[Vanderbilt Journal of Transnational Law](https://scholarship.law.vanderbilt.edu/vjtl)

Volume 23
Issue 3 *Issue 3 - 1990*

Article 3

1990

The European Community's Second Banking Directive: Can Antiquated United States Legislation Keep Pace?

Christopher T. Toll

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/vjtl

Part of the Banking and Finance Law Commons, and the European Law Commons

Recommended Citation

Christopher T. Toll, The European Community's Second Banking Directive: Can Antiquated United States Legislation Keep Pace?, 23 *Vanderbilt Law Review* 615 (2021)
Available at: https://scholarship.law.vanderbilt.edu/vjtl/vol23/iss3/3

This Note is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Journal of Transnational Law by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact mark.j.williams@vanderbilt.edu.

NOTES

The European Community's Second Banking Directive: Can Antiquated United States Legislation Keep Pace?

ABSTRACT

The European Community recently adopted the Second Banking Directive, which will lead to liberalized banking regulation throughout the Member States. Community banks will engage in a broad range of activities including commercial lending, selling securities, and issuing insurance. This broad range of activities will allow Community banks to compete more efficiently in global markets. In contrast, the strict regulatory structure of the United States includes the Glass-Steagall Act, which separates investment banking and commercial banking. This separation creates inefficiencies that reduce the competitiveness of United States banks in both international and United States markets. These inefficiencies are highlighted by the innovative Second Banking Directive. This Note will summarize the important provisions of the Second Banking Directive, including the single license system, which allows banks to operate in all twelve Member States after they have been licensed by one Member State, and the treatment of non-Community states or "third countries." Next, this Note will review the history of the Glass-Steagall Act, its recent modifications by regulatory agencies and courts, and the prospects for congressional reform. The author then examines the effects of the Second Banking Directive on the Community and the United States. Generally, Community banks will consolidate and compete more effectively in the international markets, including that of the United States. Finally, the author argues that both United States and Community banks will benefit more from continued United States regulatory action than from sweeping United States legislation.

TABLE OF CONTENTS

I. INTRODUCTION 616
II. THE EUROPEAN COMMUNITY AND THE SECOND BANKING DIRECTIVE 619
A. *History* 619
B. *The Second Banking Directive* 621
1. General Provisions 623
2. The Single License 624
3. Relations with Third Countries 626
III. THE GLASS-STEAGALL ACT 630
A. *History* 632
B. *Current Problems in United States Banking* 634
C. *Current Status of the Glass-Steagall Act* 637
D. *Future Options and Risks* 639
IV. COMPARISION OF THE EUROPEAN COMMUNITY AND THE UNITED STATES POSITIONS 642
A. *The European Community Position* 642
1. Strategy and Goals 642
2. The Effects of the Second Banking Directive on the European Community 643
B. *The United States Position* 644
1. Policy of Liberal Trade 644
2. The Effects of European Integration and United States Influence on the European Community Position 647
3. The United States Response to the Second Banking Directive 649
V. CONCLUSION 650

I. INTRODUCTION

The world economy is changing rapidly from local or national markets towards a global, twenty-four hour marketplace. Twelve western European countries (Member States) have formed the European Community (the Community or EC)[1] with the goal of unifying their markets

1. The current Member States of the Community are Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, the United Kingdom, and Germany.

The original Member States were Belgium, France, Italy, Luxembourg, the Netherlands and West Germany. On April 18, 1951, these countries signed the Treaty Establishing the European Coal and Steel Community in Paris. Treaty Establishing the Euro-

so as to compete in this future global economy. The United States government, however, has not acted with such foresight, and this inertia is apparent when one compares the United States banking regulatory structure to the Second Banking Directive (the Second Banking Directive or the Directive).[2]

Currently, banks in some Member States, such as Germany, are permitted not only to take deposits and make commercial loans, as United States banks can, but also to underwrite securities, trade these securities on the bank's account, and issue insurance. These banks, therefore, perform "universal banking." By means of a single license mechanism in the Directive, the Community has adopted a process that will promote the liberalization of the regulations of its individual Member States toward universal banking for the entire Community. The Directive is expected to result in greater efficiency of European banking and to the emergence of five to ten "pan-European" banks that will be the global players of the Community.[3] The goal of the Directive is not only to liberalize the banking market on the continent, but also to liberalize the banking systems in countries outside the Community where the pan-European banks hope to do business. Hence, the Directive enables the European Community Commission (the Commission) to enter negotiations with, and in certain circumstances restrict the access of, other countries that have a more restrictive regulatory structure. By providing the Commission with this capability, the Directive attempts to alter the banking regulatory structures of countries that provide a potential market for banks in the Community. A large market for Community banks, the United States, which is governed by the Glass-Steagall Act (Glass-Steagall),[4] has a more restrictive banking structure than the Community. As

---

pean Coal and Steel Community, *done* Apr. 18, 1951, 261 U.N.T.S. 140. In a similarly integrative step, these parties signed the EURATOM Treaty. Treaty Establishing the European Atomic Energy Community, *done* Mar. 25, 1957, 298 U.N.T.S. 167. The European Economic Community was created by these same six countries when they signed the Treaty of Rome, *done* Mar. 25, 1957, 298 U.N.T.S. 11.

Since 1957, six additional countries have joined the Community. Denmark, Ireland, and the United Kingdom joined the Community on January 1, 1978; Greece joined on January 1, 1981; and Spain and Portugal joined on January 1, 1986. *See* Jones, *Putting "1992" in Perspective*, 9 NW. J. INT'L L. & BUS. 463, 464-65 (1989). This Note will refer to these countries collectively as the Community.

2. *Second Council Directive of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC*, 32 O.J. EUR. COMM. (No. L 386) 1 (1989) [hereinafter *Second Banking Directive*].

3. *See infra* notes 214-34 and accompanying text.

4. Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified in scattered sections of 12 U.S.C.

a result, the Community, by means of the Second Banking Directive, will attempt to liberalize the current United States banking regulatory structure.

Under Glass-Steagall, the United States has two categories of banks: commercial and investment. Commercial banks receive demand deposits and make commercial loans; investment banks underwrite and trade securities for the bank's own account. Because Congress enacted Glass-Steagall in the 1930s in the wake of the Great Depression, its critics believe it is outdated. Today, many groups, including the Community, would like to repeal Glass-Steagall.

Since it is more restrictive than the universal banking standard recently adopted in the Directive, the Community favors the repeal of Glass-Steagall. United States banking regulators, with the aid of the United States courts, however, have decreased significantly the separation between commercial and investment banking. Thus, European banks will have substantial opportunities in the United States even if Congress does not repeal Glass-Steagall. On the other hand, domestic critics of United States banking law are concerned that the Glass-Steagall "wall" will impede the attempts of United States banks in their attempts to compete with European and Japanese banks in the global market. Presently, it appears that pressure to repeal Glass-Steagall from the Community, as well as from within the United States, will be insufficient to overcome congressional inertia in the near future.

This Note will first examine the Community's goals in enacting the Directive and the critical provisions of the Directive that concern the single license and Community relations with so-called "third countries."[5] Second, this Note will outline the history and current status of Glass-Steagall, as altered by regulatory action to provide increased flexibility to United States banks. Finally, this Note will review the likely effects of the Directive on both Community and United States banks and banking systems.

(1988)). These sections are referred to commonly by their original section designations in the Banking Act of 1933. The relevant sections of the Glass-Steagall Act are found at the seventh provision of 12 U.S.C. § 24 (1988) (Section 16), 12 U.S.C. § 377 (1988) (Section 20), 12 U.S.C. § 378 (1988) (Section 21), and 12 U.S.C. § 78 (1988) (Section 32). *See infra* Part III.A.

5. The Community generally refers to countries that are not Member States as third countries.

II. THE EUROPEAN COMMUNITY AND THE SECOND BANKING DIRECTIVE

A. *History*

On March 25, 1957, six European countries signed the Treaty of Rome[6] to create the European Economic Community.[7] The underlying aim of the Community is to combine the Member State resources and reduce their transaction costs to create a more efficient economic system.[8] Part of this process includes liberalizing the European financial services sector.[9] Since the laws applicable to credit institutions vary widely among Member States, the Community recognized, shortly after its formation, that total integration of the market would require the issuance of more than one directive to guide the Member States.[10] The Second Banking Directive is the culmination of an extended effort to liberalize Community banking.

The first directive in this effort, the First Banking Directive,[11] serves as the foundation for the liberalization process[12] and currently is in force in all the Member States.[13] The First Banking Directive delineates

---

6. Treaty of Rome, *supra* note 1.

7. *See supra* note 1; *see also* Mitchell, *Unified Banking in Europe by 1993*, 62 N.Y.L.J. 3, 6 (1988); Jones, *supra* note 1, at 464-65.

8. Lombay, *The Single European Act*, 11 B.C. INT'L & COMP. L.R. 31, 31 & n.4 (1988).

9. *Oversight Hearings on European Community's 1992 Program: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking Finance and Urban Affairs*, 101st Cong., 1st Sess. 75 (1989) (testimony of David C. Mulford, Under Secretary for Int'l Affairs, Dep't of the Treasury) [hereinafter *1989 Hearings*].

10. 1 Common Mkt. Rep. (CCH) ¶1486.19 at 1329-8 [hereinafter CCH Summary]. Under Community law, a "directive" describes results to be achieved and binds the individual Member States to pass laws that will attain the ends set forth in the directive. A "regulation," on the other hand, imposes restrictions directly on individuals and authorities in the Member States. Mitchell, *supra* note 7, at 3 (citing Treaty of Rome, *supra* note 1).

11. *First Council Directive of 12 December 1977 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking up and Pursuit of the Business of Credit Institutions*, 20 O.J. EUR. COMM. (No. L 322) 30 (1977) [hereinafter *First Banking Directive*].

12. *See* OFFICE OF INTERNATIONAL BANKING AND PORTFOLIO INVESTMENT, U. S. DEP'T OF TREAS., EC SINGLE MARKET: BANKING AND SECURITIES (Aug. 1, 1989) [hereinafter EC SINGLE MARKET].

13. Mitchell, *supra* note 7, at 6. The First Banking Directive was adopted December 12, 1977 and entered into force December 15, 1979. CCH Summary, *supra* note 10, at 1329-30. Greece, Spain, and Portugal were subject to the First Banking Directive upon their dates of accession to the Community. *Id.* at 1330.

"common prudential criteria for the establishment and operation of banks and other credit institutions" within the Community.[14] The First Banking Directive, however, has few provisions for permanent supervision of these institutions.[15] The Community subsequently adopted a directive on the supervision of credit institutions on a consolidated basis.[16] Under this directive, the Member State in which the credit institution has located its head office is responsible for supervision of the institution and its branches throughout the Community.[17]

In February 1986, the Community adopted the Single European Act,[18] marking a new phase in the evolution of the Community.[19] Although the Community still had not attained the goal of removing all barriers within the Community, the Single European Act set the goal of eliminating the restrictions on the movement of goods, services, persons, and capital between the Member States by December 31, 1992.[20]

As part of the continuing progression toward a unified market in financial services, the Commission submitted a proposal for the Second Banking Directive to the European Council (the Council) on February 23, 1988.[21] On April 13, 1989, the Commission approved various

---

14. 21 BULL. EC 1-1988, pt. 1.2.1, at 12 (Apr. 1988).

