates should be able principally to engage in the same activity."[69]

The other primary issue the court determined in *Citicorp* focused on the meaning of "engaged principally" in section 20.[70] While the banks argued a

60. *See Camp*, 401 U.S. 617, *ICI*, 450 U.S. 46, *Becker*, 468 U.S. 137 (1984), Securities Indus. Ass'n v. Board of Governors, 807 F.2d 1052 (D.C. Cir. 1986), *Citicorp*, 839 F.2d 47, *Clarke*, 885 F.2d 1034, and Securities Indus, Ass'n v. Board of Governors, 900 F.2d 360 (1990) [hereinafter Bankers Trust].

61. Both cases deal with the activity of an affiliate under the Bank Holding Company Act of 1956. It is under section 4(c)(8) of this Act that banks acquire an affiliate relationship with firms which engage in some underwriting activities but are, for the purposes of the Bank Holding Company Act and the Board a company "the activities of which . . . [are] so closely related to banking . . . as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8) (1988). Since the Board has the discretion to determine whether an activity is "so closely related to banking" under the Glass-Steagall Act, "the principal issue before the Board was whether the approval of the activities would contravene that Act." Citicorp. 839 F.2d at 50.

62. 839 F.2d 47 (2d. Cir. 1988).

63. The Companies involved were Bankers Trust New York Corp., J.P. Morgan & Co., Inc., Citicorp, The Chase Manhattan Corp., Manufacturers Hanover Corp., Chemical New York Corp., and Security Pacific Corp.

64. Congress was not necessarily worried about commercial banks having such affiliates. Instead, the main concern was with "entry of commercial banks into the investment banking field either directly or indirectly." *Citicorp*, 839 F.2d at 62.

65. *Id.* at 50.

66. *Id.* at 60.

67. *Id.* (quoting S. Rep. No. 77, 73d Cong., 1st Sess. 10 (1933)).

68. *Id.* at 61.

69. *Id.* at 62, (emphasis in original). "[I]t was not Congress' purpose in [section] 20 to preclude a bank affiliate from engaging in the same activities to the same extent as a member bank and we uphold the Board's determination that the reference in [section] 20 to 'securities' does not encompass those securities which [section] 16 allows banks themselves to underwrite." *Id.*

70. 12 U.S.C. § 377 (1988).

different approach to the determination of "engaged principally" than the Board, the court found that Congress intended that phrase to mean substantially engaged in the business of underwriting securities. Therefore, it deferred to the Board's five to ten percent gross revenue limit for an affiliate's securities activities.[71]

In a companion case, the D.C. Circuit considered an order by the Board to allow bank affiliates to underwrite and deal in corporate debt and equity securities.[72] While the SIA attempted to argue the definition of "security" and "principally engaged" as in *Citicorp*, the court in *Bankers Trust* precluded those issues under the doctrine of res judicata.[73] Thus the court focused on the language of section 4(c)(8) of the Bank Holding Company Act of 1956 to determine if underwriting corporate debt and securities could amount to an activity "closely related to banking" and, therefore, be permissible by a bank affiliate.[74]

When examining whether an activity is closely related to banking, the Board will have the power to decide "how closely related a particular activity must be to meet the closely related test, subject only to judicial review."[75] In *Bankers Trust*, the court examined the development of commercial banking, noting the experience that banks have received in such activities as "private placement of debt and equity securities, the syndication of loans, the purchase and sale of securities as a fiduciary for others, [and] the underwriting and dealing in bank-eligible government securities . . . ."[76] Moreover, the court explained that the relationship between commercial and investment banking is not as different as the Act mandates. Congress well understood the idea that bank underwriting securities is closely related to commercial banking, "[o]therwise, [Congress] would not have expressly permitted, in [s]ection 20 of the Act, bank affiliates to engage in even a limited amount of securities dealing."[77]

By approving the Board's determination, the court was left to decide if the benefits to the public were outweighed by the adverse effects of having a bank affiliate underwrite and deal in corporate debt and equity securities. The court addressed SIA's arguments concluding that the concerns normally attendant to a commercial bank engaging in this type of underwriting activity are not as threatening in the case of an affiliate. Consequently, the court upheld the Board's approval. First, the court explained that "bank affiliates must maintain a capital

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71. *Citicorp*, 839 F.2d at 63. The board employed a qualitative and quantitative construction of the term and stated that "an affiliate would not be principally or substantially engaged in bank-ineligible activities if: (1) the gross revenue from [Section] 20 activities did not exceed five to ten percent of the affiliate's total gross revenue. . . ." *Id.* at 63. The Board also employed a "market share" test for determining the level of activity by the affiliate, but the court rejected that aspect of the Board's test. *Id.* at 67-8.

72. 900 F.2d 360 (1990).

73. *Bankers Trust*, 900 F.2d at 363-64.

74. Section 4(c)(8) of the Bank Holding Company Act of 1956 requires the Board to engage in a two part inquiry to determine if the proposed activity is allowable by the affiliate and therefore within the exemption. First, the Board must determine if the activity is closely related to banking. Second, the board must examine if the activity would produce "benefits to the public that would outweigh possible adverse effects." *Bankers Trust*, 900 F.2d at 365.

75. *Id.*

76. *Id.* at 366. The Court continued that "banks must, to survive, develop sophistication in the . . . capacity to structure new security issues, and the expertise to buy and sell securities in a secondary market." *Id.*

77. *Id.*

ratio significantly higher than that which the SEC requires for security firms."[78] This fiscal cushion will help protect against the losses of the affiliate and prevent those losses from subtracting from the holdings of the parent bank. Second, to address Glass-Steagall concerns for conflicts of interest between the bank and the affiliates' customers thereby jeopardizing the bank's goodwill image, the court approved the Board's requirement of extensive "firewalls"[79] to separate the parent bank and its affiliates.[80] In addition to the protective measures the Board required for an affiliate to enter into the corporate debt/equity securities market, the court noted that the added "competition in the underwriting markets [would] promote greater convenience and efficiency for customers, and improve the ability of United States banks to compete effectively in world markets."[81] Consequently, the court approved the participation of these bank affiliates in "bank-ineligible" securities activities.

