REGULATION OF BANKS AS BROKERS UNDER THE SECURITIES EXCHANGE ACT OF 1934

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I. Introduction.

On July 1, 1985, the Securities and Exchange Commission, ("SEC" or "Commission") adopted Rule 3b-9[1]. Since the rule went into effect on January 1, 1986, banks have been subject to SEC regulation[2] as brokers[3] or dealers[4] under provisions of the Securities Exchange Act of 1934 ("1934 Act").[5] Rule 3b-9 affects banks which: (i) publicly solicit brokerage business for transaction-related compensation; (ii) receive transaction-related compensation for providing brokerage services for trusts, managing agency, or other managed accounts to which the bank provides advice; or (iii) deal in or underwrite securities.[6]

Not surprisingly, the SEC's adoption of the rule has caused considerable consternation in the banking community. Under the 1934 Act, banks are specifically excluded from the definitions

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1 Securities Exchange Act Release No. 34-22205, 50 Fed. Reg. 28,385 (1985) (to be codified at 17 C.F.R. §240.3b-9) [hereinafter cited as Rule 3b-9]. The rule will affect approximately 1000 commercial banks.

2 Securities Exchange Act Release No. 34-22724 (Dec. 18, 1985). The SEC will grant an extension of registration time in some cases.

3 Securities Exchange Act of 1934, § 3(a)(4), 15 U.S.C. §78c(a)(4) (1982) [hereinafter cited as 1934 Act].

4 1934 Act at § 3(a)(5), 15 U.S.C. §78c(a)(5) (1982).

5 1934 Act (codified in various sections of 15 U.S.C.).

6 Rule 3b-9.

Section 21 of the Glass-Steagall Act, *infra* note 39, generally prohibits banks from "issuing, underwriting, selling, or distributing," securities. However, there is a major controversy as to what constitutes "underwriting" with respect to banks. *See* Securities Industry Association v. Board of Governors of the Federal Reserve System, 627 F. Supp. 695 (D.D.C. 1986) (Court recognized that the term underwriting may have different meanings in the context of banking law and federal securities law). In promulgating Rule 3b-9, the SEC "expressed no opinion as to the legality" of dealing in or underwriting securities by a bank under the Glass-Steagall Act. Rule 3b-9 at 28,386 n3. However, the Commission has indicated that the term "underwrite" will be interpreted consistently with the definition of "underwriter" contained in Section 2(11) of the Securities Act of 1933. *Id.* at 28,391.

of "broker" and "dealer" and thus, at least up to now, were exempted from SEC regulation.[7] In addition, under the Banking Act of 1933 (commonly referred to as the "Glass-Steagall Act")[8] banks are specifically permitted to engage in certain brokerage activities.[9]

Initial interpretative opinions by the Comptroller of the Currency with respect to the Glass-Steagall Act restricted the role of a bank in brokerage services to that of an "accommodation agent for the convenience of customers."[10] However, subsequent interpretations by the Comptroller of the Currency found that the prior opinions were too restrictive and the scope of permissible bank brokerage activities has expanded significantly through the years.

It is in this environment of expanding bank brokerage activity that the SEC adopted Rule 3b-9. It is estimated that more than 1000 banks[11] are currently engaged in the securities brokerage business. Although banks are specifically excluded from the 1934 Act definitions of broker and dealer, and although banks have traditionally been active in the securities brokerage business, the SEC believes it has the authority to regulate those bank activities which are "functionally equivalent" to those performed by brokers and dealers.[12] The SEC contends that those "functionally equivalent" activities are within the scope of the Commission's regulatory authority.

In *American Bankers Association v. SEC*,[13] the plaintiff[14] challenged the validity of Rule 3b-9. In an October 30, 1985 deci-

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7 For over fifty years, the 1934 Act was interpreted by the Commission to exclude banks from registration and regulation. In fact, as late as 1977, in a report to Congress, the SEC stated its belief that any change in the regulation of bank securities activities would require legislative action. S. Comm. on Banking, Housing, and Urban Affairs, 95th Cong., 1st Sess., Report on Banks Securities Activities of the Securities and Exchange Commission (Comm. Print 1977).

8 Glass-Steagall Act, 48 Stat. 162 (1933) (codified as amended in various sections of 12 U.S.C.).

9 Glass-Steagall Act, §16, 12 U.S.C. §24 (1982).

10 *See infra* note 93.

11 Rule 3b-9 at 28,386.

12 Wall Street Journal, Jan. 3, 1986, at 32, col. 1.

13 American Bankers Association v. Securities and Exchange Commission, No. 85-6055 (D.C.Cir. Oct. 30, 1985), *appeal pending* (D.C.Cir. 1986).

14 The plaintiff, the American Bankers Association, represents the commercial banking industry in this action.

sion, the District Court for the District of Columbia deferred to the SEC interpretation and held that the SEC could redefine the terms "broker" and "dealer" to include commercial banks engaged in the three activities covered by Rule 3b-9. The court decided that the SEC could redefine the terms as long as: (i) the Commission acted within the intent of Congress; (ii) the Commission's action was reasonable; and (iii) Congress had not withdrawn the legislative authority previously granted to the agency.[15]

The American Bankers Association contends that the District Court's decision was erroneous and has appealed to the United States Court of Appeals for the District of Columbia.[16] The American Bankers Association argues that Rule 3b-9 should be declared invalid based upon the following: the separate and adequate body of regulatory law governing bank activities;[17] the bank exemption contained in the definitions of "broker" and "dealer" in the 1934 Act;[18] the absence of authority allowing the SEC to redefine definitions of the 1934 Act;[19] the legislative history and environment surrounding enactment of the banking and securities laws of the 1930's;[20] and the absence of need for further regulation of the brokerage activities conducted by banks.[21]

This article will discuss the historical involvement of banks in the securities brokerage business, the scope of Rule 3b-9, and the arguments presented by the American Bankers Association and the SEC in *American Bankers Association v. SEC*, currently pending before the Court of Appeals for the District of Columbia. If the SEC's position is upheld, it would substantially expand its

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15 American Bankers Association v. Securities and Exchange Commission, No. 85-6055 (D.C. Cir. Oct. 30, 1985), *appeal pending* (D.C. Cir. 1986).

16 *Id.*

17 For example, the Comptroller of the Currency, the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Federal Home Loan Bank all regulate various aspects of the banking industry.

18 *See infra* discussion at II. A.

19 *See infra* discussion at IV. B.

20 *See infra* discussion at IV. C.

21 The American Bankers Association feels there is no need for further regulation of bank brokerage activities. The SEC regulation under Rule 3b-9 would add unnecessary costs. The SEC believes there is a need to protect investors. Regulation of bank brokerage activities by banking authorities does not adequately protect the investor. *See infra* notes 113-19.

authority to redefine terms of the 1934 Act and increase its jurisdiction.

