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Regulation of Bank Securities Activities

REGULATION OF BANK SECURITIES ACTIVITIES

American banks recently have begun to offer securities services that banks previously have not provided.[1] Traditionally, banks have offered only limited securities services since the Glass-Steagall Act[2] prohibited commercial banks

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1. *See* Securities Indus. Ass'n, *Public Policy Issues Raised by Bank Securities Activities*, 20 SAN DIEGO L. REV. 339, 339 (1983) (recently banks have increased their securities activities) [hereinafter cited as *Policy Issues*]; Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 VA. L. REV. 1303, 1313 (1983) (banks have expanded brokerage services over last decade and hundreds of banks have offered discount brokerage service since 1982) [hereinafter cited as *Comptroller's New Reading*]. The Glass-Steagall Act has always permitted banks to perform accommodation transactions where the bank purchases securities for the account of customers of the bank. *See* 12 U.S.C. § 24(7) (1982) (bank may purchase or sell securities without recourse upon order for account of bank's customer); *infra* note 2 (discussion of Glass-Steagall Act). The Glass-Steagall Act also allows banks to both underwrite and purchase for their own account United States government obligations and state and municipal government obligations. *See* 12 U.S.C. § 24(7) (1982). Recently, however, banks have begun to offer sophisticated investment services to their customers. *See Policy Issues*, *supra*, at 347-52 (discussion of securities activities of banks). For example, banks manage and control the investment activities for pension funds and for individual trusts and estates. *See id.* at 348. Banks also offer dividend reinvestment plans which permit banks to pool the dividends of bank customers to purchase additional shares of stock for the customers' accounts. *See id.* Furthermore, banks provide investment advice to corporate customers and often fund long-term corporate debt. *See id.* at 850.

More recently, numerous banks have entered the discount brokerage field. *See Comptroller's New Reading*, *supra*, at 1313 (hundreds of banks have recently entered discount brokerage business). A discount broker merely executes, clears, and settles customer securities orders for a lower price than full service brokers. *See id.* n.65. A discount broker does not provide a securities customer with investment advice. *See id.* Banks have begun to offer discount brokerage through contractual agreements with discount brokerage firms, or by operating discount brokerage services as affiliates or subsidiaries of banks. *See id.* at 1313; Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 MICH. L. REV. 1498, 1499-1500 (1983) (several banks have recently entered discount brokerage business) [hereinafter cited as *Banker's Adventures*]. Several bank holding companies have acquired discount brokerage houses and now operate the discount brokerages services as affiliates of the bank holding companies. *See Comptroller's New Reading*, *supra*, at 1314-15 (numerous bank holding companies have acquired discount brokerages or have contracted to provide customers discount brokerage services). National banks also have moved to offer discount brokerage services, either through an affiliation with an existing discount brokerage house, or by organizing a discount brokerage service as a subsidiary of the national bank. *See Banker's Adventures*, *supra*, at 1500 n.9 (national banks recently have entered discount brokerage business); *see also infra* note 6 (legal debate continues concerning whether bank discount brokerage is permissible).

2. Glass-Steagall Act, Ch. 89, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12 U.S.C); *see* 12 U.S.C. § 24(7) (national banks may engage in only limited securities activities); *id.* § 377 (1982) (Federal Reserve member bank may not affiliate with corporation principally engaged in investment banking); *id.* § 378 (1982) (investment banking organization prohibited from accepting most deposits); *id.* § 78 (1982) (management and ownership ties between banks and investment firms prohibited). Congress passed the Glass-Steagall Act in 1933 in response to sentiments that the involvement of banks in securities activities had contributed to the financial collapse of the stock market and the ensuing depression. *See* 75 CONG. REC. 9887 (1932) (statement of Senator Glass). Although Congress recognized certain advantages to bank involvement in the securities market, such as increased competition and convenience for

from engaging in many of the securities activities of broker-dealers.[3] Recently, however, banks have expanded their securities activities by offering securities