Additionally, the courts have embraced the Board's widdling away of the Glass-Steagall barrier between commercial and investment banking more recently because of greater deference to the Board's interpretation of the prohibitions under Glass-Steagall and the Bank Holding Company Act.[82] In two key releases recently, the Board approved broad securities activities by bank holding company subsidiaries under section 4(c)(8)[83] of the Bank Holding Company Act.[84] The Board's approval contains numerous restrictions, such as special firewalls to

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78. *Id.*

79. The firewalls are designed to limit the risk to the parent bank, limit the type of subsidiary to a nonbank affiliate, and "prevent conflicts of interest" and other abuses. TREASURY REPORT, *supra* note 2, at XVIII-16.

80. *Id.* The court explained its concerns in the following manner noting the extensive protection the Board instituted to ensure the bank's stability:

> As for the classic Glass-Steagall-related worries that banks will be drawn into a conflict of interest in the allocation of credit to customers of their securities affiliates or that prospective losses by the affiliates would jeopardize the bank's reputations, the Board insisted on a comprehensive series of 'firewalls' to insulate the affiliates from the banks. The banks are not permitted to extend credit nor purchase from or sell assets to the affiliates. Nor are the banks permitted to extend credit to customers of the affiliates if that might be viewed as enhancing marketability or creditworthiness of an issue underwritten or distributed by the affiliate. The Board also prohibits the bank from extending credit to purchase any such securities or pay the principal, interest, or dividends on these securities, and the bank may not participate in the marketing of any securities issue distributed by the affiliate.

Id. This type of firewall demonstrates the extended activity bank affiliates may engage in, and the type of regulatory structure that Congress should implement to deal with broader capital market activities by banks, especially in underwriting and dealing in securities.

81. *Id.* at 367.

82. *See Citicorp*, 839 F.2d at 52 (quoting Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 716 F. 2d 92, 95 (2d Cir. 1983), *aff'd*, 468 U.S. 207: "'Because the Board has both primary responsibility for implementing the Glass-Steagall Act and expert knowledge of commercial banking, we must uphold its interpretation of the Act if it is reasonable.'") and *Camp*, 401 U.S. at 626 where the Court explains that "we cannot come lightly to the conclusion that the Comptroller has authorized activity that violates the banking laws. It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute." *Id.*

83. 12 U.S.C. § 1843(c)(8) (1988).

84. *See Bankers Trust New York*, *supra* note 16, at 829 (allowing subsidiary "to act as an agent in the private placement of all types of securities, including providing related advisory services, and to buy and sell all types of securities on the order of investors as a 'riskless principal.'") and *Limited Bank Underwriting Decision*, *supra* note 16 (allowing to a limited extent subsidiaries to underwrite and deal in certain securities).

guard the parent banks from the risk of expanded securities activities by a subsidiary, and special percentage caps on the amount of securities activities of an affiliate.[85] Notwithstanding these restrictions, the Board has provided a clear signal that the limitations of the Act present barriers which should be either substantially adjusted or removed to allow more diverse securities activities by banks. By following this lead set by the courts in *Citicorp* and *Bankers Trust*, and the Board in *Bankers Trust New York* and *Limited Bank Underwriting Decision*, Congress can enact a comprehensive banking reform law that would allow banks *and* their affiliates to engage in the activities already permitted, to a limited extent, by the affiliates.[86]

II. The Securities Laws and SERA

The securities laws[87] are designed to promote disclosure to the individual investor of all relevant information about a company's issue of securities on the market. This allows the investor to make an informed decision about purchasing a security. The securities laws are also designed to provide extensive, anti-fraud protection for the investor who purchases issued stock. This protection allows a defrauded investor to seek recission against the underwriters, the dealers, and the accountants. While these laws have had a considerable impact on the securities industry, their enforcement has created one of the strongest federal governmental agencies, the Securities Exchange Commission. The SEC has jurisdiction over both the registration process of securities offered for sale, and enforcement of the antifraud provisions of the '33 Act and '34 Act.[88] While these laws provide ample protection for securities firms and investors, banks are exempted and thus are not responsible to the SEC for their securities activities.

A. Exemption for Banks: The '33 Act

The key exemption from registration for banks provided by the '33 Act is contained in section 3(a)(2).[89] This section excludes from the registration requirement "any security issued or guaranteed by any bank; or any security issued by or representing an interest in or a direct obligation of a Federal Reserve Bank."[90] This exemption remains today because it is still believed that the bank regulatory apparatus and other regulatory agencies are able to compensate for a lack of

85. *Bankers Trust New York*, *supra* note 16, at 835.

86. *See* Markey, *Why Congress Must Amend Glass-Steagall: Recent Trends in Breaching the Wall Separating Commercial and Investment Banking*,25 NEW ENG. L. REV.457 (1991) in which Markey explains that approval of bank underwriting of private placements, selling of mutual funds, providing discount brokerage activities and full service brokerage and advisory services, distributing asset-backed securities, and activities of affiliates which do not amount to principal distribution point to a new understanding by the Board and the courts that investment and commercial banking are becoming inextricably intertwined. *Id.* 465-74.

87. *See supra* note 16.