15. CCH Summary, *supra* note 10, at 1329-9.

16. *Council Directive on the Supervision of Credit Institutions on a Consolidated Basis*, 26 O.J. EUR. COMM. (No. L 193) 18 (1983) [hereinafter *Consolidated Supervision Directive*]. *See* CCH Summary, *supra* note 10, at 1330.

17. *See* CCH Summary, *supra* note 10, at 1334; *see also infra* notes 52-61 and accompanying text.

18. Single European Act, Feb. 28, 1986, 25 I.L.M. 503 (1986), *reprinted in* 19 BULL. EC 1-1986, pt. 1.2.2, at 9-10 (Mar. 1986). *See also* The Single European Act, 3 Common Mkt. Rep. (CCH) ¶20,000 at 9051 (Feb. 28, 1986).

19. *See* Mitchell, *supra* note 7, at 3.

20. *Id. See also Paper by Interagency Group Airs U.S. Concerns Over 1992 Plan*, 52 Banking Rep. (BNA) 49, 49 (Jan. 2, 1989). The Single European Act is the source of the phrase "1992" used as the target date for Community unification.

21. *Proposal for a Second Council Directive on the Coordination of Laws, Regulation and Administrative Provisions Relating to the Taking up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC*, 31 O.J. EUR. COMM. (No. C 84) 1 (1988). *See* Cruickshank, *Insider Trading in the EEC*, 10 INT'L BUS. LAW. 345 (1982).

> The Treaty [of Rome] confers the right of introducing a proposal for . . . a Directive on the Commission. The Commission itself cannot adopt such a measure, but has to submit it for approval to the Council of Ministers. The Council of Ministers cannot itself take the initiative in drawing up the proposal, but must wait for the draft to be submitted to it by the Commission. In this way there is a delicate constitutional balance, for neither institution can take action without the full participation and agreement of the other.

amendments to the proposal[22] and adopted them on May 29, 1989.[23]

The purposes of these amendments were to simplify the proposed Second Banking Directive, to increase the flexibility of relations with non-Community states, and to signal clearly that the Community wanted non-Community states to establish bank subsidiaries in the Community.[24] In simplifying the proposal, the Commission removed "reciprocity"[25] provisions, which required automatic suspension of any application from a third country bank for establishment of a bank in the Community, and inserted provisions that provide for a case by case analysis of the treatment received by Community firms in the applicant's country.[26] On June 19, 1989, the Council agreed on the amendments.[27]

B. *The Second Banking Directive*

By its own terms, the Second Banking Directive is an essential part of the integration of the internal European market, particularly as it relates to the freedom to establish credit institutions and provide credit services.[28] The Directive is an important member of a group of other directives relating to the operation and supervision of credit institutions.[29]

Id.; *see also* Jones, *supra* note 1, at 467 ("Specifically, the Commission formulates proposals for Community legislation, enforces Community law against Member States and individuals, and generally acts as the executive arm of the Community."). There are three other Community bodies: the European Council, which consists of the President of the Commission and the heads of state of the Member States; the European Parliament; and the European Court of Justice. *Id.* at 468.

22. 22 BULL. EC 5-1989, pt. 2.1.9, at 15 (Oct. 1989).

23. *Id.*

24. *Commission Modifies Proposals on Reciprocity in Banking Directive*, 4 Common Mkt. Rep. (CCH) ¶95,113, at 51,197 [hereinafter *Commission Modifies Proposals*].

25. If the Community invoked the strictest form of reciprocity, it would require that third countries provide exactly the same opportunities to Community banks that the Community provided to the third countries' banks. *See* U.S. GOV'T INTERAGENCY TASK FORCE ON THE EC INTERNAL MARKET, AN INITIAL ASSESSMENT OF CERTAIN ECONOMIC POLICY ISSUES RAISED BY ASPECTS OF THE EC'S PROGRAM: A PUBLIC DISCUSSION DOCUMENT 1 (Dec. 1988) (Internal Market Pub. Doc. 1288, Dec. 1988) [hereinafter INTERAGENCY REPORT].

26. *Id.*

27. *Council Agrees Directives on Banking and Insider Dealing*, Common Mkt. Rep. (CCH) No. 634, at 1 (June 29, 1989) [hereinafter *Council Agrees*].

28. *Second Banking Directive*, *supra* note 2, at 1. *See also Commission Modifies Proposals*, *supra* note 24, at 51,197. The Second Banking Directive establishes Community law for the first of three areas necessary to create a unified financial market. The other two areas are investment services and insurance. McCune, *EC Commission to Launch Capital Rules for Investment Houses*, Reuters (Apr. 23, 1990) (Nexis).

29. *See Second Banking Directive*, *supra* note 2. These other directives are: the *First*

The Council has passed a three directive "package" concerning the general operation of banks,[30] the types of funds that banks must maintain,[31] and the amount of funds that banks must keep in reserve relative to the bank's outstanding loans.[32] The Second Banking Directive states that all three directives must come into effect simultaneously.[33] This Note will concentrate on the Second Banking Directive, since its reputedly liberalizing intent has generated the most intense international debate.

The goal of the Directive is to establish a banking market "where banks [can] operate through branches and provide cross border services, restricted only by a minimum of limitations."[34] The Community will achieve this goal through the reduction of economic barriers for various financial institutions, whose operations will include lending, leasing, securities trading, and underwriting.[35] Through the single banking license,

---

Banking Directive, supra note 11, as amended by Directive 86/524/EEC, 29 O.J. EUR. COMM. (No. L 309) 15 (1986); *Consolidated Supervision Directive, supra* note 16, at 18; *Council Directive of 8 December 1986 on the Annual and Consolidated Accounts of Banks and Other Financial Institutions*, 29 O.J. EUR. COMM. (No. L 372) 1 (1986) [hereinafter *Consolidated Accounts Directive*]; and *Council Directive of 17 April 1989 on the Own Funds of Credit Institutions*, 32 O.J. EUR. COMM. (No. L 124) 16 (1989) [hereinafter *Own Funds Directive*].

30. *Second Banking Directive, supra* note 2.

31. *See Own Funds Directive, supra* note 29.

32. *Council Directive of 18 December 1989 on a Solvency Ratio for Credit Institutions*, 32 O.J. EUR. COMM. (No. L 386) 14 (1989) [hereinafter *Solvency Ratio Directive*].

33. *Second Banking Directive, supra* note 2, at 1.

34. Ebeling, *Freedom of Establishment and Freedom to Provide Services: The Proposed Second Banking Coordination Directive*, 15 EURO. L. REV. 60, 65 (1990). Some Member States hope that the Second Banking Directive will "provide a climate which is conducive to innovation, product deregulation and even a degree of legitimate competition between regulatory structures." *Brittan Calls for More Open World Banking Markets*, Common Mkt. Rep. (CCH) No. 654, at 5 (Apr. 12, 1990) [hereinafter *Brittan Calls for Open Markets*].

35. *See U.S. Businesses, Government Urged to Be Vigilant About EC Single Market*, 52 Banking Rep. (BNA) 887 (Apr. 14, 1989) [hereinafter *U.S. Urged to be Vigilant*]; *see also* Mitchell, *supra* note 7, at 3.

> The Second Banking Directive includes an annex listing the minimum activities that licensed banks should be able to pursue throughout the EC without any national restrictions. These activities include services generally associated with basic banking activities, but they also include securities underwriting and related services and the purchase and sale of securities, financial futures and options for a bank's own account or for the account of customers.

Id. The Annex lists the activities subject to mutual recognition. 32 O.J. EUR. COMM. (No. L 386) 13 (1989). Any institution may perform activities not listed in the Annex under the general provisions of the Treaty of Rome. *Second Banking Directive, supra*

which is valid throughout the Community, the Second Banking Directive will reduce these economic barriers and harmonize both the recognition of firms and the supervisory standards for banks.[36] By establishing guidelines for the entrance of firms from third countries, the Directive will allow the Community to liberalize financial markets outside the Member States.[37]

1. General Provisions

Article 1 of the Second Banking Directive defines important terms. In two important instances, the Second Banking Directive retains the language used in the First Banking Directive. First, the Second Banking Directive adopts the First Banking Directive's definitions of "credit institution"[38] and "authorization."[39] Second, the Second Banking Directive refers to the First Banking Directive for authorization requirements[40] and maintains the First Banking Directive's provision that the Member States will share information regarding management, ownership, and financial matters between the Member States.[41]

Aside from these provisions adopted from the First Banking Directive, the Second Banking Directive also contains two significant innovations. First, to open branches within the Community, a subsidiary needs to

---

note 2, at 2.

36. *Second Banking Directive, supra* note 2, at 2. *See also Council Agrees, supra* note 27, at 1.

37. *Second Banking Directive, supra* note 2, at 2-3, 5-6.

38. *Id.* art. 1(1). The First Banking Directive defines a bank as "[a]n undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account." *First Banking Directive, supra* note 11, art. 1. The Second Banking Directive defines a "financial institution" as an establishment that performs all the activities listed in the Annex to the Second Banking Directive except for taking deposits. *Second Banking Directive, supra* note 2, art. 1(6).

39. *Second Banking Directive, supra* note 2, art. 1(2). An authorization is "an instrument issued in any form by the authorities by which the right to carry on the business of a credit institution is granted." *First Banking Directive, supra* note 11, art. 1.

40. *First Banking Directive, supra* note 11, art. 3. To obtain authorization, a credit institution must possess adequate funds of its own, and at least two persons of good reputation and experience must direct the institution. *Id.* art. 3(2). The institution also must provide a program of operations that sets forth the type of business in which the credit institution will engage and the structural organization of the institution. *Id.* art. 3(4). Within 12 months of receipt of the application, the authorizing Member State must notify the applicant institution. *Id.* art. 3(6). The home country shall notify the Commission of all authorizations, and the Commission shall publish these authorizations in the *Official Journal of the European Communities. Id.* art. 3(7).

41. *Second Banking Directive, supra* note 2, art. 8.

acquire only one banking license issued by a Member State.[42] Second, the Second Banking Directive significantly relaxes[43] the reciprocity provisions of the First Banking Directive.[44]

2. The Single License

The Second Banking Directive sets forth criteria by which a Member State may authorize the establishment of a bank.[45] This unitary licensing mechanism "applies the principle of mutual recognition of authorization and supervisory systems" between the Member States.[46] Under the single license, Member States may no longer require that branches of subsidiaries which have a license to operate in the Community and wish to do business in another Member State must fulfill certain authorization or endowment criteria.[47] Once a bank has obtained authorization and a license in one Member State, it can operate anywhere else within the Community, so long as the bank meets all the other requirements of the Directive.[48] The single license will make it possible for credit institutions to tap a potential market of 320 million customers.[49] This system is feasible, because the First Banking Directive and a June 13, 1983 directive concerning the consolidated supervision of credit institutions have begun to harmonize the basic prudential rules for banks.[50] The Second Banking Directive is the final stage in the Community's establishment of a unified banking services market and the linchpin of the legislative progression toward this goal.[51]

Under the single license system, a bank may obtain a charter in one

42. *Id.* at 2 & arts. 13, 19-21.