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bank customers, Congress believed that the hazards of commercial bank involvement in securities speculation outweighed any advantages to bank participation in the securities business. *See* S. Rep. No. 77, 73d Cong., 1st Sess. 18 (1933). Congress, therefore, prohibited national banks and state banks that are members of the Federal Reserve System from engaging in certain securities activities such as underwriting corporate stocks and bonds. *See* 12 U.S.C. § 24(7) (1982) (banks may engage in only limited securities activities and may not underwrite corporate securities); *see also infra* note 3 (explanation of Glass-Steagall Act's prohibitions on bank securities activities). *See generally*, Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 BANKING L.J. 483, 497-528 (1971) (discussion of history of Glass-Steagall Act); *Comptroller's New Reading, supra* note 1, at 1306-13 (history of Glass-Steagall Act and bank securities activities).

3. *See* 12 U.S.C. §§ 24(7), 377, 378 (1982) (prohibitions on bank securities activities). Congress intended the Glass-Steagall Act to prohibit commercial bank involvement in the securities business. *See* 75 CONG. REC. 9912 (remarks of Senator Bulkley) (Act prohibits bank involvement in securities business); *see also*, Pitt & Williams, *The Glass-Steagall Act; Key Issues for the Financial Services Industry*, 11 SEC. REG. L.J. 234, 237 (1983) (Glass-Steagall Act is barrier between combination of commercial and investment banking business); Note, *A Conduct Oriented Approach to Glass-Steagall*, 91 YALE L.J. 102, 103 (1981) (Congress intended the Glass-Steagall Act to separate commercial banking from promotional securities activities) [hereinafter cited as *Conduct Oriented Approach*]. Congressional desires to separate commercial banking from investment banking came as the result of fears that the interaction of commercial banking with the securities business caused dangerous conditions that had lead to financial instability both in banking and in the securities market. In *Investment Company Institute v. Camp*, the Supreme Court addressed the dangers of bank and securities business interaction that Congress perceived when Congress enacted the Glass-Steagall Act. *See* 401 U.S. 617, 630-34 (1971). In *Camp*, the Supreme Court examined the legality of a bank operation of an open-ended investment fund under the Glass-Steagall Act. *See id.* at 619; 12 U.S.C. § 24(7) (1982) (prohibition on banks selling securities). In finding that the fund violated the Glass-Steagall Act's prohibitions against banks selling securities, the Court discussed the potential hazards of commercial bank securities activities which led Congress to enact the Glass-Steagall Act's prohibitions on commercial bank involvement in investment banking. *See* 401 U.S. at 630-34. First, the Court noted that a bank investing its own assets in a risky security investment was dangerous because the bank's stability might depend on the success of the security investment. *See id.* at 630. Second, the Court stated that bank securities affiliates presented dangers to the financial stability of the banking and securities markets. *See id.* For example, the Court noted a bank might be tempted to make imprudent loans to the affiliate if the affiliate experienced financial troubles. *See id.* at 631. Moreover, the Court maintained that if a bank affiliate experienced financial difficulty, the public would associate the difficulty with the bank and the public could lose confidence in the bank. *See id.* Additionally, the Court recognized that a danger exists that a bank might loan a customer money to enable the customer to invest in securities that the bank underwrote or promoted. *See id.* at 632. Furthermore, the Court reasoned that banks might loan money more freely to companies whose securities the bank holds or underwrites. *See id.* at 631. Finally, the *Camp* Court contended that a bank should provide its customers with disinterested investment advice, and that a bank's affiliation with a securities brokerage business could result in a conflict with the bank's duty because the bank might encourage investments in firms associated with its securities affiliate. *See id.* at 633.