88. The registration statement contains information regarding the issuer's business and property, the securities offered and their relationship to the issuer's "other securities," the management of the issuer, and certain financial statements regarding the financial health of the company. V. DILORENZO & J. COOPER, *supra* note 49, § 99.02, at 99-4. The registration statement also contains a description of the riskiness of the offering in regards of future market projection. This is usually included to protect the issuer from future liability if the issue fails.

89. 15 U.S.C. § 77c(a)(2) (1988).

90. *Id.*

coverage by the securities laws. The '34 Act attempts to remedy this exemption by coverage under sections 13 and 15(d) for companies who have securities traded on a national exchange, which have been subject to registration under the '33 Act or where 500 or more persons hold a class of equity securities and the issuer has more than five million in assets.[91] Under the '33 Act, however, banks may fit into the section 3(a)(2) exemption and avoid coverage of the registration and antifraud provisions applicable to other issuers who fall under the '33 Act.

The '33 Act exemption raises two main issues: what constitutes a "bank" and what does "issued or guaranteed" by any bank encompass.[92] The definition of "bank" referred to in the '33 Act includes any "national bank or any banking institution organized under the laws of any state, . . . the business of which is substantially confined to banking and which is supervised by the [s]tate or . . . similar [banking] official . . . ."[93] The two requirements—that the bank be under the regulatory authority of a state banking commission and the business of the company be "substantially confined to banking"—must both be met for the bank to fit the exemption under the '33 Act.

In dealing with the second problem area under Section 3(a)(2) of "issued or guaranteed by any bank,"[94] the SEC takes the position that guaranteed should be "liberally construed" and should apply to instances where the bank "agrees to see to the payment of a security."[95] The normal situation envisioned here involves a bank backing notes or bonds and to pay them at maturity if not honored by the issuer. The term guarantee can be applied to underwriting or other types of guarantees by banks which make them responsible for placing a financial instrument on the market.[96] This type of scheme would fall under Glass-Steagall restrictions, such as section 16, but the SEC would be without jurisdiction to enforce its registration requirements against the bank because of the section 3(a)(2) exemption.[97]

B. '34 Act: SEC Coverage of Banks and Their Affiliates

The '34 Act, the second of the federal securities laws, is also designed to have information passed on to an investor about a company which is offering securities for sale. Two threshold requirements trigger coverage by the '34 Act: either the security is traded on a national exchange, or the company's assets exceed five million dollars and the shareholders of the company number 500 or more.[98] The registration requirements under the '34 Act, unlike the '33 Act, are triggered only if a company fits either of the two '34 Act requirements and is thus a '34 Act company.[99]

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91. T. HAZEN, *supra* note 17, at 70, n.30. *See also* 15 U.S.C. §§ 78m, 78o(d) (1988) and 17 C.F.R. § 240.12g-1 (1990).
92. V. DILORENZO & J. COOPER, *supra* note 49, § 99.03, at 99-8.
93. *Id.* (citing 15 U.S.C. § 77c(a)(2) (1988)).
94. 15 U.S.C. § 77c(a)(2) (1988).
95. V. DILORENZO & J. COOPER, *supra* note 49, § 99.03 at 99-9.
96. *Id.*
97. Chairman Breeden has remarked that any revision of the Act to allow banks wider securities activities should be accompanied by repealing of sections 3(a)(2) and 3(a)(5) which exempt securities issued by banks from the registration requirements of the '33 Act. *Stalemate in Reform*, *supra* note 1, at S-3.
98. 15 U.S.C. § 781(g) (1988).
99. V. DILORENZO & J. COOPER, *supra* note 49, § 100.02, at 100-4.

The key exemption under the '34 Act for banks is their absence from the definition of broker or dealer.[100] The term "broker" is any person, other than a bank, whose business involves buying and selling any security for the benefit of others.[101] Dealer encompasses any person who buys securities for his or her own account, excluding banks.[102] These two terms have been interpreted to refer to those professionals who are regularly involved in the securities business, excluding banks and individuals.[103] Banks are excluded because of their regulation under Glass-Steagall.

C. SERA and the new "in house" power of the SEC

To give the SEC more authority to enforce federal securities laws, Congress passed SERA in 1990.[104] This legislation amends the securities laws to provide the SEC more "in house" administrative enforcement power to "maintain investor confidence in the integrity, fairness, and efficiency of [the] securities markets."[105] Both the broader civil fining power and the new cease and desist power, which allow the SEC to stop a violative selling activity quickly and efficiently, protect potential investors as soon as possible. Furthermore, the ability to bar certain persons from positions on the board of directors of a company who are "unfit" to serve in such capacities will help the SEC prospectively protect investors from imprudent directors and officers who can easily engage in violative financial activity due to their position in the company.[106] These functions not only serve

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100. *Id.* § 100.03, at 100-6. Section 15(a)(1) requires that securities brokers and dealers be registered unless they fit into an appropriate exemption under the act. T. HAZEN, *supra* note 17, § 10.2.2, at 396.

101. 15 U.S.C. § 78c(a)(4) (1988). The statute states: "The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." *Id.*

102. 15 U.S.C. § 78c(a)(5) (1988). Here, the '34 Act outlines a fairly narrow definition of dealer: "The term 'dealer' means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." *Id.*

103. T. HAZEN, *supra* note 17, at 397. The law covering the "engaged in the business of" language is more complex and requires an analysis the person's activities and the securities business and what his role in that business involves. *Id.* (citing, *e.g.*, Lipton, *A Primer on Broker-Dealer Registration*, 36 CATH. U.L. REV. 899, 910 (1987).

104. *See supra* note 7.