43. *Id.* arts. 8-9.

44. *First Banking Directive*, *supra* note 11, at 31 & art. 9.

45. *Commission Modifies Proposals*, *supra* note 24, at 51,197.

46. *See* 21 BULL. EC 1-1988, pt. 1.2.1, at 12 (Apr. 1988); *see also Second Banking Directive*, supra note 2, at 1.

47. *Second Banking Directive*, *supra* note 2, art. 6(1).

48. *Id.* A bank may not use the system to avoid the stricter standards of the Member State where the bank intends to carry on business by obtaining authorization from another Member State. *Id.* at 1-2.

49. 21 BULL. EC 1-1988, pt. 1.2.1, at 12 (Apr. 1988). The Community, as a whole, is the largest trading partner of the United States. *1989 Hearings*, *supra* note 9, at 73 (statement of Rep. Annunzio, Chairman, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs).

50. *See* 21 BULL. EC 1-1988, pt. 1.2.1, at 12 (Apr. 1988); *see also supra* notes 16-17 and accompanying text.

51. *See* 21 BULL. EC 1-1988, pt. 1.2.1, at 12 (Apr. 1988); *see also Second Banking Directive*, *supra* note 2, at 1-2.

Member State (the home country) and then engage in the "universal banking" activities listed in the Annex to the Directive in other Member States (host countries).[52] Mutual recognition, through the single license, permits authorized credit institutions to perform these activities either by establishing branches or by providing services throughout the Community.[53] That is, the licensing home country, rather than the country in which the branch is located or the service provided, determines the scope of activities in which the bank may engage.[54] All of these regulatory innovations go into operation once a bank is authorized to do business in the Community. Because an institution chartered in any Member State may open branches and provide services without a host country's authorization, the single license is the "vital element" in reducing economic barriers.[55]

The goal of the single license is to create pressures within the Community for liberalization of the more restrictive regulations.[56] In an effort to attract banks from third countries to obtain authorization in their country, each Member State gradually will deregulate their banking systems and move toward the universal banking structure that currently exists in Germany.[57] Hopefully, this "competition of standards" will create uniform regulation throughout the Community.[58] The Second Bank-

---

52. *See* EC SINGLE MARKET, *supra* note 12, at 2; *see also supra* note 35 concerning the Annex. As defined by the Second Banking Directive, a "home Member State" is one that authorizes a credit institution to operate in the Community. *Second Banking Directive*, *supra* note 2, art. 1(7). A "host Member State" is defined as "the Member State in which a credit institution has a branch or in which it provides services." *Id.* art. 1(8). *See also* Zavvos, *Banking Integration in the European Community*, 9 NW. J. INT'L LAW & BUS. 572, 574-75 (1989) (Banks must comply with the cumulative requirements of home country authorization and engage in activities listed in the Annex in order to benefit from mutual recognition.).

53. *Second Banking Directive*, *supra* note 2, at 2.

54. *See* EC SINGLE MARKET, *supra* note 12, at 2. The home country is responsible for the general control and authorization of the credit institution. The home country is also responsible for the supervision of the financial soundness and solvency of banks. *Second Banking Directive*, *supra* note 2, at 2. Host countries, however, regulate the liquidity of branches and monitor the branches for the individual host country's monetary policy. *Id. See also* EC SINGLE MARKET, *supra* note 12, at 2. The Directive instructs both host and home countries to cooperate in the supervision of market risk. *Second Banking Directive*, *supra* note 2, at 2.

55. 21 BULL. EC 1-1988, pt. 1.2.2, at 12 (Apr. 1988).

56. *1989 Hearings*, *supra* note 9, at 5 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

57. *U.S. Urged to Be Vigilant*, *supra* note 35, at 887 (quoting Joan Spero, Senior Vice-President, American Express Co.).

58. Meessen, *Europe en Route to 1992: The Completion of the Internal Market*

ing Directive also may lead to more frequent contact between the national authorities and the managers of the financial institutions.[59] Finally, while the Directive allows individual Member States to enact laws that are stricter than certain provisions of the Directive,[60] the Directive aims to have strict surveillance measures without heavy procedural requirements.[61]

3. Relations with Third Countries

In addition to the single license, the Second Banking Directive has progressive standards for determining which banks may establish subsidiaries in the Community. The First Banking Directive provides that entrance into the Community market by non-Community credit institutions will be based on the principle of reciprocity.[62] "By proposing [the reciprocity] provision of the directive, the Commission attempted to provide the Community with the ability to play a role as the progenitor of the liberalization of financial services on a global scale."[63] Although it has relaxed the standard for authorization, the Community has maintained its active intent in the Second Banking Directive.[64]

Reciprocity still exists in the Directive, but now the Community will provide a third country's banks with access to the Community market if the third country provides Community banks with national treatment.[65] In such a case, the Community first must negotiate with the third country regarding the treatment of Community banks within that third coun-

---

and Its Impact on Non-Europeans, 23 INT'L LAW. 359, 366 (1989).

59. 21 BULL. EUR. COMM. 1-1988, pt. 1.2.3, at 13 (Apr. 1988).

60. *See Second Banking Directive*, *supra* note 2, at 2. Member States may enact laws stricter than the Directive in areas such as minimum capital, *id.* art. 4, ownership, *id.* arts. 5, 11, 12, and secrecy laws, *id.* art. 16.

61. *Commission Modifies Proposals*, *supra* note 24, at 51,197.

62. *First Banking Directive*, *supra* note 11, at 31 & art. 9(3). ("[T]he community may . . . agree to apply provisions which, on the basis of the principle of reciprocity, accord to branches of a credit institution having its head office outside the Community identical treatment throughout the territory of the Community."). *See also supra* note 25.

63. Mitchell, *supra* note 7, at 6.

64. *Second Banking Directive*, *supra* note 2, at 2. The preamble states that "existing reciprocity clauses will henceforth have no effect" and provides that the Community will use a more flexible approach to assess treatment by third countries on a Community-wide basis. *Id.*

65. A third country provides a Community bank with national treatment when it provides "the same competitive opportunities as are available to domestic credit institutions." *Id.* art. 9(4).

try.[66] Even if the Community does not invoke the reciprocity provisions, the Directive clearly states that the Community is interested in using its more liberal marketplace as a means of encouraging liberalization of markets throughout the world.[67]

Article 9 of the Directive provides the framework for a process of negotiation with third countries. Generally, the Community will permit a third country to operate more credit institutions in the Community if the third country provides Community banking firms with more access to the third country's markets.[68] Member States are required to inform the Commission of any particular difficulties encountered in establishing or carrying on banking activities in a third country.[69] In addition, the Commission must report the treatment that third countries afford Community banking firms in establishing and carrying on business and in acquiring holdings of third country banks.[70] These reports are submitted to the Council along with any Commission proposals six months prior to the date the Directive takes effect[71] and periodically thereafter.[72]

Paragraphs 3 and 4 of article 9 concern two events that trigger negotiations by the Commission. Under paragraph 3, if the Commission determines that a third country is denying Community firms "effective market access comparable to that granted by the Community,"[73] then the Commission may propose that the Council mandate the initiation of negotiations with the third country.[74] These negotiations are intended to obtain

66. *Second Banking Directive*, *supra* note 2, at 2-3 and Title III. *See infra* notes 68-95 and accompanying text. The Community can invoke the reciprocity provisions without negotiation only if Community banks do not receive national treatment from the third country. *Second Banking Directive*, *supra* note 2, art. 9(4).

67. *Second Banking Directive*, *supra* note 2, at 2-3 ("[T]he aim of this procedure is not to close the Community's financial markets, but rather, as the Community intends to keep its financial markets open to the rest of the world, to improve the liberalization of the global financial markets in other third countries.").

68. *Id.* art. 9.

69. *Id.* art. 9(1).

70. *Id.* art. 9(2).

71. The latest date the Second Banking Directive can go into effect is January 1, 1993. *Id.* art. 24(1).

72. *Id.* art. 9(2).

73. *Id.* art. 9(3). One problem with this standard may be each country's subjective definition of "effective market access." *See Comprehensive Regulatory Reform Needed, Economist Tells House Banking Task Force*, 54 Banking Rep. (BNA) 721, 722 (Apr. 30, 1990) [hereinafter *Comprehensive Reform Needed*] ("[T]here is little international consensus on what constitutes genuine equality of competitive opportunities or effective market access . . . .").

74. *Second Banking Directive*, *supra* note 2, art. 9(3). When there is not comparable access, the Council must vote for the negotiations by a qualified majority. *Id.* There

"comparable competitive opportunities for Community credit institutions" in the third countries.[75] Apparently, this provision was intended to address countries, such as the United States, which afford Community banks national treatment, but do not provide the same opportunities as are available in the Community.[76] Restrictions, such as those embodied in Glass-Steagall and those that derive from individual state laws, make it impossible for the United States to provide these opportunities.[77]

Under paragraph 4 of article 9, whenever the Commission determines that Community banks are not receiving national treatment,[78] the Commission may initiate negotiations aimed at improving the situation.[79] In addition, the Member States may limit or suspend action on pending and future requests for authorizations and acquisitions by parents governed by the laws of the offending third country.[80] Moreover, the Member States can limit or suspend the decisions on these requests for a maximum of three months.[81] The Council may extend the three month suspension period if it acts by a qualified majority based on a proposal from the Commission and the results of the negotiations.[82] Paragraph 4 does not affect institutions already authorized to operate in the Community and attempting to establish subsidiaries or to acquire holdings in Community firms.[83]

Article 9 allows the Commission to monitor applications from third country banks, unless the treatment problem is resolved through negotiations. Whenever article 9 applies to a third country—when the third country provides less than either comparable or national treatment to Community firms—Member States shall inform the Commission when

---

are a total of 76 ministers on the Community Commission; a qualified majority is a majority of 54 ministers. *EC Will Turn to Reciprocity Weapon Only When Negotiations Fail, EC Official Says*, 52 Banking Rep. (BNA) 648, 648 (Mar. 13, 1989) [hereinafter *EC Reciprocity*].

75. *Second Banking Directive*, *supra* note 2, art. 9(3).

76. *EC Council of Ministers Approves Banking Directive Forming EC-Wide Single License*, 52 Banking Rep. (BNA) 1387, 1387 (June 26, 1989) [hereinafter *Council Approves Directive*].

77. *Id.*

78. *Second Banking Directive*, *supra* note 2, art. 9(4). *See also supra* note 65 (definition of national treatment).

79. *See supra* note 64. When the third country provides less than national treatment, the Commission does not need a mandate from the Council to initiate negotiations; *cf. supra* note 74 and accompanying text.

80. *Second Banking Directive*, *supra* note 2, art. 9(4), subpara. 2.

81. *Id.*

82. *Id.*, subpara. 3. *See also supra* note 74 (discussing qualified majority).