II. Background

In analyzing the controversy surrounding the SEC's adoption of Rule 3b-9, it is necessary to examine the historical development of the securities and banking regulatory framework which exists today.

A. *Securities Regulation and the Securities Exchange Act of 1934*

In an effort to protect investors from the various abuses which existed in the securities markets during the period leading up to the Great Depression, Congress enacted the 1934 Act. In part, the 1934 Act regulates the registration and subsequent reporting requirements of brokers and dealers. Broker as defined in Section 3 of the 1934 Act specifically excludes banks:

> unless the context otherwise requires . . . the term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, *but does not include a bank*.[22] (Emphasis added).

Similarly, the definition of dealer, also contained in Section 3, excludes banks:

> unless the context otherwise requires . . . the term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, *but does not include a bank* . . . .[23] (Emphasis added).

Thus, banks are excluded from the definitions of both broker and dealer and have not traditionally been required to register as such with the SEC.[24]

The term "bank" is comprehensively defined in Section 3(a)(6) of the 1934 Act and the definition specifically enumerates each type of institution or person included in the definition. In pertinent part Section 3(a)(6) provides:

> unless the context otherwise requires . . . (6) the term "bank" means (A) a banking institution organized under the laws of the United States; (B) a member bank of the Federal Reserve

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22 1934 Act at 3(a) 4, 15 U.S.C. §78c(a)(4) (1982).
23 1934 Act at 3(a) 5, 15 U.S.C. §78c(a)(5) (1982).
24 *See* 1934 Act 15 U.S.C. §78c(a)(6) (1982) ("Banks" defined).

> System; (C) any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under Section 11(k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the purpose of this title; and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.[25]

It should be noted that, as originally proposed, the 1934 Act did not contain an exclusion for banks from the definitions of broker and dealer. During congressional hearings on the bill, however, it was noted that banks regularly engaged in activities "effecting securities transactions for the account of others."[26] Congress was asked to clarify its intent as to whether or not banks were to be included within the definitions of broker and dealer.[27] Congress responded by excluding banks from the definitions of broker and dealer not in general terms, but in a series of carefully shaped provisions.[28]

B. *Regulation of Banks*

1. The Glass-Steagall Act

Prior to 1933, commercial banks engaged extensively in underwriting both corporate and municipal securities primarily through securities affiliates and trust companies. In the wake of the Great Depression, Congress was concerned with preventing another collapse of the financial markets and focused its attention on regulation of those markets. In the banking segment of the financial markets, Congress was concerned with certain prac-

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25 *Id.*

26 William C. Potter, Chairman of the Board of Guaranty Trust Co., *Stock Exchange Practices, Hearings on S. Res. 84 before the Senate Committee on Banking and Currency*, 73d Cong., lst Sess. 7221-22 (1934); American Bankers Association Appellate Brief, at 11-12.

27 American Bankers Association Appellate Brief, at 11-12.

28 In enacting later statutes in the securities area, Congress repeatedly chose to exclude banks from the statutory provisions. *See* Investment Company Act of 1940, 15 U.S.C. §§80a 2(a)(6),(11)(1982); 80(a)-3(c)(3),(11)(1982); Investment Advisors Act of 1940, 15 U.S.C. §§80b-2(a)(3),(7),(11)(1982).

tices[29] which threatened the safety of depositors' funds and undermined the public's confidence in the banks.[30]

In an effort to alleviate these concerns, Congress enacted the Glass-Steagall Act[31] which prohibited many of the underwriting activities in which banks previously had been engaged. In addition, through certain prohibitions, this Act subjected bank securities activities to regulation. Prohibitions under the Glass-Steagall Act are twofold. First, restrictions are placed on activities which can be lawfully performed by banks.[32] Second, restrictions are placed on bank affiliations with non-banking institutions.[33]

The Glass-Steagall Act has four operative sections embodying these prohibitions. Section 16[34] contains the basic prohibition on bank activities, precluding them from dealing in securities except upon the order, and for the account of, customers. With respect to bank involvement in securities activity, Section 16 provides in pertinent part:

> the business of dealing in securities and stock by the [banking] association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own ac-

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29 The practices with which Congress was concerned included:
(i) The use of a securities affiliate to support the price of a bank's own stock by purchasing that stock;
(ii) Exorbitant management fees paid to affiliates and their officers who were also often the officers of the bank;
(iii) The use of securities affiliates as a dumping ground for bad loans made by the banks. 5 DELORENZO, SCHLICHTING AND COOPER, BANKING LAW, Volume 5, §96.02[1] (Matthew Bender 1985) [hereinafter cited as BANKING LAW].

30 Congress feared that banks were diverting their deposits to finance unsound investments which threatened the safety of their depositors' funds. *Hearings on the Stock Exchange Practices; Senate Committee on Banking and Currency*, 72d Cong. 2d Sess. (1933). *Hearing Pursuant to S. Res. 71 before a sub-committee of the Senate Committee on Banking and Currency*, 7lst Cong., 3d Sess. (1931) at 1058.

Congress was concerned that public confidence was undermined by the operation of investment services by banks. Congress believed that the risk inherent in stock operations would impair public confidence in the banks that conducted or were connected with securities operations. *See, e.g.*, remarks of Senator Bulkley, 75 Cong. Rec. 99912 (1932). *See generally*, Investment Co. Inst., v. Camp, 401 U.S. 617, 630-31 (1971).

31 Glass-Steagall Act, 48 Stat. 162 (1983) (codified as amended in scattered sections of 12 U.S.C.).

32 Glass-Steagall Act, §16, 12 U.S.C. §24 (1982).

33 *See infra* notes 37 and 39.

34 12 U.S.C. §24 (1982).

> count and the association shall not underwrite any issue of securities or stock . . . .[35]

By its terms, Section 16 prohibits national banks and state member banks of the Federal Reserve System[36] both from purchasing as a principal and underwriting most securities.

Section 20[37] prohibits a member bank from being affiliated with any organization whose principal business is underwriting. In pertinent part, Section 20 provides:

> no member bank shall *be affiliated* in any manner described in subsection (b) of Section 221(a) of this title with any corporation, association, business trust, or other similar organization *engaged principally*, in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.[38] (Emphasis added).