105. H.R. Rep. No. 101-616, 101st Cong., 2d Sess., *reprinted in* 1990 U.S. CODE CONG. & ADMIN NEWS 1379, 1381 [hereinafter LEG. HISTORY]. Generally, the legislation amends the securities laws to do the following:

> [(1)] authorize the federal courts to order the payment of civil money penalties, in addition to disgorgement, for a broad range of violations of federal securities laws; [(2)] authorize the Commission to order disgorgement and impose civil money penalties in certain administrative proceedings under the Securities Exchange Act of 1934 (Exchange Act), the Investment Company Act of 1940 (Investment Company Act), and the Investment Advisors Act of 1940 (Investment Advisors Act); [(3)] authorize the Commission to issue cease-and-desits orders for violations of the securities laws; and [(4)] expressly affirm the inherent authority of a federal district court, in connection with injunctive actions brought by the Commission, to issue orders that prohibit an individual from serving as an officer or director of any reporting company if the individual has violated Section 17(a)(1) of the Securities Act of 1933 (Securities Act) or Section 10b of the Exchange Act or the rules thereunder and the individual's conduct demonstrates substantial unfitness to serve as an officer or director.

Id.

106. 15 U.S.C. § 77t(e) (1990).

the securities industry, but also pave the way for greater control by the SEC over the entire financial market, especially one where banks play a larger and more competitive role.

Specifically, SERA is divided according to its amendments of the securities laws. Under the amendments to the '33 Act, the SEC may seek three tiers of penalties in a district court for any violation of the '33 Act.[107] The SEC can ask the court to prohibit any person whose conduct "demonstrates substantial unfitness" from serving as an officer or director of a '34 Act reporting company.[108] SERA also gives the SEC power to require any person who may violate the securities laws or any regulations thereof to cease and desist from such activity.[109] This authority allows the SEC greater ability to head off future violations and require violating companies to comply with the securities laws or face severe civil and other penalties. The power to cease and desist also gives the SEC greater control over how companies comply with the securities laws. The ability to stop all activity with regarding a certain security because of possible violations gives the SEC greater flexibility to protect the investor before harmful action takes place.

The amendments to the '34 Act make similar changes as noted for the '33 Act with the addition of a provision for civil remedies in administrative proceedings. Under section 21B of the '34 Act, as amended, the SEC or "appropriate regulatory agency" may impose a civil penalty against any person who has willfully violated, aided or abetted a violation, who has caused a report required to be filed pursuant to the securities laws to be false or misleading, or who has failed to "supervise" to prevent such violation.[110] SERA also provides a tiered

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107. 15 U.S.C. § 77t(d)(1), (2) (1990).

108. 15 U.S.C. § 77t(e) (1990).

109. 15 U.S.C. § 77h-1 (1990). The authority of the SEC to issue a cease and desist order is explained in the following manner:

> If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this title, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, . . . require such person to comply, or take steps to effect compliance, . . . upon such terms and conditions and within such time as the Commission may specify in such order.

Id.

110. 15 U.S.C. § 78u-2 (1990). The amendments here to the '34 Act give the SEC the power to prospectively protect investors from violations and use the administrative process to attack willful violators without going into district court. Section 21B contains the following language:

> [T]he Commission or the appropriate regulatory agency may impose a civil penalty if it finds, . . . after notice and opportunity to be heard that such person-
>
> (1) has willfully violated any provision of the Securities Act of 1933, the Investment Company Act of 1940, the Investment Advisors Act of 1940, or this title [the Securities Exchange Act of 1934], or the rules or regulations thereunder, . . .;
>
> (2) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;
>
> (3) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission or with any other appropriate regulatory agency under this title, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in light of the circumstances

fining system for violations of the '34 Act.[111] Additionally, whether a penalty serves the public interest, as the last part of section 21B(a) requires, is covered by section 21B(c). Here, when assessing to impose a penalty, the SEC "or the appropriate regulatory agency may consider" six different criteria: "(1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;" (2) direct or indirect harm to other persons because of such act or omission; "(3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior," (4) whether the SEC or another regulatory agency has previously found such person to have violated federal or state securities laws or regulatory rules; (5) the need to deter such person and other persons from committing such acts or omissions in the future; and (6) any other matters "as justice may require."[112]

Supplementary to its extensive fining power, the SEC also has new cease and desist authority under the '34 Act, as amended.[113] This power can be exercised either temporarily or permanently to stop violative financial activity at its source and to apply uniform regulations.[114] Thus, the SEC has the ability to deal with creative capital market activities which go beyond prudent investment practices. By extending the regulatory arm to persons associated with those involved in "misconduct," the SEC can effectively apply the securities laws early in the process through efficient administrative authority. Thus, the SEC can act more quickly and more decisively to protect investors and maintain high investor confidence in the securities industry.

D. Updating Securities Laws to Cover Bank Securities Activities

One of the more formidable obstacles Congress must overcome to implement comprehensive banking is the tremendous regulatory overlap which could accompany expanded securities activities by banks.[115] The Board and the Comptroller

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under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein; or

(4) has failed to reasonably supervise, within the meaning of section 15(b)(4)(E) of this title, with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision;

and that such penalty is in the public interest.

Id.

111. 15 U.S.C. § 78u-2 (1990).

112. 15 U.S.C. § 78u-2 (1990).

113. These provisions of SERA covering the cease and desist authority of the SEC are similar for violations of both the '33 Act and '34 Act.

114. 15 U.S.C. § 78u-3(a), (c) (1990). The applicability of the temporary order is limited to a respondent who acted "at the time of the alleged misconduct . . . as a broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, government securities dealer, or transfer agent, or is, or was at the time of the alleged misconduct, an associated person of, or a person seeking to become associated with, any of the foregoing." 15 U.S.C. § 78u-3(c)(2) (1990).