Congress enacted the various section of the Glass-Steagall Act to separate commercial banking and investment banking and prevent the types of financial hazards of bank involvement in the securities business that the *Camp* Court cited. Section 16 of the Glass-Steagall Act (section 16) prohibits national banks from engaging in substantial securities activities by limiting national bank securities powers generally to the purchase and sale of securities without recourse for the account and only upon the order of bank customers. *See* 12 U.S.C. § 24(7) (1982) (limitations of national bank securities activities). Although § 16 generally prohibits national banks from

services that arguably do not violate the Glass-Steagall Act.[4] Consequently, banks have increased their securities activities to include securities services that resemble closely the securities services of broker-dealers.[5] While a debate continues with respect to the limits of permissible bank securities activity under the Glass-Steagall Act,[6] an equally important issue concerns the appropriate regulation of the securities activities that banks perform.[7]

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underwriting securities or purchasing securities for the bank's own account, § 16 does permit banks to underwrite or purchase for their own account United States Treasury obligations, general state and municipal bonds, and obligations of some specified government agencies. *See id.* Section 5(c) of the Glass-Steagall Act makes the Act's prohibitions on selling, underwriting, or holding of investment securities by national banks applicable to state chartered banks that are members of the Federal Reserve System. *See* 12 U.S.C. § 335 (1982). Section 21 of the Glass-Steagall Act (Section 21) prohibits any organization engaged in a list of securities activities such as underwriting or selling stocks and bonds from simultaneously accepting deposits. *See* 12 U.S.C. § 378(a) (1982). Section 21 applies not only to national banks and state member banks, but also to any entity that engages in the commercial activities of receiving deposits subject to withdrawal by the customer. *See id.* Section 20 of the Glass-Steagall Act bars any national or member bank from affiliating with any entity principally engaged in the investment banking or securities business. *See* 12 U.S.C. § 377 (1982).

4. *See supra* note 2 and accompanying text (banks now engage in extensive securities activities). *But cf. infra* note 6 and accompanying text (legal battle continues over legality of bank securities activities).

5. *See Applicability of Broker-Dealer Registration to Banks* [Current] FED. SEC. L. REP. (CCH) ¶83,445, at 86,327 (Nov. 8, 1983) (banks provide investment services that are functionally indistinguishable from services registered broker-dealers offer) [hereinafter cited as *SEC Bank Registration Proposal*]; *supra* note 2 (banks securities services resemble services of broker-dealers).

6. *See Banker's Adventures, supra* note 1, at 1500-01 (securities industry contesting banks entry in new securities fields). In January 1983, the Federal Reserve Board allowed the Bank America Company to acquire a discount brokerage firm, Charles Schwab & Co., as a subsidiary of the bank holding company. *See Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys.*, 716 F.2d 92, 94 (2d Cir. 1983) (court examined litigation concerning bank holding company discount brokerage service), *petition for cert. granted*, 82 U.S.L.W. 3545 (Jan. 24, 1984). The Securities Industry Association (SIA), however, brought an action against the Federal Reserve Board claiming that the operation of a discount brokerage subsidiary of a bank holding company violated the Glass-Steagall Act because the bank holding company impermissibly engaged in the investment banking business. *See id.* at 94-100 (SIA's Glass-Steagall claims and court's analysis of claims). The United States Second Circuit in *Securities Indus. Ass'n*, ruled that the bank holding company discount brokerage subsidiary was permissible under the Glass-Steagall Act. *See id.* The propriety of a bank holding company discount brokerage business, however, now awaits resolution by the United States Supreme Court. *See Supreme Court to Review Fed Approval of BankAmerica's Purchase of Schwab*, 16 SEC. REG. & L. REP. (BNA) No. 4 at 162-63 (Jan. 27, 1984) (discussion of claims raised in litigation).

The propriety of national banks offering discount brokerage services also is in question. *See Securities Indus. Ass'n v. Comptroller of the Currency*, No. 82-2865 (D.D.C. Nov. 2, 1983) (national banks may establish discount brokerage services but not across state lines). In addition to discount brokerage, a debate continues with respect to other securities services that banks permissibly may offer. The SIA, for example, has challenged the Comptroller of the Currency's decision that a national bank may offer an investment advisory service through a subsidiary. *See SIA Challenges OCC Approval of Bank's Broker, Investment Adviser Subsidiaries*, 15 SEC. REG. & L. REP. (BNA) No. 48 at 2236-37 (Dec. 9, 1983).