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35 *Id.* Section 16 of the Glass-Steagall Act does provide exceptions for banks dealing, underwriting or purchasing securities for its own account with respect to certain types of obligations, e.g., obligations of the United States. *Id.*

36 The original statute provided that national banks could purchase and sell investment securities for their customers, making it unclear if stocks could be purchased and sold, or if only debt securities were encompassed by the exception. The Banking Act of 1935 amended Section 16 of the Glass-Steagall Act to clarify that stock transactions for customer accounts were permitted. Thus, member banks can purchase securities on the order and for the account of their customers, i.e., they can act as brokers. The House and Senate Committees reporting on this amendment saw no objection to this practice, noting "since buying and selling for the account of a customer does not involve investment by the bank of its own funds . . . no objection can be seen thereto." H.R. Rep. No. 1948, 73d Cong., 2d Sess. 2 (1934) and S. Rep. No. 1260, 73d. Cong., 2d Sess. 2 (1934). *See* Securities Industry Association v. Comptroller of the Currency, 577 F. Supp. 252 (D.D.C. 1983), *aff'd*, 758 F. 2d 739 (D.C. Cir. 1985), *cert. denied*, — U.S. —, 106 S. Ct. 790 (1986).

The restrictions on underwriting securities and dealing in securities for a bank's own account were imposed on nationally chartered banks by the Glass-Steagall Act. The Federal Reserve Act subjected all member banks, including state member banks to the same restrictions. Non-member state banks insured by the Federal Deposit Insurance Company, ("FDIC") are indirectly subject to these restrictions. BANKING LAW, Volume 5, §96.02[2][a] (Matthew Bender 1985).

37 12 U.S.C. §377 (1982).

38 *Id. See also* Securities Industry Association v. Board of Governors of the Federal Reserve, 468 U.S. 137 (1984) (The term "public sale" is used in conjunction with the terms "issue," "flotation," "underwriting," and "distribution" of securities. It did not apply to the discount brokerage activity of Charles Schwab & Co. BankAmerica's acquisition of Charles Schwab & Co., was not in violation of Section 20 because Schwab was not engaged principally in the "issue, flotation, underwriting, public sale, or distribution . . . of stocks" although it did offer discount brokerage services).

Section 21[39] of the Glass-Steagall Act generally prohibits an entity which is in the business of underwriting, selling or distributing securities, from also receiving deposits. It prohibits:

> [the same] person, firm, corporation, association, business trust or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatsoever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor, provided, that the provisions of this paragraph shall not prohibit national banks or state banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, *to the extent permitted to national banking associations by the provisions of Section 24 of this Title.*[40](Emphasis added).

However, this provision does not prohibit a bank engaging in security activities permitted under Section 16 of the Glass-Steagall Act from engaging in those activities.

The final applicable provision of the Glass-Steagall Act, Section 32,[41] prohibits officers, directors and employees of companies primarily engaged in the securities business from simultaneously working in the banking business. It provides:

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of a partnership, and no individual *primarily engaged* in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve at the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank

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39 12 U.S.C. §378 (1982).

40 *Id.*

41 12 U.S.C. §78 (1982).

or the advice it gives its customers regarding investments.[42] (Emphasis added).

It is this set of provisions which the Comptroller of the Currency has interpreted as permitting national banks to engage in brokerage activities for customers who have no preexisting relationship with the bank.[43]

2. The Bank Holding Company Act of 1956

In a further effort to draw a line between permissible and impermissible bank activities, Congress passed the Bank Holding Company Act of 1956.[44] This Act limits bank holding company activities to those of a financial nature. Congress intended to prevent the concentration of banking resources in the hands of a few companies and to prevent unsafe practices. One particular practice Congress sought to avoid was the unsound extension of credit by a bank to a non-bank affiliate and the accompanying jeopardy to the bank depositors' funds. Section 4(c)(8) of this Act limits bank holding companies to banking activities or activities closely related to banking.[45] The Federal Reserve Board, which exercises authority over bank holding companies in conjunction with state banking authorities, has interpreted this restriction to encompass the provisions of the Glass-Steagall Act prohibiting banks from conducting certain securities services.[46] Nevertheless, the Federal Reserve Board has authorized bank holding companies to acquire discount securities brokerage services, and the Supreme Court has affirmed the Board's decision.[47]

III. SEC's Rule 3b-9

The SEC in Rule 3b-9 has incorporated a functional test in the definition of banks to determine whether the statutory exclusion of banks from the definitions of broker and dealer contained in the 1934 Act applies. Rule 3b-9 provides that the term "bank"

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42 *Id.*

43 *See* discussion *infra* and notes 92-7.

44 12 U.S.C. §§1841 - 50 (1982).

45 12 U.S.C. §1843 (c)(8) (1982).

46 12 C.F.R. §225.125(b) (1986). Glass-Steagall Act, §16, 12 U.S.C. §24 (1982).

47 Securities Industry Association v. Board of Governors, 468 U.S. 207 (1984). The Supreme Court upheld the Federal Reserve Board's decision to allow BankAmerica to acquire Charles Schwab & Co., a discount brokerage.

as used in the definitions of "broker" and "dealer" in the 1934 Act does not include a bank which:

(i) Publicly solicits brokerage business for transaction-related compensation;
(ii) Receives transaction-related compensation for providing brokerage services for trusts, managing agency, or other accounts to which the bank provides advice; or
(iii) Deals in or underwrites securities. [48]

The first activity covered by Rule 3b-9 is the public solicitation[49] of brokerage business for transaction-related compensation. Under the rule, a bank which publicly promotes the availability of internalized brokerage services and receives transaction-related compensation for brokerage trades effected as a result of that promotion is required to register with the SEC as a broker-dealer.[50] Alternatively, a bank can form a subsidiary or affiliate to conduct the brokerage business. As it presently exists, Section 3 of the 1934 Act requires the subsidiary or affiliate to be registered with the SEC as a broker or dealer.

The rule does not apply, however, to certain networking arrangements whereby a bank, under a contractual agreement with a registered broker-dealer, agrees to promote the availability of brokerage services.[51] Thus, by contracting away its brokerage business, a bank may be able to avoid registration as a broker-dealer under Rule 3b-9. However, the networking exception is not automatic. Fairly stringent requirements must be met before a networking ex-

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48 Rule 3b-9(a). *See also supra* note 6.

49 The Commission has decided not to define the term "public solicitation." Rule 3b-9 at 28,388.

50 In discussing Rule 3b-9, the SEC stated that a bank that "sends out literature to its customers promoting the availability of its brokerage services or otherwise advertises those services through newspaper or magazine advertisements would be publicly soliciting brokerage business." *Id.*

The SEC also stated its belief that actively soliciting customers to participate in self-directed IRA accounts or other self-directed accounts where the bank "as a matter of course provides execution as well as custodial services" would be engaged in the public solicitation of brokerage business. *Id.* It appears that a bank may not have to actually advertise brokerage services, but only advertise services that incorporate brokerage activities to fall within the rule. The Commission did indicate, however, that it would consider exercising its exemptive authority if customers are permitted to choose either registered broker-dealer or the bank's internal trading facility to execute self-directed trades. *Id.* at 28,388 to 28,389.