83. *Second Banking Directive*, *supra* note 2, art. 9(4), subpara. 4.

any firm from that third country requests authorization either to establish a subsidiary or to obtain a majority holding in a Community firm.[84] The Member State need not inform the Commission, however, if the Community reaches an agreement with the third country or the time limits in subparagraphs 2 and 3 of paragraph 4 expire.[85] Regardless of the behavior of third countries or agreements made by Member States, article 9 shall comply with any bilateral or multilateral agreements governing the establishment or pursuit of credit institutions.[86]

The negotiation process of article 9 is a compromise between a mirror image definition of reciprocity,[87] as initially adopted in the First Banking Directive, and the national treatment standard, which the United States advocates.[88] Although the Second Banking Directive recognizes the national treatment standard, it advocates "comparable competitive opportunities,"[89] which would allow Community banks, while operating in third countries, to engage in services that the Directive permits.

The Second Banking Directive improved upon the First Banking Directive in several other areas,[90] but other directives are necessary to harmonize completely the Community banking industry. These future directives[91] will address the funds a bank must keep in reserve,[92] the ratio of these funds to outstanding loans,[93] management of large exposures,[94] and deposit guarantees.[95]

---

84. *Id.* art. 9(5).

85. *Id.* The Second Banking Directive refers to a three month suspension of decisions on authorization of new institutions or acquisition of an existing institution. *Id.* art. 9(4), subpara. 2. Subparagraph 3 refers to the extension of the three month suspension by a qualified majority of the Council. *Id.* art. 9(4), subpara. 3.

86. *Id.* art. 9(6).

87. *See supra* note 25.

88. *Council Approves Directive, supra* note 76, at 1387.

89. *Second Banking Directive, supra* note 2, art. 9(3).

90. The Second Banking Directive requires a minimum capital level of five million European Currency Units, the compulsory disclosure of information on major shareholders, and imposes a maximum level of involvement in non-banking activities (e.g., owning industrial firms) not to exceed 50% of the bank's own funds or 10% on any one venture. 21 BULL. EC, 1-1988, pt. 1.2.2, at 12-13 (Apr. 1988). Further improvements consist of structures for cooperation between supervisory authorities of different Member States. *Id.*

91. *See* 21 BULL. EC, 1-1988, pt. 1.2.1, at 12 (Apr. 1988).

92. *See Own Funds Directive, supra* note 30.

93. *See Solvency Ratio Directive, supra* note 32.

94. *Commission Recommendation of 22 December 1986 on Monitoring and Controlling Large Exposures of Credit Institutions*, 30 O.J. EUR. COMM. (No. L 33) 10 (1987).

95. *Commission Recommendation of 22 December 1986 Concerning the Introduc-*

The single license of the Second Banking Directive opens the door to the entire Community's banking market, not only for European banks, but also for international entities. Entry, of course, may be conditioned on the treatment of Community firms by the potential entrant's home country. Another innovation in the Directive is the Annex,[96] which contains a broad range of activities that expand the access by individual firms to different facets of European financial markets. The Annex will allow United States firms to engage in more activities in the Community than they can at home. Because entry remains conditioned on a third country's policies, and the United States banking market is more restrictively structured than the Community's, United States firms may have difficulty entering the Community's market in the future.

III. THE GLASS-STEAGALL ACT

Although the Community generally is satisfied with the current state of United States regulation,[97] the Community will lobby to change several pieces of United States legislation[98] that restrict the ability of Com-

---

tion of Deposit-Guarantee Schemes in the Community, 30 O.J. EUR. COMM. (No. L 33) 16 (1987).

96. *See supra* note 35.

97. The Community will permit United States banks to enter the Community market without further changes in United States legislation. The Community does recognize, however, that the United States has a more restrictive regulatory regime than the Community. *See EC Would Not Take Action Against U.S. if Banking Laws Not Reformed by 1992*, 54 Banking Rep. (BNA) 591, 591 (Apr. 2, 1990).

98. Aside from the Glass-Steagall Act, the Community is concerned with: (i) the McFadden Act, 12 U.S.C. § 36(c) (1982) (restricting interstate banking), *see Greenspan Says Japanese Banks' Financial Position Are Undermined by Market Drop*, 54 Banking Rep. (BNA) 633, 633 (Apr. 9, 1990) [hereinafter *Japanese Banks' Position Undermined*]; (ii) the fact that at least half the directors of a United States subsidiary must be United States citizens; (iii) the limits on a foreign bank's uncollateralized Fedwire (federally sponsored electronic funds transfer system) overdraft capacity, which substantially reduces a bank's capacity relative to domestic banks, *see EC Report on U.S. Trade Barriers Cites Financial Services, Banking Laws*, 54 Banking Rep. (BNA) 704, 705 (Apr. 26, 1990) [hereinafter *EC Report Cites Banking Laws*]; and (iv) section 4 of the Bank Holding Company Act, 12 U.S.C. § 1843 (1982) (prohibiting banks from underwriting insurance and securities), *see Brittan Calls for Open Markets, supra* note 34, at 7. The Community also has stated that regional compacts between states could become a major problem. *Id.* at 6. An example of one of these compacts, which only allows banks that have a United States owned parent to expand from one state into another, exists between Florida and Virginia. *See Time to Open Non-EC Markets, Brittan Tells Bankers' Group*, 54 Banking Rep. (BNA) 272 (Feb. 12, 1990) [hereinafter *Time to Open Markets*].

munity banks to obtain "comparable competitive opportunities"[99] or the same level of banking liberalization the Directive makes available in the Community. This Note focuses on Glass-Steagall, because it is the foundation for the United States regulatory structure and the legislation most relevant to the ability of United States financial institutions to compete globally.[100] Moreover, Glass-Steagall raises the cost of capital for banks and for United States businesses, because it reduces the efficiency with which United States banks operate. This increased cost of capital affects the competitive ability of both United States banks and the companies financed by those banks.[101]

Unlike the Second Banking Directive, Glass-Steagall is conservative and outdated. Its framers generally opted for such policies as safety for depositors' money and the elimination of conflicts of interest over marketplace efficiency. Moreover, Glass-Steagall was a compromise;[102] its "purposes" were varied and have been disputed. Although United States

---

99. *Second Banking Directive*, *supra* note 2, art. 9(3). *See also Community Looks to Third Countries for Banking Liberalisation*, Common Mkt. Rep. (CCH) No. 651, at 6 (Mar. 1, 1990) ("The Commission will be vigorous in its determination to negotiate away barriers to Community banks and other financial companies doing business abroad.").

100. *See Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says*, 54 Banking Rep. (BNA) 521, 521 (Mar. 26, 1990) [hereinafter *Reform Needed to Help U.S. Banks*].

> Although U.S. banks are permitted to engage in securities underwriting overseas, Regulation K stipulates that no single underwriting commitment may exceed $2 million or represent 20 percent or more of the issuer's capital and surplus or voting shares. When the EC integrates its financial markets in 1992, U.S. banks could own EC banks as subsidiaries, and engage in a wide range of financial activities permitted by member nations. But they would still be restricted by Reg K . . . .

Id. The Comptroller of the Currency of the United States, Robert Clarke, felt Regulation K, 12 C.F.R. § 211 (1990), was overly restrictive. *Id.* On the other hand, the Chairman of the Federal Reserve Board, Alan Greenspan, did not believe Regulation K restricted competition. *Japanese Banks' Position Undermined*, *supra* note 98, at 633.

101. *Reform Needed to Help U.S. Banks*, *supra* note 100, at 521.

102. Testifying in support of Senator Glass's legislation were the Superintendent of Banking for the State of New York, the Chairman of the Board of the General Electric Company, and a Harvard Professor. *See* Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672, 694-95 (1987). Banking regulators would not support actively Senator Glass's bill. Commercial bankers opposed it, and though the legislation was a part of his platform, the newly elected President, Franklin Delano Roosevelt, was ambivalent about it because of deposit insurance. *Id.* at 695. Support for a resolution increased, however, as the public began to perceive that the bankers were to blame for the persisting depression. *Id.*

interests and the Community favor repeal of Glass-Steagall, any legislation that replaces it similarly may suffer from compromise and special interests. United States regulators and courts have made deep inroads into the inefficient structures present in Glass-Steagall, and these continuing efforts may provide an operating environment for banks that is superior to one created by sweeping legislation.

A. *History*

After World War I, the group of United States firms offering securities expanded from a close-knit group of specialty firms to include larger commercial banks.[103] Initially, banks had offered securities services for the benefit of wealthier customers.[104] Often, banks established separately incorporated securities affiliates to take advantage of less restrictive state corporation laws.[105] As banks shifted their primary method of funding from loans to new issues of stock,[106] commercial banks successfully competed with investment banks by drawing on their large capital bases and networks of securities affiliates.[107] By 1930, the presence of bank securities affiliates had grown substantially.[108] The Great Depression resulted in widespread bank failures.[109] These failures prompted Congress to enact the Banking Act of 1933, popularly known as the Glass-Steagall Act.[110]

Of Glass-Steagall's four major provisions,[111] two concern the conduct of banking and securities firms, and two limit the affiliations of banks and securities firms. Section 16 prohibits banks both from underwriting any stocks or securities, except as provided in the statute, and from investing for the bank's own account. Banks, however, may purchase and sell securities upon the order of, and for the account of, customers.[112]

---

103. *Id.* at 692.
104. *Id.*
105. *Id.* Corporation laws were generally more liberal than banking laws. *Id.*
106. *Id.*
107. *Id.*
108. *See* Note, *Requiem on the Glass-Steagall Act: Tracing the Evolution and Current Status of Bank Involvement in Brokerage Activities*, 63 TULANE L. REV. 157, 161 (1988) ("[I]n 1930 commercial banks and their affiliates underwrote an estimated 60% of all bond issues, up from 37% only 3 years earlier."); *see also* S. KENNEDY, THE BANKING CRISIS OF 1933 at 212 (1973).
109. Note, *supra* note 108, at 161.
110. Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified in scattered sections of 12 U.S.C. (1988)).
111. *See supra* note 4.
112. 12 U.S.C. § 24 (1988).

Section 21 prohibits securities firms from receiving deposits.[113] Under section 20, banks may not be affiliated with any firm that deals in securities.[114] Under section 32, directors, officers, or employees of a securities firm may not, at the same time, serve as a director, officer, or employee of a bank.[115] Thus, the effect of Glass-Steagall is to separate commercial from investment banking activities.[116]

In 1932, Senator Glass stated that "one of the greatest contributions to the unprecedented disaster which has caused this almost incurable depression was made by these bank [securities] affiliates."[117] By separating commercial from investment banking, the drafters hoped to restore the public's confidence in the commercial banking system.[118] Lacking this assurance, potential depositors would not place their money with banks, and the entire economy eventually would fail.[119] Another purpose of Glass-Steagall, cited by both commentators and the United States Supreme Court, was the elimination of potential conflicts of interest that frequently arose when commercial banks engaged in securities activities.[120]

---

113. 12 U.S.C. § 378 (1988).