7. *See infra* notes 16-22 and accompanying text (disparity in regulation between bank and broker-dealer securities activities fosters divergent views on appropriate regulation).

Presently, banks and broker-dealers are subject to different regulatory schemes that may result in inadequate regulation of bank securities activities.[8] The Securities Exchange Act of 1934 (Exchange Act)[9] regulates the securities activities of broker-dealers by requiring the registration and regulation of brokers[10] and dealers[11] with the Securities and Exchange Commission (SEC).[12] Sections 3(a)(4) and 3(a)(5) of the Exchange Act, however, expressly exempt banks from the definitions of both broker and dealer.[13] The Exchange Act, therefore, does not require banks offering securities services that resemble the services registered broker-dealers provide to register with the SEC.[14] Consequently, banks are not subject to the same scheme of regulation as the SEC imposes on broker-dealers.[15] Bank securities activities, nonetheless, are subject to regulation by the federal and state banking agencies.[16] The various

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8. *See infra* notes 22-55 and accompanying text (disparity in regulations on bank and broker-dealer securities activities).

9. 15 U.S.C. §§ 78a-78kk (1982). The Securities Exchange Act of 1934 (Exchange Act) regulates the trading of securities through control of the exchange and the over-the-counter securities market. *See* L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 39 (1983). The Exchange Act accomplishes regulation of the securities market through self-regulation by the securities industry under the general regulatory authority of the SEC. *See id.* at 40. All brokers-dealers must register with the SEC thereby becoming subject to the rules promulgated under the Exchange Act regulating broker-dealer securities activities. *See* 15 U.S.C. § 78o (1982) (registration and regulation of brokers and dealers).

10. 15 U.S.C. § 78c(a)(4) (1982) (broker is person effecting securities transactions for accounts of others, but does not include bank).

11. 15 U.S.C. § 78(c)(5) (1982) (dealer is person buying or selling securities for his own account but does not include bank).

12. 15 U.S.C. § 78o (1982) (registration and regulation of brokers and dealers with SEC).

13. *See* 15 U.S.C. § 78c(a)(4), (5) (1982) (definitions of broker and dealer); *see also* 15 U.S.C. § 78c(a), (b) (1982) (bank is national bank, Federal Reserve member bank, or state banking institution receiving deposits and exercising fiduciary powers similar to national banks). Section 78c(a)(4) of the Exchange Act defines "broker" as a person engaged in the securities business of effecting transactions for accounts other than the broker's own account, but expressly excludes any bank. *See* 15 U.S.C. § 78c(a)(4) (1982) (definition of broker). Similarly, all banks are specifically excluded from the Exchange Act's definition of a dealer. *See* 15 U.S.C. § 78c(a)(5) (1982) (definition of a dealer). The Exchange Act, therefore, excludes banks from the SEC's regulatory scheme because the Act requires only brokers and dealers to register with the SEC. *See* 15 U.S.C. § 78o (1982) (brokers and dealers must register with the SEC); *infra* note 10 (banks excluded from definition of broker); *infra* note 11 (banks excluded from definition of dealer).

14. *See* 15 U.S.C. § 78o (1982) (only brokers and dealers must register with the SEC); 15 U.S.C. § 78c(a)(4), (5) (1982) (banks excluded from definitions of broker and dealer).

15. *See supra* note 13 (banks are not subject to same regulatory scheme as broker-dealers since banks are exempt from SEC registration).