51 *Id.*

ception can be found.[52]

The second bank activity within the scope of Rule 3b-9 is the receipt of transaction-related compensation[53] in connection with the execution of brokerage transactions for advised accounts.[54] The rule covers banks which exercise investment discretion or provide investment advice to accounts from which the bank also generates profits from the execution of transactions.[55]

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52 Paragraph (a)(1) of the rule "would not require registration of a bank which enters into a contractual or other arrangement with a registered broker-dealer who would offer brokerage services on or off the premises of the bank, provided that:

(i) The broker-dealer is clearly identified as the person performing the brokerage services;

(ii) Bank employees perform only clerical and ministerial functions in connection with brokerage transactions unless they are qualified as registered representatives pursuant to the requirements of the SRO's [self-regulatory organizations] such as the National Association of Securities Dealers, Inc.;

(iii) The bank's employees do not receive compensation either directly or indirectly related to the volume of securities transactions they effect, unless they are qualified as registered representatives pursuant to the SRO's requirements; and

(iv) The broker-dealer performs clearing services for the bank on a fully disclosed basis."

Id. at 28,389.

53 Transaction-related compensation is defined in Rule 3b-9(d) as "monetary profit to the bank in excess of cost recovery providing brokerage execution services." *Id.* at 28,395.

54 Rule 3b-9 at 28,394. Paragraph (a)(2) of Rule 3b-9 causes the bank exclusion in Sections 3(a)(4), and 3(a)(5) of the 1934 Act to be unavailable to a bank that receives transaction-related compensation for providing brokerage services to "covered accounts." Covered accounts include trusts, managing agency, or other accounts to which the bank provides investment advice. The definition of "investment advice" encompasses activities broader than the simple providing of management services to accounts. The Commission interprets "investment advice" to include individualized advice as well as investment seminars and research on particular securities or groups of securities that is disseminated generally to covered accounts. *Id.* at 28,390.

Apparently, if a bank provides investment seminars to customers of directed accounts and received transaction-related compensation for brokerage services, regardless of the fact that the bank does not have investment discretion, the bank may have to register.

55 The Commission does not view these types of activities any differently from those of full service broker-dealers. It is the Commission's belief that its rules and those of self-regulatory organizations such as NASD will "meaningfully supplement banking regulation in the context of these transactions." *Id.*

Assuming the requirements of Rule 3b-9(a)(2) are met and given the definition of transaction-related compensation of Rule 3b-9(b), broker-dealer registration would be required if a bank executed trades through a registered broker-dealer

The third banking activity brought within the scope of SEC regulation by Rule 3b-9 is the "dealing in and underwriting of securities."[56] Under the Glass-Steagall Act, banks are generally prohibited from being involved in underwriting of or dealing in securities. However, certain exceptions do exist which allow banks to deal in or underwrite securities in limited circumstances.[57] For example, banks are permitted to underwrite securities of the United States Government.[58]

However, for purposes of Rule 3b-9, the Commission said that it was not expressing any view on whether bank securities activities under the rule would constitute underwriting for purposes of the Glass-Steagall Act.[59] Instead, the Commission has stated that the term "underwrite" will be interpreted consistently with the definition of "underwriter" contained in Section 2(11) of the Securities Act of 1933.[60]

IV. The Case of American Bankers Association v. SEC

The arguments being proffered by both parties[61] in *American Bankers Association v. SEC* focus on three central issues: the plain language of the 1934 Act; the definitional powers granted to the SEC; and the legislative history and historical involvement of banks in securities activities.

A. *"Plain Language" of the 1934 Act*

1. American Bankers Association's Position

In its initial argument, the American Bankers Association asserts that the language used in the 1934 Act compels the conclusion that Rule 3b-9 is invalid. The starting point in every case involving statutory construction, the American Bankers Associa-

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which received commissions from the covered accounts and then shared a percentage of the commissions with the bank, or if a bank executing transactions internally required that covered accounts pay brokerage fees which exceeded the costs of execution.

56 Rule 3b-9 at 28,394.

57 Glass-Steagall Act, 12 U.S.C. §24 (1982). *See also supra* note 6.

58 *Id.*

59 Rule 3b-9 at 28,391. *See also supra* note 6.

60 Rule 3b-9 at 28,391. *See also supra* note 6.

61 In addition to the parties to the litigation, *amicus curiae* briefs have been filed by the New York Clearinghouse Association and the Dealer Bank Association, and by the National Council of Savings Institutions.

tion contends, is the language itself.[62] In this instance, the terms "broker" and "dealer" are clearly defined in the 1934 Act.[63] Likewise, the term "bank" is also clearly defined.[64] In addition, banks are specifically excluded from the definitions of broker and dealer. The entities subject to Commission regulation pursuant to Rule 3b-9 are easily characterized as banks within that statutory definition.[65] Therefore, the American Bankers Association concludes that the banks subject to Commission regulation[66] under Rule 3b-9 should not, by the plain meaning of the 1934 Act, be subject to such regulation.

Although the American Bankers Association acknowledges that the entire definitional portion of the 1934 Act is prefaced by the words "unless the context otherwise requires,"[67] it believes that the Commission has exaggerated the extent to which that language confers additional powers. The use of a "context" analysis does not permit the Commission to make general rules which are contrary to the rest of the statute.

The American Bankers Association believes that the Commission's position that it can redefine a term such as "bank," a term already specifically defined in the statute, would be an overreaching construction of the law and "would substantially negate all of Section 3" of the 1934 Act.[68] Furthermore, the words "unless the context otherwise requires" have been generally inter-

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62 American Bankers Association Appellate Brief, U.S. Court of Appeals for the District of Columbia, December 31, 1985, at 6 (*citing* International Brotherhood of Teamsters v. Daniels, 439 U.S. 551, 558 (1979); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring)).

63 1934 Act at §3(a)(4), 15 U.S.C. §78c(a)(4) (1982), §3(a)(5), 15 U.S.C. §78c(a)(5) (1982).

64 1934 Act, 15 U.S.C. §78c(a)(6) (1982).

65 American Bankers Association Appellate Brief at 8. (Where the language of a statute is plain and unambiguous, the courts must apply the statute as written, particularly in the absence of any legislative intention to the contrary. *Citing* Securities Industry Association v. Board of Governors of the Federal Reserve System, 468 U.S. 137 (1984); American Tobacco Co., v. Patterson, 456 U.S. 63 (1982); FAIC Securities, Inc., v. United States, 768 F.2d 352 (D.C. Cir. 1985)).

66 Rule 3b-9.

67 1934 Act, §78c(3)(a), 15 U.S.C., (1982).