115. *See* EXPANDED BANK POWERS, *supra* note 8, at Appendix D for a comparison of the different substantive regulations between banks and securities firms and the attendant disadvantages if banks are not made subject to the same regulations as securities firms. The SEC attempted to have banks included in the definition of broker-dealer under the '34 Act and thus required to register with the SEC. The D.C. Circuit, however, concluded that Rule 3b-9 was "inconsistent with Congressional

have the primary regulatory responsibility of commercial banks while the SEC solely governs securities activities.[116] Deference to the SEC under a new regulatory scheme of comprehensive banking would be necessary to eliminate regulatory overlap and provided efficient and proper regulation of expanded bank activities. Moreover, the extent to which securities laws would govern bank securities activities would be limited to those activities which are not considered traditional banking activities.

Although ridding the marketplace of excessive regulation, instituting comprehensive banking would require Congress to establish a different regulatory philosophy towards bank capital market activity. Since the securities laws are concerned with full disclosure, they require that the issuer disclose all necessary information so investors can make knowledgeable financial decisions, as well as be aware of SEC enforcement of the securities laws.[117] In contrast, bank regulation is more concerned with public confidence and the need to protect the public from unnecessary information by maintaining confidentiality in their regulatory activities.[118] The ability to limit the regulatory scope of bank regulators to those activities which are within the scope of traditional banking activities, and those bank activities which are within the scope of securities regulation, is necessary to have the securities and banking laws work together. Otherwise, unfair and inconsistent regulation would result for banks participating in the securities industry which would be detrimental to the investor, the banks, and the public.[119] Because banks are, for example, exempt from the definition of broker-dealer under the '34 Act,[120] they enjoy savings in their securities activities compared to other brokers and dealers who must register with the SEC.[121] Ultimately, "less stringent regulations faced by banks allow them to respond to market opportunities more quickly and easily than securities firms."[122] To properly expand the capital market activities of banks, the securities laws should take precedence and govern bank activity in this area.

III. Enacting Comprehensive Banking Legislation

The decision to revise Glass-Steagall and implement comprehensive banking legislation is one of the most politically sensitive decisions facing Congress today.

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intent" and therefore the SEC needed to have Congress amend the '34 Act to include banks within the definition of broker-dealer. HAZEN, *supra* note 17, at 399 (citing American Bankers Ass'n v. S.E.C., 804 F.2d 739 (D.C. Cir. 1986) and Note, *The Validity of SEC Rule 3b-9 which Requires Banks to Register as Broker-Dealers*, 43 WASH. & LEE L. REV. 989 (1986)).

116. The primary difference between banking regulation and securities regulation is that banking regulation is designed to protect "depositors and [to] preserv[e] . . . the financial soundness and stability of banks," while the securities regulation is designed to protect the securities investor. EXPANDED BANK POWERS, *supra* note 8, at 36.

117. *Id.* at 41.

118. *Id.*

119. The SIA summed up the concern for a consistent regulatory scheme in the following manner: "Permitting banks to expand their securities activities without comparable regulation cannot be sound public policy . . . . [F]ailure to subject banks to the same regulation imposed upon non-banks conducting similar activities would provide them an unfair advantage over their competitors." EXPANDED BANK POWERS, *supra*, note 8, at 42.

120. U.S.C. § 78c(a)(4), (5) (1988).

121. EXPANDED BANK POWERS,*supra* note 8, at 43.

122. *Id.*

In the wake of an unprecedented collapse of the savings and loan industry, many feel that allowing commercial banks to underwrite and deal in equity securities will be the commercial banking industry's calling card to follow suit. The banking community, however, feels the burdens of the Act are causing commercial banks to loose competitiveness in the constantly changing financial markets.[123] Consequently, the modernization of the financial industry into a world market has left many American commercial banks behind their world competitors because of the restrictions of Glass-Steagall.[124] Moreover, the ability of commercial banks to maintain adequate capital resources to meet the diverse demands of their customers continues to be hindered by Glass-Steagall.[125] This situation presents Congress with compelling reasons to pass the necessary reforms to place commercial banks into the competitive capital markets completely. While opening a new front for capital investment, Congress would place American commercial banks back into world competition.

A. Better Regulation from the Proper Regulatory Point of View

The implementation of comprehensive banking must be accompanied by better regulation instead of deregulation as in the savings and loan industry. The Board has begun to recognize the needed reforms through approval of applications by some of the nation's largest commercial banks to engage in expanded securities activities.[126] These actions by the Board involve some limited underwriting by a bank holding company subsidiary as long as the subsidiary is separately capitalized and the underwriting activity does not exceed revenue limits of ten percent of the total subsidiary's activity.[127] The Board also has approved underwriting

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123. J.P. MORGAN, *supra* note 9, at 30-34. It is more likely that expanded underwriting activities would create a new steady "stream" of revenue from new diverse activities which would help banks in troubled times and boost their earnings in good times. Ultimately, "permitting bank affiliates to underwrite and deal in corporate securities would increase the system's stability." *Id.* at 22.

124. Isaac and Fein, *Facing the Future-Life Without Glass-Steagall*, 37 CATH. U.L. REV. 281, 294 (1988). "Commercial banks not only are constrained by Glass-Steagall in responding to technological and market changes [in the form of more demanding all around service] but are facing increased competition from nonbank financial institutions in the provision of traditional banking services . . . . Glass-Steagall has significantly hindered the ability of banks to keep pace with these changes and has diminished their role in the financial system." *Id.* at 295. *See also* TREASURY REPORT, *supra* note 2, at XVIII-23 (discussing the recent declines of American commercial banks in the world financial community. This decline is believed to be the result of extensive regulation of American banks which their foreign counterparts do not experience.). *See id.* Table 10, at XVIII-25 (comparing the services allowed in certain countries based on regulatory freedom or prohibition).