16. *See* C. GOLEMBE & D. HOLLAND, FEDERAL REGULATION OF BANKING 15-19 (1983) (discussion of federal agencies regulating banks). The primary agencies responsible for the regulation of the financial industry in the United States include the Comptroller of the Currency (Comptroller), the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC) and the fifty state banking departments. *See id.* at 15-16. The Comptroller has primary responsibility for the regulation of federally chartered national banks. *See* 12 U.S.C. §§ 21-24, 26-27 (1982) (defining Comptroller's powers and responsibilities). The Federal Reserve is responsible for overseeing bank holding companies and state chartered banks that are members of the Federal Reserve System. *See* 12 U.S.C. §§ 1841-50 (1982) (Federal Reserve responsible for regula-

banking agencies impose fewer and less comprehensive regulations on bank securities activities than the regulations that the SEC imposes on broker-dealers.[17] As banks continue to offer diverse securities services in competition with the traditional broker-dealer, the interest of assuring securities investors maximum protection requires modifications in existing laws and regulations to provide uniform regulation of comparable bank and broker-dealer securities activities.[18] Groups concerned with the regulation of bank securities activities have offered various proposals to rectify the problem of inadequate regulation of bank securities activities.[19]

The securities industry and the banking industry disagree with respect to the necessity of a change in bank securities regulation.[20] The securities industry contends that the regulation of broker-dealers by the SEC is more burden-

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tion of bank holding companies); 12 U.S.C. §§ 321, 324-25 (1982) (Federal Reserve regulates state banks electing to join Federal Reserve System). The FDIC regulates state banks that are not Federal Reserve System members but that have federal deposit insurance. *See* 12 U.S.C. §§ 1815, 1817 (1982). Additionally, the Federal Home Loan Bank Board (FHLBB) regulates federal savings and loan associations. *See* 12 U.S.C. § 1464(a) (1982) (FHLBB responsible for regulation of thrifts).

17. *See Banker's Adventures, supra* note 1, at 1530-32 (disparities exists between regulations of bank and broker-dealer services especially with respect to training of securities personnel, advertising, and margin loan regulation); *infra* notes 22-52 and accompanying text (disparities in regulation of bank and broker-dealer securities regulation).

18. *See infra* notes 50-55 and accompanying text (disparity of regulatory schemes of bank and broker-dealer securities activities requires changes to establish uniformity of regulation).

19. *See, e.g.*, S. 1609, 98th Cong., 1st Sess. (1983) (proposed Financial Institutions Deregulation Act); *SEC Bank Registration Proposal, supra* note 5, at 86,325-29. (SEC's proposed rule 3b-9); NASD NOTICE TO MEMBERS 83-72 (Dec. 20, 1983) (proposed amendment to NASD By-Laws). The Treasury Department supports congressional legislation designed to expand permissible bank securities activities while equalizing the regulations on broker-dealers and banks offering similar securities services. *See* S. 1609, 98th Cong., 1st Sess. (1983); *infra* notes 62-82 and accompanying text (discussion of proposed legislation). Since Congress has failed to amend existing securities regulations, the SEC has proposed a rule modifying the definition of "bank" under the Exchange Act. *See SEC Bank Registration Proposal, supra* note 5, at 86,325-29 (SEC's proposed rule 3b-9); *infra* notes 86-133 and accompanying text (discussion of proposed rule). Under proposed rule 3b-9 a financial institution engaging in certain securities activities would no longer be termed a bank and, therefore, would have to register with the SEC and be subject to the same rules and regulations applicable to broker-dealers. *See SEC Bank Registration Proposal, supra* note 5, at 86,326; *infra* notes 87-88 and accompanying text (bank performing certain securities activities required to register with SEC under proposed rule 3b-9); *see also infra* notes 125-32 and accompanying text (SEC's proposed rule 3b-9 is positive response to disparate regulation of bank and broker-dealer securities activities absent congressional action). The National Association of Securities Dealers (NASD) has proposed an amendment to the organization's By-Laws that would require certain employees of financial institutions with contractual arrangements with broker-dealers to register as representatives with the NASD and be subject to NASD rules and qualification standards. *See* NASD NOTICE, *supra*, at 1-4; *infra* notes 134-47 and accompanying text (discussion of NASD proposal); *see also infra* notes 148-51 and accompanying text (NASD's proposal would help provide equivalent regulation of bank and broker-dealer securities activities).