68 American Bankers Association Appellate Brief at 15. The American Bankers Association asked the question "why would Congress have gone to the trouble of writing 41 separate definitions of terms used in the Act . . . when what Congress really meant to say was that the 41 terms meant whatever the Securities and Exchange Commission decided those terms should mean from time to time, depending on the 'context'?"

preted by courts to refer to the statutory context and not to the factual context surrounding a particular transaction.[69]

2. The SEC's Position

The Commission counters the American Bankers Association's argument by asserting that the definitions contained in Section 3 of the 1934 Act are not "plain" or unambiguous.[70] The entire definitional section of the 1934 Act is prefaced by the clause "unless the context otherwise requires."[71] The Commission argues that the prefatory words must be read in conjunction with the definitions.[72] The words "unless the context otherwise requires" contemplate that exceptions to the 1934 Act's defini-

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69 *Id.* at 20, *citing* SEC v. National Secur., Inc., 393 U.S. 453, 466 (1969) ("Congress itself has cautioned that the same words may take on different coloration *in different sections of the securities laws*; both the 1933 and the 1934 Acts prefaced their lists of general definitions with the phrase "unless the context otherwise requires" .... We must therefore address ourselves to the meaning of the words "purchase or sale" in the context of Section 10(b). Whatever these or similar words may mean in the numerous other contexts in which they appear *in the securities laws* only this one narrow question is presented here.") (Emphasis added).

In addition, the American Bankers Association cites as authority for the proposition that the context clause refers to a statutory context rather than the factual context surrounding a particular transaction, the Second Circuit case of Schillner v. H. Vaughn Clarke and Co., 134 F. 2d 875,878 (2d Cir. 1943) ("[T]he word 'sell' may have a narrower meaning in Section 5 than it has in Section 12. The broad definition set out in Section 2 is to be accorded 'unless the context otherwise requires.' In Section 5, where the draftsmen differentiated between use of the mails to sell and the use of the mails for delivery after sale, the context requires a narrower definition of the term 'sell', but there is nothing in Section 12 to require the definition to be so narrowed."). In a more recent case affirmed by the United States Supreme Court, the Third Circuit held:

> that the context clauses themselves do not authorize judicial exclusions of securities from the scope of the Act when the "factual circumstances" seem to warrant it .... Congress did not intend the context clause as a font of authority to narrow the compass of the term 'stock' when the underlying facts may seem to warrant. If that result is to obtain, it must evolve from some other indication in the language, structure, or legislative history of the Acts. The context clause alone is no such authority.

Ruefenacht v. O'Halloran, 737 F. 2d 320,331 (3d Cir. 1984), *aff'd sub nom.*, Gould v. Ruefenacht, — U.S. —, 105 S.Ct. 2308 (1985).

70 Securities and Exchange Commission Appellate Brief at 38, *citing* Marine Bank v. Weaver, 455 U.S. 551, 555 (1982).

71 Securities and Exchange Commission Appellate Brief at 40.

72 Securities and Exchange Commission Appellate Brief at 40, *citing* Reiter v. Sonotone Corp., 442 U.S. 330, 339 (1979) ("... in construing a statute ... [a court is] obliged to give effect, if possible, to every word Congress used.").

tions can and will be made whenever the circumstances require.[73] In other words, the "context clause" qualifies the 1934 Act's definitions by reference to the factual circumstances in which the definitions are employed and not merely by reference to the statutory text in which the definitions are used.[74] The Commission concludes that the context clause requires an analysis of the purposes and assumptions upon which Congress relied in enacting the 1934 Act. Accordingly, in light of the growth of bank brokerage transactions, the Commission believes that its promulgation of Rule 3b-9 is entirely consistent with, and permitted by, the "context" language of the statute.[75]

B. *The 1934 Act — Sections 3(b) and 23(a)(1), and the Commission's Ability to Define Terms and Promulgate Rules and Regulations*

1. American Bankers Association's Position

The second argument of both the American Bankers Association and the Commission focuses on the scope of the rule making and definitional powers granted to the Commission in the 1934 Act. Section 3(b) in pertinent part provides:

> The Commission . . . shall have [the] power by rules and regulations to define technical, trade, accounting, and other terms used in this chapter, consistently with the provisions and purposes of this chapter.[76]

The American Bankers Association contends that the Commission is trying to avoid the plain meaning of the statute by relying on an overly broad definition which is contrary to prior District of Columbia Court of Appeals decisions. In *FAIC Securities, Inc., v. United States*,[77] the United States Court of Appeals for the District of Columbia was faced with a somewhat analogous situation involving an agency's definitional powers. The Federal Deposit Insurance Act grants the Federal Deposit Insurance Corporation ("FDIC") authority virtually identical to the definitional authority granted to the

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73 Securities and Exchange Commission Appellate Brief, at 40.

74 *Id.* at 41; *Cf.* Ruefenacht v. O'Halloran, 737 F.2d 320, 331 (3d Cir. 1984), *aff'd sub. nom.*, Gould v. Ruefenacht, — U.S. —, 105 S. Ct. 2308 (1985).

75 Securities and Exchange Commission Appellate Brief, at 44.

76 15 U.S.C. §78c(b) (1982).

77 768 F.2d 352 (D.C. Cir. 1985).

Commission in the 1934 Act.[78] However, when the FDIC attempted to use its definitional power to promulgate a rule limiting deposit insurance coverage in cases involving "brokered deposits", the court disallowed the agency's efforts.[79] The court held that the:

> general authority to define terms and the extent of insurance coverage resulting from those terms, does not confer power to *redefine* those terms that the statute itself defines, and thereby to alter the extent of insurance coverage which the statute specifically accords. The conferral of such power would amount to a repeal of the originally mandated definition.[80] (Emphasis added).

Consistent with the court's position in *FAIC Securities*, the American Bankers Association contends that, by promulgating Rule 3b-9, the Commission is seeking to redefine a term already defined in the statute. The SEC is repealing the statutory definition of a bank through the use of its general definitional authority.[81]

In a related line of argument, the American Bankers Association contends that Section 23(a)(1) of the 1934 Act[82] does not confer upon the Commission the authority to repeal the definition of bank or its statutory exemption. Such a power, the American Bankers Association argues, would be an unconstitutional delegation of legislative powers without standards. Section 23(a)(1) provides only that the Commission:

> shall each have the power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter . . . .[83]

2. The SEC's Position

The Commission, on the other hand, believes Sections 23(a)(1) and 3(b) of the 1934 Act represent broad rule making powers granted to it by Congress which allow it to act and effect congressional intent in light of changed circumstances.[84] The Commission asserts that Congress knew at the time it enacted the

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78 12 U.S.C. §813(m)(1) (1982).