125. The underwriting which the Board has approved for commercial banks includes private placement of corporate securities, full service brokerage and investment advice, limited underwriting of corporate debt and equity, commercial paper, municipal bonds, asset-backed securities, and consumer receivable related securities. Garten, *Subtle Hazards, Financial Risks, and Diversified Banks: An Essay on the Perils of Regulatory Reform*, 49 MD. L. REV. 314, 342 (1990). While these activities have allowed banks to expand the different financial services they may offer, the limits and restrictions have hindered full benefit from these securities activities. *Id.*

126. *See Limited Bank Underwriting Decision*, *supra* note 16 and *Bankers Trust New York*, *supra* note 16.

127. *Limited Bank Underwriting Decision*, *supra* note 16. Here the Federal Reserve Board approved applications by J.P. Morgan, Chase Manhattan, Bankers Trust, Citicorp, and Security Pacific to engage to a limited extent in underwriting and dealing in certain corporate securities through subsidiary affiliates separate from the bank holding company. The Board recently approved some limited equity underwriting by bank holding company subsidiaries. The companies, Bankers Trust, Canadian Imperial Bank of Commerce, and the Royal Bank of Canada, all handle the securities through separate

activities by securities affiliates of parent commercial banks by liberally interpreting section 20 of the Act's "engaged principally" language, and finding that if a subsidiary does not principally engage in securities underwriting, it will not violate the Act.[128] This same approach was attempted by Congress in the Proxmire Financial Modernization Act of 1988 ("Proxmire Act")[129] but it failed to pass in the House despite virtually unanimous support in the Senate. The central theme, however, was to give bank subsidiaries the ability to engage in broader securities activities prohibited by banks themselves, provided protective "firewalls" were set up inside the corporate structure to separate the two entities.[130] Since Congress did not pass the Proxmire Act, the Board has initiated some reform through a limited approval of special applications by banks to engage in expanded securities activities through their affiliates or nonbanking subsidiaries.[131] The result, while gaining some financial success for banks, has been "achieved in a piecemal, inefficient, and often irrational manner."[132]

A better, more uniform approach to the current trend to loosening Glass-Steagall restrictions case by case should involve direct Congressional reform by passing new legislation which allow banks greater securities activities under the guidance of the SEC. One structural approach to expanded securities activities by banks should involve the separate affiliate concept. This concept, as currently practiced by most commercial banks engaging in permissible securities activities, should be adjusted somewhat from complete separation to allowing banks some interaction with their affiliates while remaining separate to avoid compromising financial situations. The essence of the affiliate concept is to protect against "conflicts of interest, unfair competition, and concentration of resources."[133] While these are real concerns and ones which drive the fundamental notions behind the Act, the bank affiliate should be allowed to share ministerial functions with their parent bank.[134] This would allow both efficient and sophisticated management of the capital market activities of the bank and a degree of separateness which would assure both Congress and the public that the parent bank was not involved in an imprudent relationship with its affiliate. While the attempts under the Proxmire Act to accomplish this structure were substantial, yet unsuccessful, Congress again has the impetus to pass comprehensive banking legislation in the wake of enacting SERA.

B. Using SERA to Reinforce SEC Authority over Bank Securities Activities

The greater control mechanisms at the SEC's disposal after SERA are the type of regulatory tools needed to control broader bank securities activities.

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affiliates which are completely separate from the bank itself and are not dependent on the bank as a source of capital or customers. *See J.P. Morgan & Co., Inc.*, 76 Fed. Res. Bull. 26, 27 (1990) and *Bankers Trust New York*, *supra* note 16, at 830-31.

128. *Bankers Trust New York*, *supra* note 16, at 832.

129. Proxmire Financial Modernization Act of 1988, S. 1886, 100th Cong., 1st Sess., 134 CONG. REC. S3360-3437 (daily ed. March 30, 1988).

130. Isaac and Fein, *supra* note 124, at 302.

131. *See supra* note 16 and accompanying text.

132. TREASURY REPORT, *supra* note 2, at XVIII-19.

133. Isaac and Fein, *supra* note 124, at 305.

134. *Id.* at 306, 308. By sharing ministerial functions small banks with aspirations in the securities markets would not be automatically excluded if they did not have complex parent-affiliate relationships established. Again, under SEC jurisdiction, these smaller banks, engaging in broader securities activities, would be subject to similar securities laws and safe harbors for their securities activities. *See generally*, Kaufman and Mote, *supra* note 19.

SERA gives the SEC authority to maintain investor confidence in the securities markets as well as protect the investors from violative conduct before it affects the investor.[135] The SEC's new powers under SERA also give the SEC broader authority to impose civil fines, prohibit a person from serving in an authoritative position on the board of a company, and issue cease and desist orders halting possibly violative securities activities.[136] Ultimately, this new "in-house" authority results in greater flexibility to handle all types of securities activities from different types of financial institutions. Thus, bank participation in capital market activities, through the affiliate arrangement, would fall under the protective eye of the SEC, providing regulatory stability and a level playing field among all participants in the capital markets.

While Congressional revision of Glass-Steagall should be a cautious step, it is also important to realize that many of the hazards which prompted Congress to enact the Banking Act of 1933 are now controlled through the securities laws. The primary concerns of prohibiting use of bank funds in speculative investments and maintaining the goodwill of the banking industry as a whole have largely been accomplished, even in light of the savings and loan crisis. The banking industry today has developed financial resources to generate capital from a diverse network of capital market activities to help maintain stability, notwithstanding the restrictions of the Act. Yet banks are unable to enjoy all of the benefits that accompany full participation in the capital markets because of the barriers of the Act. Revising Glass-Steagall to allow banks to underwrite and deal in corporate securities would help to promote new growth through even handed regulation.[137] Additionally, concerns over bank affiliates participating in imprudent securities activities from connections with their parent bank would be treated through firewalls.[138] Congressional deference to the SEC for broader securities activities by banks would institute a new, streamlined layer of protection insuring that the concerns which prompted Congress to enact the Act would not go unnoticed.[139]

Moreover, the idea of allowing the SEC to control the new securities activities of banks is a natural step for the shift in regulatory philosophies which would accompany revising the Act.[140] Linking reforms with a regulatory structure under the securities laws would provide Congress the assurance that while it may be

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135. LEG. HISTORY, *supra* note 135, at 1381.