114. 12 U.S.C. § 377 (1988).

115. 12 U.S.C. § 78 (1988).

116. Note, *Banking and Securities Law: The Glass-Steagall Act—Has It Outlived Its Usefulness?*, 55 GEO. WASH. L. REV. 812, 813-14 (1987).

117. 75 CONG. REC. 9887 (1932) (statement of Sen. Glass). Senator Glass was the main catalyst of banking reform in the early 1930s. *See* Langevoort, *supra* note 102, at 693-98.

118. Note, *supra* note 108, at 162. Despite the fact that the United States Supreme Court recognized this aim in Investment Company Institute v. Camp, 401 U.S. 617, 631 (1971), one commentator has questioned the weight that Congress gave to the restoration of consumer confidence when it enacted Glass-Steagall due to the contemporaneous adoption of deposit insurance. *See* Langevoort, *supra* note 102, at 690. Senator Glass "strongly opposed . . . the idea of federal deposit insurance." *Id.* at 695. Professor Langevoort also notes that Glass-Steagall's legislative history does not assume the existence of the insurance provisions. *Id.* at 690 n.60.

119. Note, *Destroying the Barriers Between Commercial and Investment Banking: Should Congress Repeal the Glass-Steagall Act?*, 45 WASH. & LEE L. REV. 1115, 1115 n.2 (1988) (citing H.R. REP. NO. 150, 73d Cong., 1st Sess. 6-7 (1933)).

120. *Camp*, 401 U.S. at 620. *See* Note, *supra* note 108, at 162-63; *see also* Note, *supra* note 119, at 1115 n.2. Examples of this conflict of interest occur when a bank, which has underwritten a failing securities offering, recommends that depositors purchase the security. *Id.* at 1116 n.3 (citing 75 CONG. REC. 9912 (1932) (statement of Sen. Bulkley)). "The depositors' purchases would save the offering, and the bank would earn a commission on the sale." *Id.* The bank also might make unsound loans to help an affiliate overcome financial difficulties. Note, *supra* note 119, at 1116 n.3 (citing *Hearings Pursuant to S. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 1064 (1931)). In another scenario, a bank might be tempted

Though the United States is not currently in the midst of an economic depression, its financial community faces several challenges including the savings and loan crisis, federal deposit insurance reform, and international competition. Any legislation passed today likely would be the creation of similar compromises and might lead to similar difficulties in the future.

B. *Current Problems in United States Banking*

The competitive relationship between the banking and securities industries has changed substantially in the past two decades. In the early 1970s, the two industries performed very different services.[121] While the securities industry generally provided investors with high risk investments with potentially high yields, banks provided investors with safer opportunities and lower yields.[122] By the early 1980s, innovation by the investment industry in low-yield, low-risk products blurred the distinctions between the two industries.[123] In general, investors prefer to diversify both risk and yield within their portfolio. If an investor is able to obtain this diversification through one securities firm, as opposed to using both a bank and a securities firm, then the rational investor will reduce transaction costs and place more money with the single securities

---

to lend money to a firm in which the bank's security affiliate had invested heavily. *See id.*

Although these concerns were genuine, one commentator has suggested that any conflicts of interest could have been addressed by regulation rather than by a complete divorce of the commercial banking and securities industries. *See* Langevoort, *supra* note 102, at 690-91. Professor Langevoort points out that only one instance of actual abuse was recorded in the legislative history, and it involved "grave personal misconduct by the bank insiders." *Id.* at 690 n.57 (citing *Camp*, 401 U.S. at 617, 629-30). Professor Langevoort goes on to argue that the only real problem occurs when "bank officers or directors [have] a personal interest in the success of the securities affiliate or the issuer of the securities." *Id.* Also, Congress may have perceived other conflicts of interest arising from the banker's position as a fiduciary to the depositor. In this capacity, bankers were to provide disinterested investment advice that could be undermined by a "salesman's interest" in securities offered by the bank's securities affiliates. *See Camp*, 401 U.S. at 631-33. Congress also expected banks to act as "impartial sources of credit." Norton, *Up Against "the Wall": Glass-Steagall and the Dilemma of Regulated ("Re-regulated") Banking Environment*, 42 BUS. LAW. 327, 334 (1987) (citing 75 CONG. REC. 9912 (1932) (statement of Sen. Bulkely)). Banks, however, made loans to customers with the expectation that the funds would be used to purchase securities from the lender's affiliate. Note, *supra* note 108, at 163. *See also* Langevoort, *supra* note 102, at 690; *Camp.*, 401 U.S. at 631-32.

121. Langevoort, *supra* note 102, at 703.

122. *Id.* at 687-88.

123. *Id.* at 703. *See also id.* at 677.

firm.[124] As a result of the investment industry's ability to offer a wider range of options, substantial sums were reallocated from banks to securities firms.[125]

The effect of the Glass-Steagall "wall" was to relegate banks to the field of low-yield, low-risk demand deposits and increasingly outmoded commercial lending. At the same time, securities firms were expanding into areas that virtually duplicate the services offered by banks. Thus, a "competitive imbalance" exists in the finance industry in favor of securities firms.[126]

Currently, the only competitive advantage banks have over the cash management accounts of securities firms is deposit insurance.[127] The United States Treasury Department recently requested comments on the federal deposit insurance system and its substantial revision.[128] Thus, banks are constrained by Glass-Steagall in comparison to their domestic competitors, and if banks have any advantage on account of deposit insurance, it soon may vanish.

Glass-Steagall has increased the risks that banks confront because banks are unable to diversify in the face of reduced profits. One reason for decreased profitability is congressional deregulation of interest rate limits.[129] Prior to congressional action, this regulation had required that banks pay substantially less than market rates on checking accounts and time deposits.[130] The regulation assured banks a reasonable profit margin between the rates they paid to depositors and the rates they received

124. *Id.* at 687.

125. *Id.* at 703.

126. *Id.* at 688.

127. *Id.* at 709 n.125.

128. Commentators were asked to address limiting factors such as the scope or amount of insurance and alternatives to the current system. *See Treasury Invites Comments on FIRREA Mandated Study of Deposit Insurance*, 53 Banking Rep. (BNA) 869, 869-70 (Dec. 11, 1989). Also, commentators were questioned regarding the number of insured accounts one depositor may have at one institution, and were asked to compare United States and foreign insurance systems, auditing, and accounting procedures. *Senate Banking Will Focus on Deposit Insurance, International Competitiveness*, 54 Banking Rep. (BNA) 430, 430 (Mar. 12, 1990). The Bush Administration believes that any restructuring of the financial services industry must include revision of the deposit insurance system. *Id. See also President's Annual Economic Report Highlights Deposit Insurance Reform*, 54 Banking Rep. (BNA) 239, 239 (Feb. 12, 1990) ("Glass-Steagall initiatives, and those related to deposit insurance cannot be considered separately from one another . . . .").

129. Langevoort, *supra* note 102, at 681 (summarizing the effect of eliminating Regulation Q, 12 C.F.R. § 217 (1990)).

130. *Id.*

from borrowers.[131] As unregulated interest rates rose with inflation in the 1970s, Congress eliminated the regulated rate limits, forcing banks to pay higher market rates to depositors.[132] To compensate for reduced profit margins, banks incurred greater risks.[133] As banks undertook these increased risks, the Glass-Steagall separation remained, prohibiting banks from diversifying.[134] The inability to diversify is one of the greatest risks faced by United States banks as a result of the Glass-Steagall "wall."[135] Pressures from both international and domestic non-banking institutions will strain United States banks if they are not allowed to expand and diversify.[136]

As for international competition, one Congressman noted that a decrease in competitiveness by United States banks could impair the ability of United States manufacturers to sell their goods overseas, which would lead to further erosion of the United States economy.[137] One of the most important factors for United States manufacturers, the cost of capital, which determines a corporation's ability to seize opportunities, is relatively high in the United States compared to other countries.[138]

With this in mind, observers are calling for the United States to follow the example of the Community and comprehensively review the financial

131. *Id.*

132. *Id.* at 682.

133. *Id.*

134. Litan, *Evaluating and Controlling the Risks of Financial Product Deregulation*, 3 YALE J. ON REG. 1 (1985).

135. *1989 Hearings, supra* note 9, at 18 (testimony of Manuel H. Johnson, Vice-Chairman, Fed). Recently, one United States official stated that bank safety could be achieved by a profitable system that allows diversification of risk. *Id.* at 14 (testimony of Robert L. Clarke, Comptroller of the Currency). Diversification by banks would lead to increased capital for the bank and to a system that is safer than one "all chopped in pieces where no one can make any money." *Id.* Banks and regulators view new products, such as discount brokerages, as a way to stabilize earnings and reduce overall risk. Note, *supra* note 108, at 159 (citing Litan, *supra* note 134, at 10). One researcher has determined that commercial banks can reduce volatility of earnings by 15% to 30% if there were no barriers to offering innovative financial products. *Id.*

136. To help banks compete, regulators have been more permissive with capital requirements. *See Credit Quality of Major U.S. Banks Hurt by Shift to Securities Markets*, 48 Banking Rep. (BNA) 152, 152 (Jan. 19, 1987). These lower requirements, which increase the risk that a bank will be unable to survive an economic shock, coupled with lower profitability of the core business of banking, have led a leading bond rating company to note that investing in bank debt is increasingly risky. *Id.*

137. *Rep. LaFalce Calls U.S. Banks Complacent About Need to Compete in Global Market*, 54 Banking Rep. (BNA) 721, 721 (Apr. 30, 1990) [hereinafter *LaFalce Calls U.S. Banks Complacent*].

138. *Id.*

regulatory structure with the hope that it will encourage competition, efficiency, and lower costs.[139] A United States official expressed hope that Community integration will serve as an impetus for the United States to repeal Glass-Steagall, because it will provide benefits both to consumers with lower costs and to banks with the ability to diversify.[140]

C. *Current Status of the Glass-Steagall Act*

Since Congress has not modified Glass-Steagall substantially, both courts and regulatory agencies have been the source of the expansion of the areas in which banks may operate. By the early 1970s, regulators had rejected a restrictive reading of some sections of Glass-Steagall,[141] because strict adherence to Glass-Steagall's restrictions placed banks at a competitive disadvantage.[142] Some banking regulators, especially the Office of the Comptroller of the Currency (OCC), favor the relaxation of barriers to banks entering the securities field.[143] The OCC's view stems

139. *Comprehensive Reform Needed*, *supra* note 73, at 721-22 (quoting C. Fred Bergsten, Director, Institute for Int'l Economics). Senator Donald Reigle, Chairman of the Senate Banking Committee, also supports the creation of an umbrella regulatory body before further deregulation. *ICI Urges Glass-Steagall Repeal, BHC Act Amendments, Narrow Banks*, 54 Banking Rep. (BNA) 722, 723 (Apr. 30, 1990).