79 FAIC Securities, Inc. v. United States, 768 F.2d 352 (D.C. Cir. 1985).

80 *Id.*

81 *See* Board of Governors v. Dimension Financial Corp., — U.S. —, 106 S.Ct. 681 (1986).

82 1934 Act at §23(a)(1), 15 U.S.C. §78w(a)(1) (1982).

83 *Id.*

84 Securities and Exchange Commission Appellate Brief at 49.

1934 Act that it could not amend the law every time a new product, service, or entity emerged in the securities market.[85] It appears clear to the Commission that Congress intended to give it broad rule making powers.

Furthermore, the Commission rejects the American Bankers Association's argument that its interpretation of the definitional powers conferred upon it under the 1934 Act constitutes an unconstitutional delegation of legislative powers. In support of its position, the Commission notes that Section 23(a)(1) requires that a:

> regulation promulgated thereunder . . . [be] reasonably related to the purpose of the enabling legislation.[86]

In addition, Section 3(b) requires that the Commission's definitions be consistent "with the provisions and purposes" of the 1934 Act.[87] The Commission concludes that its promulgation of Rule 3b-9 is a reasonable exercise of its powers and is entitled to deference by the courts.

C. *Legislative History and Historical Involvement of Banks in Securities Activities*

1. American Bankers Association's Position

As previously noted, banks are exempt from the broker and dealer registration requirements of the 1934 Act on the face of the law itself and have not, in the fifty years in which the law has been in existence, been required to register with the SEC as brokers or dealers. The American Bankers Association believes that the legislative history of both the Glass-Steagall Act and the 1934 Act clearly shows that Congress intended to exclude bank brokerage activities from SEC regulation by means of the bank exemption.[88]

It is undenied that, prior to the enactment of the Glass-Steagall Act in 1933, banks were engaged in the retail brokerage securities business.[89] Legislative history surrounding the passage

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85 *Id.*

86 *Id.* at 52.

87 *Id.*

88 American Bankers Association Appellate Brief at 10-14; American Bankers Association Appellate Reply Brief at 4-11.

89 American Bankers Association Appellate Reply Brief at 5. "Banks were engaged in the retail securities brokerage business to an extent widespread enough to

of the Glass-Steagall Act shows that it was Congress' intention to allow national banks "to purchase and sell investment securities for their customers *to the same extent as heretofore*."[90] (Emphasis added). Congress intended to leave bank securities brokerage activities unaffected by the Glass-Steagall Act. It was the "underwriting, sale and distribution" of securities by a bank that Congress sought to prohibit in the Glass-Steagall Act. Therefore, the American Bankers Association contends, Congress, knowing that banks were engaged in the securities brokerage business, still chose to exempt banks from SEC regulation as broker-dealers.[91]

Since the adoption of the Glass-Steagall Act, the scope of the involvement of banks in the securities brokerage business can be gleaned from an analysis of various interpretative rulings and opinions issued by the Comptroller of the Currency during the past fifty years. As previously described, Section 16 of the Glass-Steagall Act permits banks to purchase and sell securities for their customers.[92] In a 1936 interpretative ruling, the Comptroller of the Currency outlined the scope of permitted bank activity in the securities business.[93] In the Comptroller's opinion, bank

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warrant judicial notice." *Citing* Block v. Pennsylvania Exchange Bank, 253 N.Y. 227, 232, 170 N.E. 900, 901-02 (1930). *See also* Blakey v. Brinson, 286 U.S. 254 (1932); McNair v. Davis, 68 F.2d 935 (5th Cir. 1934), *cert. denied*, 292 U.S. 647 (1934).

90 S.Rep. No. 77, 73d Cong., lst Sess. 16 (1933).

In a recently decided U.S. District Court case for the District of Columbia, the court held that:

> Banks had engaged in retail brokerage sales prior to passage of the [Glass-Steagall] Act and Congress, apparently convinced that the evils associated with investment-banking activities do not inhere in such activities, drafted Section 16 to permit banks to 'purchase and sell investment securities for their customers to the same extent as heretofore . . . .'

Securities Industry Association v. Board of Governors of the Federal Reserve System, 627 F.Supp. 695, 703 (D.D.C. 1986).

The court believed that what little legislative history there is concerning the permissive phrase of Section 16 indicates that Congress intended to allow banks to continue the traditional retail brokerage services they had provided prior to passage of the Act. *Id.*

91 American Bankers Association Appellate Brief at 12.

92 Glass-Steagall Act, 12 U.S.C. §24 (1982).

93 Ruling of the Comptroller of the Currency, Treasury Dep't. Bull., Oct. 27, 1936, reprinted in 4 CCH. FED. BANKING L. REP. ¶49,202. Comptroller of the Currency Digest of Opinions (1960), portions reprinted in 4 CCH BANKING L. REP. ¶49,202 at Section 32.

securities transactions were limited to that of an "accommodation agent for the convenience of customers."[94] Furthermore, the bank could not make a profit on such transactions. However, as the American Bankers Association notes in *American Bankers Association v. SEC*, the notion of an "accommodation" agent was purely a matter of interpretation on the part of the Comptroller. The concept did not appear in the Glass-Steagall Act or in the related congressional reports and debates.[95]

The Comptroller's opinion was modified in 1947, and again in 1957, to allow banks to receive compensation for transactions it executed as an accommodation for its customers.[96] Finally, in 1974, the Comptroller of the Currency rejected the earlier interpretations as being too restrictive and cleared the path for banks to offer brokerage services to the public.[97]

The American Bankers Association contends that the limiting language contained in the Glass-Steagall Act was not intended to cover brokerage activities conducted by banks. In support of its contention, the American Bankers Association cites two recent cases in which the courts have interpreted the language of the Glass-Steagall Act broadly. In a 1985 District of Columbia Court of Appeals case challenging the Comptroller's interpretation of permissible activities under the Glass-Steagall Act, banks were permitted to establish or purchase a discount securities brokerage subsidiary.[98] Similarly, the Supreme Court confirmed that a bank holding company may operate a discount

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94 *Id.* In addition, banks were required to provide such services to their customers at cost. The Comptroller believed that an "accommodation" agency should not permit the bank to make a profit on its customers' securities transactions. *See also supra* note 39.

95 *See* American Bankers Association Reply Brief at 6.

96 5 BANKING LAW, *supra* note 36, at §96.03[2].

97 Letter from James E. Smith, Comptroller of the Currency, to G. Duane With (June 10, 1974) reprinted in 1973-78 [transfer binder] FED. BANKING L. REP. CCH ¶96,272.