136. *See supra* notes 104-114 and accompanying text.

137. *Bankers Trust*, 900 F.2d at 367.

138. The securities affiliate activities Congress found improper amounted to a failure to properly disclose information, loans to parties to purchase securities from the affiliate, loans to the affiliate itself, purchase of stock by the affiliate of a company who received a loan from the parent bank, parent bank purchase of stock from their securities affiliate for the bank's own account, and use by the securities affiliate of the parent bank's name and personnel. *See* TREASURY REPORT, *supra* note 2, at XVIII-6.

139. Professor Garten has recognized that with new regulation comes new hazards, different "subtle hazards" than those noted by the Court in *Camp*. They include the "hazard of inefficient diversification," the "hazard of inefficient funding," and the "hazard of inefficient management." Garten, *supra* note 15, at 336-76. These hazards stem from problems in a bank's "organization, structure and management that arise when banks diversify into new businesses[,]" and not from engaging in new activities themselves." *Id.* at 385. Professor Garten offers a transitional approach to allow banks into new activities to gauge the impact of these "new" hazards and make the appropriate adjustments, since the consequences of deregulation are unpredictable. *Id.* at 385-91.

140. Isaac and Fein, *supra* note 124, at 315, n.175, (citing S.1886, § 301). *See also* notes 9-11 and accompanying text.

giving banks new powers, it is doing so under the trustful eye of the SEC.[141] The broader powers would contribute to growth, stability, and diversity in the entire financial industry while helping to catapult American banks back into world competitiveness. By giving the SEC jurisdiction over all securities activities of banks not considered traditional bank activities,[142] Congress would eliminate the burden of "dual" regulation guidelines by the SEC and banking agencies.[143] The new enforcement procedures under SERA would ensure proper regulatory authority over a bank's expanded capital market participation. Moreover, the SEC would have the necessary authority to handle the burden of regulating banks and their affiliates if they were to enter the securities markets.[144]

One important concern regarding changes to the current regulatory structure involves the ability of the banking agencies to continue to regulate those activities which qualify as traditional banking activities. Banks should be able to perform those services which are a part of traditional banking functions, without falling under the jurisdiction of the SEC. This is the best way to keep the two regulatory structures separate and to provide banks the necessary assurance against regulatory overlap when entering the securities market.

IV. Impact of Comprehensive Banking on Banks, Underwriting and Brokerage Firms, and the Capital Markets

Critics of comprehensive banking legislation fear that it will disrupt an already fragile banking system that has suffered from ubiquitous savings and loan failures. While these failures resulted from deregulation, loosening the restrictions on commercial banks provides a change in regulation to proper oversight with improved and efficient regulation.[145]

Some commentators believe that by the partial approval of some limited underwriting by bank affiliates, conflicts of interest will exist and it remains what the regulatory agency can do to limit their negative effect.[146] The SEC has adopted a policy of providing safe harbors for situations which present conflicts of interest in relatively important securities practices.[147] The safe harbor allows the activity to continue under tight regulatory control through explicit guidelines in spite of the conflict of interest. This same type of practice could be expected under a

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141. "The securities laws should govern bank securities affiliates in matters relating to investor protection, potential conflicts [of interest], advertising and disclosure issues, and abusive practices that are within the realm of the securities laws." Isaac and Fein, *supra* note 124, at 315.

142. *See supra* note 106-114 and accompanying text.

143. Isaac and Fein, *supra* note 124, at 314. *See* American Bankers Ass'n v. SEC, 804 F.2d 739 (D.C. Cir. 1986), wherein the court overruled rule 3b-9 of the SEC also to include banks within the definition of broker-dealer under the '34 Act. The court recommended to the SEC to get Congress to pass such legislation directly amending the '34 Act. The amendment, included in the Proxmire Act, was unsuccessful.

144. It appears Congress has already contemplated this idea by including government securities brokers-dealers [including commercial banks] in the applicability section of SERA to cease and desist procedures under the '34 Act amendment. *See supra* note 113 and 15 U.S.C. § 78u-3 (1990).

145. EXPANDED BANK POWERS, *supra* note 8, at 13.

146. Peters, *Securities Regulation in the Nineties*, 9 ANN. REV. BANKING L. 375, 379 (1990).

147. Some important safe harbors include the private placement safe harbors in Regulation D, Rules 501-506, 17 C.F.R. § 230.501-230.506 (1990), and the gun jumping safe harbors for broker-dealers in rules 137-139, 17 C.F.R. § 230.137-230.139 (1990).

revised regulatory structure where Congress gave the SEC jurisdiction over the securities activities of banks.[148]

More significantly, however, comprehensive banking legislation would produce a number of important economic benefits to the commercial and investment banking industry. These benefits include helping the small investor with lower commissions on underwriting new issues because of greater market competition, greater accessibility to the market for small investors through familiar and well established depositor-banker relationships, maintaining the goodwill of the banking industry with appropriate regulation and separation of securities affiliates, and increased cash flows from new capital market activities.[149] The ultimate effect of regulatory reform is greater stability in the investment banking world; where natural synergistic forces coalesce under a more efficient and naturally structured regulatory system.[150] Thus, institutional regulation—resulting in different regulatory requirements for institutions with similar financial activities—would be eliminated. Traditional banking activities would thus be regulated by the Board, and securities activities would fall under SEC jurisdiction.