Against international competition, United States banks have not fared well. "Since 1983, the United States is the only country of the major industrialized nations whose total cross-border banking assets shrank . . . . " *LaFalce Calls U.S. Banks Complacent*, *supra* note 137, at 721. Currently, 260 foreign banks operate in the United States, controlling 25% of United States bank assets and 27% of the United States business loan market, while United States international lending has dropped 25% in four years and United States banks appear to be retreating from the international arena, in general, and Europe, in particular, just as opportunities are increasing. *Congress Needs to Take a Global View of U.S. Banking System, LaFalce Says*, 54 Banking Rep. (BNA) 181, 182 (Jan. 29, 1990) [hereinafter *Congress Needs to Take a Global View*].

140. *1989 Hearings*, *supra* note 9, at 11 (testimony of Robert L. Clarke, Comptroller of the Currency). Representative LaFalce, Chairman of the Task Force of the Financial Institutions Subcommittee of the House Banking Committee, stated that "only a tiny handful" of United States firms were taking advantage of the integration in the Community. *Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says*, 54 Banking Rep. (BNA) 521, 521 (Mar. 26, 1990).

141. Fischer, Gram, Kaufman & Mote, *The Securities Activities of Commercial Banks: A Legal and Economic Analysis*, 51 TENN. L. REV. 467, 471 (1984).

142. *See* Comment, *Banks and Bank Holding Companies: Going for Brokerage Under Glass-Steagall*, 4 ANN. REV. BANKING L. 315, 320 (1985).

143. *Id. See Five BHCs Posed to Underwrite Equity; New York Fed Bank to Review Procedures*, 54 Banking Rep. (BNA) 289 (Feb. 19, 1990) ("In the Jan. 18 order, the Fed determined that bank holding companies could underwrite debt and equity securities under Section 20 of the Glass-Steagall Act" after a one year waiting period.); *see also J.P. Morgan Gets Stock-Underwriting Power, but Banks' New Role May Be Mostly Sym-*

from its perception of "fundamental changes in the economic and regulatory structure" that have occurred since the 1930s.[144] One writer asserts that the agencies are amending Glass-Steagall by administrative fiat.[145] The agencies, however, are not acting alone.

Once Congress delegates the power to regulate the banking industry to administrative agencies, the courts serve as a check on the agencies. The courts generally have provided the banks with greater operating latitude through the combination of literal interpretation of the statute and deference to the agencies.[146] When the courts interpret Glass-Steagall literally, they limit its restrictive reach such that opportunities for banks in the marketplace increase.[147] As for deference, most initiatives by the banking industry require agency approval, and the agencies have accommodated marketplace change.[148] Deference serves to reduce Glass-Steagall's impact.[149] Although deference may not be the best analytical tool,[150] it does allow the courts to incorporate the realities of the modern banking marketplace into the framework of outdated legislation. Through deference and literal interpretation, courts and agencies minimize "the frustrating and potentially dysfunctional effects that Glass-Steagall might otherwise have on the development of the market for financial services."[151]

Agency action and court deference have expanded the range of services[152] that subsidiaries of bank holding companies may offer. These

---

bolic, Wall. St. J., Sept. 24, 1990 at C1, col. 4 (reporting that the Fed granted J.P. Morgan & Co. the power to underwrite corporate stock issues).

144. Plotkin, *What Meaning Does Glass-Steagall Have for Today's Financial World?*, 95 BANKING L.J. 404, 406 (1978).

145. Note, *supra* note 116, at 826.

146. *See* Langevoort, *supra* note 102, at 717-18; *see also* Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys., 900 F.2d 360 (D.C. Cir. 1990) (noting that the Securities Industry Association has a weak argument "because of the enormous deference we are obliged to give to the Board's determination that the activities proposed are 'closely related to banking,' . . . and that those activities will produce net benefits to the public"); *Banks' Securities Underwriting Upheld, Appeals Court Bars Relitigation of Claims*, 54 Banking Rep. (BNA) 660, 661 (Apr. 16, 1990).

147. Langevoort, *supra* note 102, at 717 n.144.

148. *Id.* at 718.

149. *Id. See* Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837, *reh'g denied*, 468 U.S. 1227 (1984) (outlining the Supreme Court's position on deference to administrative agencies).

150. Professor Langevoort asserts that "the rhetoric of deference is invoked after the court concludes the administrative decision is a sound one. In that sense, it adds little or nothing to the analysis." Langevoort, *supra* note 102, at 718 n.145.

151. *Id.* at 717.

152. Note, *supra* note 119, at 1118.

include retail discount brokerage services[153] and institutional investment advice and brokerage services.[154] In addition, non-bank subsidiaries of bank holding companies may underwrite and deal in mortgage-backed securities and consumer-receiver related securities.[155] Banks may engage in the private placement of commercial paper,[156] and state banks, which are not members of the Federal Reserve System, may have subsidiary relationships with securities firms.[157] Because of agency deregulation, both United States banks and foreign banks are able to compete with United States non-bank financial entities.

Although these actions by the courts and the agencies may appear to be by "fiat," the alternative is no response to the changing market. Ideally, Congress is the proper United States governmental entity to amend Glass-Steagall, but it has done nothing. Even if Congress passed legislation, it probably would be encumbered by compromise. Given congressional inaction, the contribution of courts and agencies, responding to each innovation as the banks create it, is the best mechanism for "updating"[158] the banking regulatory structure.

D. *Future Options and Risks*

Members of Congress recently have noted that the separation of banking functions under Glass-Steagall has served the country poorly in recent years.[159] Moreover, the Bush Administration claims it is committed to the repeal of Glass-Steagall.[160] Currently, however, there has been no real progress toward repeal.[161]

The stakes for United States banks are increasing as the Japanese push towards repeal of their banking separation law[162] and as the Sec-

---

153. Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys., 468 U.S. 207, 216-17 (1984).

154. Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys., 821 F.2d 810, 811 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988).

155. Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys., 839 F.2d 47, 60 (2d Cir.), *cert. denied*, 486 U.S. 1059 (1988).

156. Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys., 807 F.2d 1052, 1062 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

157. Investment Co. Inst. v. FDIC, 815 F.2d 1540, 1546 (D.C. Cir.), *cert. denied*, 484 U.S. 847 (1987).

158. *See* Langevoort, *supra* note 102, at 719.

159. *1989 Hearings*, *supra* note 9, at 39 (statement of Rep. Barnard).

160. *EC Policy on Foreign Banks Seen Leading to Chaos for U.S. Banks*, 52 Banking Rep. (BNA) 647, 647 (Mar. 13, 1989) [hereinafter *EC Policy on Foreign Banks*].

161. Celarier, *Glass-Steagall Is a Global Issue*, 48 U.S. BANKER 72 (May 1989). *See Congress Needs to Take a Global View*, *supra* note 139, at 182.

162. Celarier, *supra* note 161, at 72.

ond Banking Directive effectively deregulates European banking. These outside developments emphasize the problems within the United States financial industry that stem from the separation of investment and commercial banking operations.

The banking regulatory agencies also recognize the need for more substantial reform, but there is some disagreement over the extent of deregulation required. The Federal Depositors Insurance Corporation (FDIC) would permit non-bank activities by subsidiaries of the banks.[163] The FDIC argues that, by dismantling Glass-Steagall and the bank holding structure and by insulating the banking functions from other subsidiaries, the United States could obtain a better regulatory "product" than currently exists.[164] The Federal Reserve Board (the Fed), on the other hand, argues that non-banking operations should occur in subsidiaries of the bank holding company.[165] In this way, banks would remain separated from non-banking activities. The Fed fears exposing deposit insurance and other safeguards to non-banking activities,[166] and argues that "firewalls" should remain intact. These firewalls are designed to withhold insurance protection from non-banking affiliates. If protected by federal insurance, affiliates could be afforded an unfair advantage over competitors who are not affiliated with a bank holding company.[167]

One private individual, however, has argued that Congress must insti-

---

163. *1989 Hearings*, *supra* note 9, at 145 (written statement of L. William Seidman, Chairman, FDIC).

164. *Id.* at 21 (statement of Rep. Parris). *See also id.* at 144-45 (written statement of L. William Seidman, Chairman, FDIC).

165. *Id.* at 20 (statement of Manuel H. Johnson, Vice-Chairman, Fed). *See also id.* at 125 (written statement of Manuel H. Johnson, Vice-Chairman, Fed). The Fed has regulatory control over bank holding companies, but not banks themselves.

166. *Id.* at 17 (testimony of Manuel H. Johnson, Vice-Chairman, Fed). This exposure could occur if the United States expanded to universal banking too quickly. *Id.* "[T]here are major efficiencies and opportunities [from deregulation] and we should seize them, but we should not do it without protecting the exposure of taxpayers through the insurance fund." *Id.*

167. *Id.* at 5. *See* Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 MICH. L. REV. 1498, 1528-29 (1983). Any attempt to alter radically the financial industry by way of repeal or substantial liberalization of Glass-Steagall seriously would disturb, not only the structure of the United States finance industry, but also the structure of the government agencies in charge of regulating the industry. *See Hearing of the Senate Banking, Housing and Urban Affairs Comm. on Deposit Insurance Revision and Financial Services Industry Restructuring*, 101st Cong., 2d Sess. (July 25, 1990) (Nexis) (Testimony of Nicholas Brady, Secretary of the Treasury) ("As we explore the reform of our financial institutions, we will also need to explore the reform of our regulatory structure, although to be frank, the inevitable turf fights involved may prevent the full achievement of this goal.").

tute universal banking, both domestically and abroad, to enable United States banks to "meet [the global] competition head-on."[168] According to this individual, the firewalls are onerous and inefficient.[169] If these firewalls are extended to offshore operations, United States overseas securities affiliates would be unable to compete with European universal banks.[170]

Other individuals think that Congress need not ensure the access of United States banks to the Community market, because negotiations between the United States government, industry officials, and Community officials are sufficient.[171] Still others believe that the United States should address the problems of deficit reduction and securities deregulation first.[172]

Another option may be to pattern liberalization of the banking regulatory structure after European regulation, incorporating the experience of United States banks operating in Europe.[173] In the private sector, United States banking groups have established task forces to study the effects of European unification on United States banks.[174]

"No country can ignore what is happening around the world in this area without risking irreparable harm to its own institutions."[175] Currently, Glass-Steagall preserves deposit safety, but that safety may be a luxury the United States no longer can afford.[176] Deposit safety forces United States banks to operate inefficiently and to bear substantial costs

---

168. *1992 Poses Competitive Threat to U.S. Banks, Regulators Say*, 53 Banking Rep. (BNA) 464, 465 (Oct. 2, 1989) (quoting F. William Hawley, Director, Int'l Gov't Relations, Citicorp/Citibank) [hereinafter *1992 Poses Competitive Threat*].

169. *Id.*

170. *Id. See supra* note 100.

171. *Id.* at 465 (quoting Robert D. Hormats, Vice-Chairman, Goldman Sachs Int'l).

172. *1989 Hearings, supra* note 9, at 54-55 (testimony of Nicholas A. Rey, Managing Director, Bear Stearns & Co.). Another commentator has noted that since United States banks can perform several non-bank functions outside the United States under the Edge Act, 12 U.S.C. § 226 (1988), United States banks may push for increased activity offshore, providing banks more latitude in the absence of legislation that revises Glass-Steagall. Wallison, *The Statutory and Policy Underpinnings of United States Bank Securities Activities Abroad*, 4 B.U. INT'L L.J. 117, 123 (1986).