The Comptroller's opinion was subsequently upheld by the courts. *See* New York Stock Exchange v. Smith, 404 F. Supp. 1091 (D.D.C. 1975), *vacated on other grounds*, 562 F. 2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

98 Securities Industry Association v. Comptroller of the Currency, 577 F. Supp. 252,255 (D.D.C. 1983), *aff'd*, 758 F. 2d 739 (D.C. Cir. 1985), *cert. denied*, — U.S. —, 54 U.S.L.W. 3450 (U.S. Jan. 13, 1986). (In upholding the Comptroller's decision to allow Security Pacific National Bank to establish a discount brokerage subsidiary the Court held that the language of Section 16 limiting bank securities to those for the account of customers does not limit bank brokerage activity, but serves to dis-

securities brokerage affiliate.[99]

In light of the historical involvement of the banking industry in the securities brokerage business and the legislative history surrounding the enactment of the Glass-Steagall Act, the American Bankers Association contends that banks have had continuous authority to offer brokerage services. The unduly restrictive interpretation of the Comptroller of the Currency in 1936 was a reflection of the post-Depression conservatism of the era. As evidenced by more recent interpretations of regulatory bodies and by judicial decisions, banks clearly have the authority to offer discount brokerage securities services free of the vestiges of SEC regulation under the 1934 Act.

2. SEC's Position

In a position somewhat related to its context argument, the SEC disagrees with the American Bankers Association's analysis of the legislative history and historical context in which the Glass-Steagall Act was enacted.[100] The SEC contends that, by enacting the Glass-Steagall Act, Congress intended to create a virtually impenetrable wall between the banking and securities business.[101] As an example, the SEC refers to various comments made by the Comptroller of the Currency around the time the Glass-Steagall Act was enacted.[102] The comments generally reveal a confusion on the part of the Comptroller and the banking

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tinguish such activity from buying and selling of securities by the bank for its own account.)

99 Securities Industry Association v. Board of Governors of the Federal Reserve Board, 468 U.S. 207 (1984).

100 Securities and Exchange Commission Appellate Brief at 20-32. *See, e.g., id.* at 20 n.20. The Commission's position is not undermined by recent judicial and administrative constructions of the Glass-Steagall Act, occurring almost fifty years after the passage of that Act. The relevant consideration in this case is Congress' presumptions concerning banking law in 1934 when it enacted the Securities Exchange Act, not the accuracy of these presumptions or the construction placed upon banking law in recent judicial and administrative decisions. "The intent of Congress must be told from the events surrounding the passage of the . . . legislation." "[O]pinions attributed to a Congress . . . years after the event cannot be considered evidence of the intent of the Congress [that enacted the statute]. . . ." Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 200 (1963). *See also* United States v. Naftalin, 441 U.S. 768 (1979).

101 Securities and Exchange Commission Appellate Brief at 22.

102 *Id.* at 24-7, *citing 1933 OCC Ann. Rep.* at 11; N.Y. Times, May 17, 1934, at 1, col. 1.

industry as to the intended scope of the prohibitions contained in the Glass-Steagall Act. Referencing the earlier interpretations of the Comptroller of the Currency[103] which restricted banks to an "accommodation" role, the SEC proposes that it was in that context that Congress adopted the 1934 Act. In other words, the SEC argues, when enacting the 1934 Act, Congress presumed that a solid barrier had been erected between the banking and securities businesses by the Glass-Steagall Act. This, the SEC asserts, was the "principal factor" behind Congress' decision to exclude banks from the 1934 Act definitions of broker and dealer. Accordingly, given the nearly absolute prohibition on bank brokerage activity under the Glass-Steagall Act, there was no need for further regulation of bank brokerage activities under the 1934 Act.[104]

The SEC contends the development of the Comptroller of the Currency's interpretation of the Glass-Steagall Act over the years is irrelevant. Rather, it is Congress' perception at the time the legislation was enacted that is critical.[105] Furthermore, the SEC believes the recent cases interpreting the Glass-Steagall Act relied upon by the American Bankers Association are not specifically on point and therefore should not be construed as allowing banks to engage directly in securities activities without fear of violating the Glass-Steagall Act.[106]

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103 5 BANKING LAW, *supra* note 94.

104 Securities and Exchange Commission Appellate Brief at 30.

105 *Id.* at 19-20, *citing* Merrill, Lynch, Pierce, Fenner and Smith v. Curran, Inc., 456 U.S. 353, 381 (1982) (quoting Cannon v. University of Chicago, 441 U.S. 677,698-99 (1979)).

106 Securities and Exchange Commission Appellate Brief at 21 n.21. The Supreme Court has not held that banks may directly engage in retail brokerage business with the general public without violating the Glass-Steagall Act. The Supreme Court expressly reserved this question in Securities Industry Association v. Board of Governors of the Federal Reserve Board, 468 U.S. 207 (1984) ("We have no occasion to determine whether Section 16 would permit banks to engage in brokerage activity on behalf of the general public as well as for their own customers.") The Court ruled in that case that a bank holding company can legally own a discount brokerage subsidiary registered with and supervised by the Securities and Exchange Commission, without violating the Bank Holding Company Act. The Court affirmed the Federal Reserve Board's finding that the subsidiaries discount brokerage business was "closely related to banking" because banks long have arranged the purchase and sales of securities as an accommodation to their customers. *Id.* at 211. The question whether a brokerage activity is closely related to "banking" as this phrase is used in the Bank Holding Company Act, is wholly separate from the question whether banks themselves may engage in such activities

V. Public Interest

A. *American Bankers Association's Policy Position*

As previously noted, Rule 3b-9 affects approximately 1,000 commercial banks which conduct securities activities.[107] The American Bankers Association believes that such internal activity is a banking function and, as such, regulation of the activity should be under the auspices of bank regulatory agencies. It is the position of the Comptroller of the Currency that bank securities activities are already subject to extensive review and regulation by federal and state banking agencies.[108] Furthermore, the Comptroller has stated his belief that the regulation of bank securities activities by federal and state banking agencies is more than adequate. In studying the necessity for regulation in a form such as Rule 3b-9, the Comptroller analyzed the past effectiveness of regulation by banking authorities in this area. After completing his analysis, the Comptroller stated that he had found "no instances of abuse" to support the implementation of Rule 3b-9.[109] Given the adequate regulation of bank securities activities by banking agencies, further regulation by the SEC is not necessary.[110]

In addition to SEC regulation being unnecessary, the Ameri-

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without violating the Glass-Steagall Act. *Id.* at 216 n.20. The Supreme Court again recently declined to address the Glass-Steagall issue. *See* Securities Industry Association v. Comptroller of the Currency, 756 F.2d 739 (D.C. Cir. 1985) (affirming District Court ruling that the Glass-Steagall Act does not prohibit national bank ownership of discount brokerage subsidiaries), *cert. denied*, — U.S. —, 54 U.S.L.W. 3460 (1986).