The primary impact of Glass-Steagall revisions allowing commercial banks broader underwriting authority on world, national, and regional financial markets would involve greater competition in a highly concentrated securities market.[151] Traditionally, profitable underwriting of initial public offerings and secondary offerings has been concentrated in a small number of underwriting firms, such as Goldman Sachs, Merrill Lynch, Morgan Stanley, Solomon Brothers and Shearson Lehman.[152] The result has been an underwriting business with high costs with relatively poor access to the public markets. By allowing commercial banks to enter the underwriting business without limits on their securities business,[153] competition would increase creating a "level playing field" in the underwriting industry.[154] By removing barriers such as the amount of nonbanking activity an affiliate may engage in, or the high degree of separateness required by Glass-Steagall between banks and their affiliates, Congress would remove many of the causes of high costs on innovative financial services.[155]

In addition to the economic and functional effects of comprehensive banking, overhauling the Act would have a minimal operational effect on commercial banks.[156] Commercial banks traditionally engage in numerous underwriting activities and complex loan placements. Consequently, they have acquired a number of skills which are very similar to the practices of the investment banker.[157]

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148. Peters, *supra* note 146, at 379.

149. Clark and Saunders, *Glass-Steagall Revised: The Impact on Banks, Capital Markets, and the Small Investor*, 97 BANKING L.J. 811, 832-835 (1980).

150. TREASURY REPORT, *supra* note 2, at XVIII-27. This system encompasses ridding the banking industry of duplicative regulation and instituting "functional regulation" so that "largely comparable activities offered by different financial institutions are regulated on an equivalent basis." *Id.* at XVIII-31.

151. J.P. MORGAN, *supra* note 9, at 42.

152. *Id.* at 30, n.2.

153. *Limited Bank Underwriting Decision*, *supra* note 16.

154. J.P. MORGAN, *supra* note 9, at 38.

155. *Id.*

156. TREASURY REPORT, *supra* note 2, at XVIII-14.

157. The risk associated with underwriting and dealing in government and municipal securities is

Because many of the skills required to be an investment banker are shared between commercial and investment banking, revising the Act would result in a relatively smooth transition for commercial banks into broader securities activity.[158]

V. Conclusion

Revising the Act to allow banks to engage in securities requires a common sense approach to the current regulatory structure. Comprehensive banking is required for the American banking industry to raise up and challenge the myriad of services now offered by foreign banks who are attracting bigger investors. Similarly, securities firms have become bogged down in the restrictions of section 21 and limits on their ability to provide diversified financial services. "Congressional failure to enact Glass-Steagall reform legislation, however, will ensure a further weakening of the banking system as banking organizations see their traditional business erode and their profits shrink in the face of competition for financial services which they cannot provide under current law."[159]

The sophistication of modern financial markets, and a better regulatory structure under the helmsmenship of the SEC would guide comprehensive banking down a responsible path.[160] Simple deregulation is not the answer, as the savings and loan debacle proved. Better, more efficient regulation, however, is what Congress should embrace under the Bush Administration's proposal. The new powers the SEC has under SERA give it greater in-house power to deal with violations of the securities laws. Subjecting banks to the securities laws where the bank engages in securities activities, and not traditional bank activities, would

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similar to the risk involved with corporate securities. Moreover, the attendant risks with securities placement is short and less revealing while "bank lending activities frequently involve credit exposure for a number of years and relatively illiquid assets." J.P. MORGAN, *supra* note 9, at 13. Additionally, when a underwriter decides to underwrite a particular corporate issue, he has extensive market and price research to determine the company's credit and commercial health to avoid having to deal with a sticky issue (one that will not sell). *Id.* Similarly, commercial banks often have to do the same type of research with loan participation arrangements and syndications which "require the lead (managing) banks to line up others in the industry to commit beforehand to the assumption of certain portions of the credits extended." TREASURY REPORT, *supra* note 2, at XVIII-14. Commercial banks repeat this same activity when they engage in private placement activities. Consequently, the business effect on commercial banks to engage in corporate underwriting would be minimal.

158. Guidance by the SEC will maintain the integrity of the banking system during this transition to ensure that the failures of the savings and loan industry are not repeated in the commercial banking industry. The importance of goodwill and reputation to commercial banks would preclude imprudent banking activities which would exploit possible conflicts of interest in a banking-securities firm affiliation. J.P. MORGAN, *supra* note 9, at 29. Additionally, the regulatory framework of the SEC, with its disclosure requirements and antifraud provisions, enhanced by SERA, provides investors with the requisite information to make informed decisions on investment, and the necessary deterrence for potential abuses, as well as the ability to address abuses that do occur. *Id.*

159. Isaac and Fein, *supra* note 124, at 318-19.

160. Because the SEC has a sophisticated regulatory structure to deal with the volatile securities industry, it is they who are best equipped, with their latest weapon SERA, to ensure the proper implementation of comprehensive banking legislation under efficient regulation.

> Congress has designated the SEC, together with the self-regulatory organizations, as the regulatory authority for the securities business. The SEC's statutory framework, rules, expertise, and examination and enforcement procedures [enhanced by SERA] - not those of the banking agencies - are best designed to oversee securities activities and ensure the protection of investors and the fairness of the securities markets. It is only prudent that the securities business of banks be subject to this same regulatory system.

EXPANDED BANK POWERS, *supra* note 8, at 43.

provide the protection to insure commercial banks against failure in the face of new and expanded securities activities.

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