173. *See* Bradfield, *Current Regulations Dispel Concerns of Glass-Steagall Demise*, ANN. REV. BANKING L. 445, 450-451 (1989).

174. *EC Diplomat Says U.S. Should Seek Int'l Agreement on Banking Services*, 52 Banking Rep. (BNA) 930, 931 (Apr. 24, 1989).

175. *1989 Hearings, supra* note 9, at 72 (statement of Rep. Annunzio, Chairman, Subcomm. on Financial Institutions Supervision, Regulation and Insurance, House Comm. on Banking, Finance and Urban Affairs).

176. *Id.* at 8; *1992 Poses Competitive Threat, supra* note 168, at 464 (quoting L. William Seidman, Chairman, FDIC).

that foreign firms do not incur. According to one United States official, the presence of these unique burdens is the principal reason for the withdrawal of United States banks from the international front.[177] Community integration and liberalization will exacerbate the impact of these costs on United States banks.[178] One European official has warned that if the United States does not coordinate its regulations with those in Europe, the United States financial industry will be of "reduced importance" in the global market.[179]

IV. COMPARISON OF THE EUROPEAN COMMUNITY AND THE UNITED STATES POSITIONS

The banking policies of the United States and the Community are in conflict. The United States advocates allowing countries to decide their own mutual policy, and the Community attempts to sway the policies of other countries. This section examines the policies of both the Community and the United States and how they have affected each other's policymaking.

A. *The European Community Position*

1. Strategy and Goals

The Community policy towards third countries, expressed in the Second Banking Directive, is reciprocal national treatment. Ordinarily, "countries offering national treatment to banks based in the European Community will be offered national treatment for their banks throughout the Community."[180] The United States claims to offer national treatment without precondition[181] and sees the Community's version of national treatment as stricter than the standard adopted in many multilateral agreements,[182] such as the General Agreement on Tariffs

177. *1992 Poses Competitive Threat, supra* note 168, at 466 (quoting David C. Mulford, Under Secretary for Int'l Affairs, Dep't of Treasury).

178. *Id.* at 464 (quoting Robert L. Clarke, Comptroller of the Currency).

179. *Id.* at 57 (testimony of Serge Bellanger, Exec. Vice-President and General Manager, Cicunion Européenne, Int'l).

180. *Id.* at 6 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

181. "In principle, our version of national treatment is unconditional, while the EC's formulation allows for reciprocity." Statement of David C. Mulford, Under Secretary for Int'l Affairs, Dep't of the Treasury before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs (Sept. 28, 1989), *reprinted in* TREASURY NEWS (NB-477) [hereinafter TREASURY NEWS].

182. *See id.*

and Trade (GATT).[183] The Community contends that it can impose these stricter standards, because the banking sector currently is not covered by GATT.[184] While some Member States would prefer to maintain the strict standards to protect Community firms from outside competition,[185] most Member States want to exploit the Community's position to increase negotiating leverage against non-Community countries and to obtain greater access to foreign markets.[186] European banks will want the Community to trade access to Community markets for access to foreign markets.[187]

As adopted, the Second Banking Directive provides for negotiations with all countries that do not provide banking opportunities comparable to those opportunities offered within the Community.[188] By means of this negotiation mechanism, the Community expects to change the practices of other states.[189]

2. The Effects of the Second Banking Directive on the European Community

A study by the Commission has estimated that the liberalization of financial services in the Community would boost Gross Domestic Product (GDP) by 1.5 percent over approximately five years.[190] This figure is roughly one-third of the total Community GDP gains anticipated from the entire 1992 program.[191] The adoption of the Second Banking Directive by the Member States will have two principal effects on the European banking sector. First, there will be greater competition among banks because financial services no longer will be restricted by financial

183. *opened for signature*, Oct. 30, 1947, 61 Stat. A3 TIAS No. 1700, 55 U.N.T.S. 187, *reprinted in* GENERAL AGREEMENT ON TARIFFS AND TRADE, BASIC INSTRUMENTS AND SELECTED DOCUMENTS [GATT, BISD] (1969).

184. *See* INTERAGENCY REPORT, *supra* note 25, at 1; *see also Paper by Interagency Group Airs U.S. Concerns Over EC 1992 Plan*, 52 Banking Rep. (BNA) 49, 49 (Jan. 2, 1989) [hereinafter *Paper by Interagency Group*].

185. *Paper by Interagency Group*, *supra* note 184, at 49.

186. INTERAGENCY REPORT, *supra* note 25, at 2.

187. *EC Policy on Foreign Banks Seen Leading to Chaos for U.S. Banks*, 52 Banking Rep. (BNA) 647, 647 (Mar. 13, 1989).

188. *See supra* notes 73-77 and accompanying text.

189. *1989 Hearings*, *supra* note 9, at 43 (testimony of Robert D. Hormats, Vice-Chairman, Goldman Sachs Int'l). *See Community Looks to Third Countries for Banking Liberalisation*, Common Mkt. Rep. (CCH) No. 651, at 6 (Mar. 1, 1990) ("The Commission will be vigorous in its determination to negotiate away barriers to Community banks and other financial companies doing business abroad.").

190. TREASURY NEWS, *supra* note 181, at 2.

191. *Id.*

markets, national borders, or distance.[192] This increase in competition will affect previously well-protected market shares.[193] Over the long run, lower profit margins that result from increased competition may induce European firms either to restructure their activities or to expand into third country markets such as the United States.[194]

Second, greater competition will lead to a new class of five to ten larger "pan-European" universal banks that will dominate the Community and will be the major Community banks in the global market.[195] These pan-European banks will be the market leaders in France, England, and Germany and also will have representation in all important European economic centers.[196] In addition, several smaller regional, national, or specialty banks will emerge within the Community.[197]

Despite liberalization and increased competition, the Community banking industry will remain stable.[198] The Community believes it can protect both investors and its economy through effective and flexible regulatory structures.[199]

B. *The United States Position*

1. Policy of Liberal Trade

The United States supports European integration as manifested both by President Bush's agreement to meet with the Community's President twice yearly[200] and the United States Department of Treasury's endorsement of the Community objective of economic liberalization.[201] Further-

---

192. Mitchell, *supra* note 7, at 6.

193. *Id.*

194. *1989 Hearings, supra* note 9, at 4-5.

195. *See id.* at 52 (testimony of Dr. Ernst-Moritz Lipp, General Manager and Chief Economist, Dresdner Bank, AG); *see also Sasser Predicts "Cyclone" of Legislation on Deposit Insurance and "Too Big to Fail,"* 54 Banking Rep. (BNA) 287, 288 (Feb. 19, 1990) ("European banks are likely to be larger after 1992."). *But see* Lascelles, *Early Alliances Fail to Impress—Towards 1992 and the World's Largest Single Market,* Fin. Times, Survey (May 9, 1990) (Nexis) ("There is no such thing as a pan-European bank, and you won't see it for 20 to 30 years." (quoting John Tugwell, Chief Executive of Int'l Business, National Westminster)).

196. *1989 Hearings, supra* note 9, at 197 (written statement of Dr. Ernst-Moritz Lipp, General Manager and Chief Economist, Dresdner Bank, AG).

197. *Id.*

198. *Brittan Calls for Open Markets, supra* note 34, at 6.

199. *Id.*

200. *US and EC Agree to Hold Regular Summits,* Common Mkt. Rep. (CCH) No. 652, at 7-8 (Mar. 15, 1990).

201. TREASURY NEWS, *supra* note 181, at 1.

more, the Vice-Chairman of the Fed has expressed his hope that the Uruguay Round of GATT negotiations will "achieve liberalization of trade and financial services."[202] Still another United States official has noted that an integration of the world market will lead to a stronger and more competitive global market, benefiting all the countries involved.[203]

Through its support for general market liberalization, the United States encourages a policy of national treatment.[204] With some exceptions for national security,[205] the United States provides foreign investors with the opportunities to establish and operate banks on terms no less favorable than those available to domestic investors in similar circumstances. In the financial services sector, the United States contends that national treatment means equality of competitive opportunity[206] and competition between domestic and foreign firms on "equal footing."[207]

---

202. *1989 Hearings*, *supra* note 9, at 6-7 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

203. *Id.* at 9 (testimony of Robert L. Clarke, Comptroller of the Currency).

204. *See supra* note 65 (definition of national treatment). In a move to alter this policy, a proposed amendment to the 1988 Omnibus Trade and Competitiveness Act, the Fair Trade and Financial Services Act of 1990, S.2028, 101st Cong., 2d Sess. (1990), addresses situations where United States firms are denied actual national treatment. *Reigle, Garn Introduce Bill to Promote National Treatment*, 54 Banking Rep. (BNA) 225, 225 (Feb. 5, 1990). This bill appears to adopt a standard similar to that of the Community. The United States would first negotiate for equal competitive opportunities, and regulators could deny the applications of firms from countries that deny United States firms national treatment. *Id.* Although the United States has followed a policy of unconditional national treatment since 1978, this bill would include a requirement of "effective market access" by United States banks into foreign markets before the United States would provide national treatment to foreign banks. The United States is in the minority with unconditional national treatment, and this change may bring the United States more international leverage. *Administration Reviewing Unconditional National Treatment Policy, Mulford Says*, 54 Banking Rep. (BNA) 412, 412 (Mar. 5, 1990). *See infra* note 208. The Bush Administration opposes this bill because it would restrict capital flows and increase protectionism. *Hearing of the Senate Banking, Housing and Urban Affairs Comm.*, 101st Cong., 2d Sess. (Apr. 5, 1990) (testimony of David C. Mulford, Under Secretary for Int'l Affairs, Dep't of Treasury) (Nexis).

205. INTERAGENCY REPORT, *supra* note 25, at 6.

206. *Id.*

> [W]e provide foreign firms in the United States with the same competitive opportunities as domestic firms. We ask the same of the EC. We expect the member states and the EC Commission to adhere to international commitments to non-discrimination, including those contained in GATT, the Codes and Instruments of the OECD [Organization of Economic Cooperation and Development], and bilateral FCN [Friendship, Commerce, and Navigation] treaties.

Id. at 1.