107 Securities activities conducted through subsidiaries or affiliates are subject to SEC regulation because those entities are broker-dealers within the 1934 Act definition and are registered with the Commission. The effect of Rule 3b-9 on entities such as BankAmerica Corp./Charles Schwab and Co., and Security Pacific National Bank is negligible. Rule 3b-9 at 28,386, 28,393.

108 *See, e.g.*, Office of the Comptroller of the Currency, Withdrawal of Notice of Proposed Rule Making, 50 Fed. Reg. 31,605, 31,606 (1985). *See also* In re Franklin National Bank Securities Litigation, 445 F. Supp. 723, *supplemented*, 449 F. Supp. 574 (S.D.N.Y. 1978) (Comptroller of the Currency granted power to regulate and examine national banks by Congress primarily for the benefit of the public.)

109 50 Fed. Reg. 31,605, 31,607 (1985). Having found no instances of abuse, the Comptroller concluded that regulation and examination of bank securities activities must be working.

110 Therefore, the American Bankers Association argues there is little to be lost in terms of public policy if Rule 3b-9 is declared invalid. Covered banks would still be regulated by bank regulatory authorities.

can Bankers Association notes the significant added costs that would be imposed upon covered banks by Rule 3b-9. If the banks decided to conduct their brokerage activities in a subsidiary or affiliate,[111] legal and filing fees associated with incorporating those entities would be incurred. There would also be registration and legal fees associated with SEC registration.[112] Other costs to banks would include the commitment of $25,000 in order to meet the SEC's net capital requirement,[113] membership fees associated with being a member of the National Association of Securities Dealers ("NASD"),[114] and costs associated with state requirements for filing as broker-dealers.

The American Bankers Association contends that Rule 3b-9 will result in unnecessary SEC regulation of bank brokerage activities, and added real costs to banks with little added benefit to the public. The American Bankers Association believes that smaller banks will not conduct securities activities themselves. They will not go through the cost of forming and registering themselves, an affiliate, or a subsidiary. As a result, the American Bankers Association argues, these banks will be put out of a business in which they should legitimately be able to participate.

B. *SEC's Policy Position*

The Commission believes that the increased volume of brokerage transactions effected by banks raises substantial investor protection concerns. While the Commission recognizes that bank examiners in their review of banking institutions often examine for bank securities violations, such review is not sufficient

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111 Securities Industry Assoc. v. Board of Governors, 468 U.S. 207 (1984), and Securities Industry Assoc. v. Comp. of the Currency, 577 F. Supp. 252, 255 (D.D.C. 1983), *aff'd*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, — U.S. —, 54 U.S.L.W. 3450 (U.S. Jan. 13, 1986). The SEC does not object to these two decisions because the non-bank affiliate or subsidiary is fully subject to the federal securities laws as a broker-dealer. Rule 3b-9, *supra* note 1, at 28,386.

112 The SEC registration and associated legal costs would be incurred if the bank decided to conduct its brokerage transactions through a subsidiary, affiliate, or the bank itself.

113 SEC Rule 15c3-1, 17 C.F.R. §240.15c3-1 (1985). There is an exception for broker-dealers which do not carry customer accounts, in which case the minimum capital requirement is $5,000. *Id.*

114 As a practical matter, a bank affiliate or subsidiary would have to become a member of NASD. *See* NASD By-Laws, Article 3, Schedule A, Section 1 and Section 2(a).

because the primary focus is on bank solvency and depositor protection. It is not geared toward investor protection, as is the SEC review process.[115] Examinations performed by banking agencies are not comparable to the pervasive examination programs of brokers and dealers conducted by the self-regulatory organizations ("SRO's") under Commission supervision.

In contrast to banking regulations which do not adequately protect investors, the SEC believes that the comprehensive protection afforded to investors under the 1934 Act should apply. The 1934 Act requires broker-dealers to comply with net capital, books and records, and customer protection rules.[116] In addition, the Commission and SRO's have developed a comprehensive scheme for qualifying, examining, and supervising persons employed in the securities brokerage business.[117] The Commission believes there is a demonstrated need for such a supervisory system even with respect to the relatively limited securities activities of banks.[118]

The Commission has also expressed concerns as to investor protection in the advertising of bank brokerage activities,[119] and in the absence of insurance for customer securities held by banks for safekeeping.[120] Finally, the Commission believes that fair competition among securities participants is enhanced by Rule 3b-9.[121] Therefore, the Commission concludes that the significant gaps in the banking agencies regulation of bank brokerage activities provide more than adequate basis for the Commission's adoption of Rule 3b-9 to bring the banks rapidly expanding securities activities within the pervasive regulatory scheme for brokers-dealers.

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115 Rule 3b-9 at 28,387.

116 Securities and Exchange Commission Appellate Brief. Touche Ross and Co., v. Redington, 442 U.S. 560 (1979).

117 Rule 3b-9 at 28,389. The Commission focused on this area as one in which banking agencies have not provided comparable regulation.

118 *Id.* at 28,387.

119 *Id.*

120 *Id. citing OCC Handbook for National Bank Examiners*, § 412.1, at 3 (Feb. 1985). *Cf.* Securities Investors Protection Act of 1970, 15 U.S.C. §78(aaa).

121 Rule 3b-9 at 28,387. All institutions providing brokerage services should be subject to the same regulatory scheme that Congress set up for broker-dealers and empowered the Securities and Exchange Commission to enforce.

VI. Conclusion

In deciding *American Bankers Association v. SEC*, the Court of Appeals for the District of Columbia will be confronted with the arguments set forth above. The court will have to decide whether the SEC has the authority to redefine the terms "broker" and "dealer" in light of: the plain language of the 1934 Act; the definitional powers granted to the SEC in the 1934 Act; and the legislative history and historical involvement of banks in securities brokerage activities.

A decision by the court affirming the SEC's purported authority to redefine terms explicitly defined in the statute would confer a great deal of power upon the SEC which it has not had or even asserted up until now. The effect of such a decision would have far-reaching implications with respect to the Commission's ability to redefine other terms contained in Section 3 of the 1934 Act. If the Commission can redefine terms already defined in the statute because it determines the factual circumstances surrounding the "context" in which these terms were originally adopted have changed, it is difficult to envision where limitations on such powers would be placed.

Based upon the legislative history of the Glass- Steagall Act and the 1934 Act, the language of the statutes themselves, and the abrupt departure from more than fifty years of contrary interpretation by the SEC, it appears that the SEC was not intended to have the power to repeal statutory definitions by administrative fiat. Whether the Court of Appeals will be persuaded by the "need for regulation" argument of the SEC and depart from the recent direction of the Supreme Court in confirming "plain language" interpretation of statutory terms[122] remains to be seen.

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[122] Board of Governors v. Dimension Financial Corp., — U.S. —, 106 S. Ct. 681 (1986).