207. *Id.*

Somewhat idealistically, one official has claimed that the United States adopted the national treatment policy because the policy is equitable, it sets an example as an alternative policy to countries that do not open their markets to foreign banks, and the United States financial system benefits from the dynamic participation of foreign banks.[208] Underlying national treatment are United States policies of free access and non-discrimination,[209] which are reflected in the International Banking Act of 1978.[210] Through its policy of national treatment, the United States "recognizes that there are differences in types of governments and regulatory systems,"[211] and the United States seeks entry into other countries on terms that each country sees fit to establish. The United States hopes that the Community will structure its financial markets to provide United States banks with equal competitive opportunities and freedom of access.[212]

Unlike the Second Banking Directive's negotiation process, the United States has no institutional leverage to apply against the Community in the event United States banks are denied access to Community markets. Therefore, whereas the United States views its national treatment policy

---

208. *1989 Hearings, supra* note 9, at 5 (testimony of Manuel H. Johnson, Vice-Chairman, Fed). Although the United States provides at least national treatment, there are examples of the United States providing "better than national treatment" to other countries. *Id.* First, under the International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1978), foreign banks are allowed to operate non-banking affiliates within the United States, even though United States banks are not permitted to operate those types of affiliates in the United States. *1989 Hearings, supra* note 9, at 6. This measure avoided extraterritorial application of United States law to foreign banks. *Id.* In another example, the Fed decided that if a foreign country's treatment of United States firms was not discriminatory, it would deem that country to have offered United States firms the same competitive opportunities to sell the foreign country's securities. *Id.* Also, geographic restrictions on banking activities are not violations of national treatment because the restrictions apply to both United States and foreign banks and were adopted for public policy reasons. *Id. See also* TREASURY NEWS, *supra* note 181, at 3 & n.15. Private parties, however, have noted that United States legislation has been proposed that would violate the United States own national treatment standard. *1989 Hearings, supra* note 9, at 54-55 (testimony of Nicholas A. Rey, Managing Director, Bear Stearns & Co.). Mr. Rey referred to legislation that would impose extensive reporting requirements on foreign acquirers in the United States and stated that adoption of this legislation would hurt the United States negotiating position. *Id.*

209. EC SINGLE MARKET, *supra* note 12, at 6-7.

210. Pub. L. No. 95-369, 92 Stat. 607 (1978) (codified in scattered sections of 12 U.S.C. (1988)).

211. *Paper by Interagency Group, supra* note 184 at 49.

212. *1989 Hearings, supra* note 9, at 10 (testimony of Robert L. Clarke, Comptroller of the Currency).

as a passively liberal outlook, the Community policy of reciprocal national treatment is a liberalizing and more active policy. Implicitly, the United States prefers that foreign states and firms entering the United States market do not dictate the terms by which the United States market operates, since these entrants do not have the same concern for domestic policy as United States lawmakers.[213] The Community, however, with banks that are likely to gain strength after 1992, wants access not only to the markets available to United States banks, but also to the same types of financial markets that are available under the Directive. The Community and the United States, therefore, are not in conflict over which United States laws should be repealed, but rather over whether the Community will impose restrictions on United States entrants to its markets if the United States is unable to repeal those laws.

2. The Effects of European Integration and United States Influence on the European Community Position

Reciprocity was described as the proposed Second Banking Directive's most controversial political issue.[214] While the United States advocates national treatment by all nations, it fears that reciprocity still exists in the adopted version of the Second Banking Directive, since "access to the EC market will be conditional on treatment of EC firms in third country markets" through the negotiation process.[215] Although the Community will apply it more flexibly, reciprocity can be used against the United States.[216] Some argue that the ultimate purpose behind the Community's integration is the protection of European markets,[217] and that reciprocity could result in restricted access to the Community market by United States firms.[218] Although a Community Commissioner has stated that the reciprocity clause "is emphatically not a harbinger of protectionism,"[219] it is not clear what criteria the Community will apply in judging whether

---

213. *See 1989 Hearings*, *supra* note 9, at 6 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

214. *EC Changes Will Have Mixed Effects on Fledgling Global Banking, Panel Says*, 52 Banking Rep. (BNA) 600, 601 (Mar. 6, 1989).

215. TREASURY NEWS, *supra* note 181, at 3.

216. EC SINGLE MARKET, *supra* note 12, at 5. One member of the Bush Administration called the concept of reciprocity, once it was enacted into law, a "club in the closet" to be used to force changes in the United States financial system. TREASURY NEWS, *supra* note 181, at 3.

217. Hilton, *The EC Threat*, 15 U.S. BANKER 68, 68 (May 1989).

218. INTERAGENCY REPORT, *supra* note 25, at 1.

219. *EC Will Turn to Reciprocity Weapon Only When Negotiations Fail, EC Official Says*, 52 Banking Rep. (BNA) 648, 648 (Mar. 13, 1989).

Community banks receive national treatment from third countries.[220] At a minimum, the Community will use the negotiation process of the Second Banking Directive to lobby for more liberal banking regulations in the United States.[221]

United States officials have warned that if the Community invokes the reciprocity measure that still exists in the Second Banking Directive, Community banks will face the consequences:

> [T]here should be no illusions about the consequences of possible EC actions. If U.S. firms are discriminated against in the EC, there would likely be consequences for EC national institutions. An obvious first step might be to scrutinize the "better than national treatment" privileges which many European financial institutions enjoy in the United States.[222]

However, Community banks might be large enough that these sanctions would not be a significant threat.

Although the United States disagrees with the Community's proposed treatment of other countries,[223] comparison of the First Banking Directive's reciprocity provisions[224] to the Second Banking Directive's current "relations with third countries"[225] shows that the United States has influenced the Community's position. The reciprocity provision of the First Banking Directive received substantial criticism from United States interests. This led to an amendment of the proposed Second Banking Directive in April 1989.[226] United States officials believe that the current standard is a "quite substantial improvement over the original reciprocity provision."[227]

A more substantial United States fear is that Community banks will

---

220. *1989 Hearings*, *supra* note 9, at 50 (testimony of Hideo Ishihara, Managing Director, Industrial Bank of Japan).

221. *1989 Hearings*, *supra* note 9, at 43 (testimony of Robert D. Hormats, Vice-Chairman, Goldman Sachs Int'l). *See also id.* at 31 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

> [U]nder current principles we don't have to adjust our existing standards for banks to the European standards. All we need to do is provide them equal opportunity to U.S. domestic banks under the existing structure. However . . . European Community representatives will continue to lobby and press for a more level playing field between the United States and the European Community. . . .

Id.

222. TREASURY NEWS, *supra* note 181, at 4.

223. *See supra* notes 200-213 and accompanying text.

224. *See supra* notes 62-64 and accompanying text.

225. *See supra* notes 65-95 and accompanying text.

226. *Council Agrees*, *supra* note 27, at 1.

227. *1989 Hearings*, *supra* note 9, at 28 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

have a competitive advantage in the United States by virtue of European integration.[228] The Community currently is moving towards universal banking under the Second Banking Directive. As a result, large European banks will emerge as formidable competitors to United States banks.[229] Even though United States banks may enjoy expanded markets in the Community due to the lack of functional borders, the European "super banks" will compete with United States banks[230] both in the Community and in the United States.[231] The inefficiencies in the United States resulting from Glass-Steagall are a principal reason for the competitive advantage of European banks.[232] According to the United States, because the Community already will have an advantage over United States banks on account of their ability to consolidate and to engage in a broad range of activities in Europe, the Community banks should not be permitted to use reciprocity provisions to further exploit their advantage within the United States.

Aside from increased competition, the integration may not cause the United States to suffer any other ill effects. The Community banks may prefer to change Glass-Steagall and certain state limitations, but these laws will not cause the Community to exclude United States banks.[233] Regardless of access, United States banks already have begun to restructure their activities as a result of the currently reduced profit margins.[234] These profit margins are not expected to increase in the unified market.

3. The United States Response to the Second Banking Directive

In the absence of any crisis, it is unlikely that Congress will take steps to anticipate the integration of the Community market and expand United States banking powers.[235] Similarly, the Bush Administration has

228. *1989 Hearings, supra* note 9, at 27 (statement of Rep. Hubbard).

229. TREASURY NEWS, *supra* note 181, at 5.

230. *1989 Hearings, supra* note 9, at 10 (testimony of Robert L. Clarke, Comptroller of the Currency). Any expansion by United States banks in the Community will be strictly in the wholesale field. *Id.* at 42 (statement of Sir Jeremy Morse, Chairman, Lloyds Bank).

231. *Id.* at 8 (testimony of L. William Seidman, Chairman, FDIC).

232. *See id.* at 34.

233. *Id.* at 34 (testimony of Robert L. Clarke, Comptroller of the Currency). *See also EC Official Says U.S. Officials Satisfied with Draft Banking Standards*, 52 Banking Rep. (BNA) 1080, 1080 (Mar. 8, 1989) (statement of Sir Leon Brittan, Vice-President, European Community Commission).

234. *1989 Hearings, supra* note 9, at 4 (testimony of Manuel H. Johnson, Vice-Chairman, Fed).

235. *Id.* at 19 (testimony of Robert L. Clarke, Comptroller of the Currency).

not provided Congress with any proposals for restructuring United States financial institutions,[236] although the Administration claims it favors the repeal of Glass-Steagall.[237]

After 1992, United States firms must open a subsidiary in at least one Community country to obtain the single license. However, it appears that many United States banks may not be interested in entering the Community market. Noting that United States banks have been losing their global market share in recent years, one industry professional in the Community stated that there was no evidence that United States banks have changed their strategic goals in light of the Community's plan to consolidate the European market in 1992.[238]

V. Conclusion

It is not clear whether the Community's transformation to a single financial market will be a smooth one. According to one United States Treasury official, the Community will have serious problems before reaching its goals of a unified and efficient market.[239] While noting that integration inevitably will strengthen the Community market,[240] this official stated that the Community will have difficulty adjusting to problems that stem from the potential inability of a central authority to manage regional variations in the economy and problems from different currencies.[241] Thus, the United States worries may be exaggerated. Nevertheless, the Second Banking Directive emphasizes the problems that exist in the United States system even without external pressure.

Apparently, United States banks are not contemplating significant expansion into the global market in the near future. United States banks, however, would like to preserve their domestic market share. With the advent of European "super banks," United States banks may find their domestic market share declining. This would support the position that Congress should act quickly to reduce the negative impact of the increase in European competitiveness. The situation, however, may never rise to

---

236. *See 1992 Poses Competitive Threat, supra* note 168, at 466.

237. *See EC Policy on Foreign Banks, supra* note 160, at 647.

238. *1989 Hearings, supra* note 9, at 53 (testimony of Dr. Ernst-Moritz Lipp, General Manager and Chief Economist, Dresdner Bank).

239. *Id.* at 89 (testimony of David C. Mulford, Under Secretary for Int'l Affairs, Dep't of Treasury).

240. The measures already adopted by the Community will alter radically the economic and legal environment in which firms do business in the Community after 1992. Jones, *supra* note 1, at 475-76.

241. *1989 Hearings, supra* note 9, at 90-91 (testimony of David C. Mulford, Under Secretary of Int'l Affairs, Dep't of Treasury).

the critical level that would prompt Congress to act. Even if Congress were to act, both depositors' groups and investment banking groups would lobby to limit the latitude of the banks' operations. The compromise required to enact this type of legislation could restrict severely its ability to resolve the problems the United States currently confronts.

Thus, the regulators, with their own focus on the banking industry, are the best governmental actors to address the problems of United States banking regulatory structure. Though it takes time to litigate each of the banking industry's innovative products, the regulators and their allies, the courts, have shown that they will allow banks to expand the scope of services offered. Both United States and Community banks will be served best by incremental change from the regulators and courts, rather than by sweeping and possibly protectionistic banking deregulatory legislation.

Christopher T. Toll