20. *Compare infra* notes 21-35 and accompanying text (securities industry contends major change in bank securities regulation necessary) *with infra* notes 37-48 and accompanying text (banking industry believes present regulatory scheme adequate).

some than the regulation that the various banking agencies place on bank securities activities.[21] The securities industry claims that the Exchange Act places strict and complex regulations on broker-dealers to assure investor protection, and that the absence of equivalent regulations of bank securities activities results in inadequate protection for bank securities customers.[22] For example, a broker-dealer registered with the SEC is subject to rules regulating the broker-dealer's training and competency.[23] The securities industry claims that without similar regulations on bank securities personnel a bank securities customer might receive inadequate investment information from a bank employee who is not as competent as a broker-dealer.[24] In addition to competency regulations, the Exchange Act requires broker-dealers to supervise their personnel.[25] The Exchange Act also provides different margin loan regulations for banks and broker-dealers.[26]

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21. *See* Evans, *Regulation of Bank Securities Activities*, 91 BANKING L.J. 611, 616-19 (1974) (banks subject to less burdensome regulation than broker-dealers); *Policy Issues, supra* note 1, at 357-60 (less burdensome regulation of bank securities activities gives banks advantages in securities services).

22. *See Policy Issues, supra* note 1, at 358-59 (investors inadequately protected because banks not subject to same regulations as broker-dealers); *infra* notes 23-32 & 50-52 and accompanying text (disparate regulations imposed on bank and broker-dealer securities activities).

23. *See* 15 U.S.C. § 78o(b)(7) (1982) (brokers and dealers must meet qualification standards established by SEC); NASD MANUAL (CCH) ¶1102A, at 1052, 1055 (Schedule C of NASD By-Laws requires that representatives pass qualification examination); 2 NEW YORK STOCK EXCHANGE GUIDE ¶2304 (1983) (New York Stock Exchange (NYSE) rule 304A requiring members to pass qualification examination). Broker-dealers are subject to numerous regulations of several agencies. Broker-dealers must register with the SEC and adhere to the requirements imposed by the Exchange Act. *See* 15 U.S.C. § 78o (1982) (all brokers and dealers required to register with SEC). Additionally, § 6(a) of the Exchange Act provides that in order for a national securities exchange to receive registration, the exchange must enact rules to assure fair dealing between brokers and their customers. *See* 15 U.S.C. § 78f(b)(5) (1982) (registered exchange must enact rules of fairness). Exchange members must comply with the exchange's rules and are subject to disciplinary action for violation of the exchange's rules. *See* 15 U.S.C. § 78f(b)(6) (disciplinary action for exchange members who violate rules). Moreover, broker-dealers participating in over-the-counter transactions also must become members of the National Association of Securities Dealers (NASD). *See* NASD MANUAL (CCH) ¶102, at 110 (membership in NASD permits firm to participate in over-the-counter securities business). NASD members are subject to strict rules and regulations concerning qualifications and standards of proper conduct. *See id.* at 110-11.

24. *See Policy Issues, supra* note 1, at 359 (disparities in regulation of banks and broker-dealers including broker training affords less protection to investors of securities through banks).

25. 15 U.S.C. § 78o(b)(4)(E) (1982).

26. *Compare* 15 U.S.C. § 78g(d)(D) (1982) (regulation of bank margin loans only applies to stock purchase loan but not loans for nonequity security purchases) *with* 15 U.S.C. § 78(g)(c)(1) (1982) (regulation of brokerage margin loans applies to loan for purchase or maintenance of any security). Generally, margin loans regulations are restrictions placed on banks and broker-dealers with respect to permissible loans made to investors for the purchase of securities. *See id.* The regulations applicable to bank loans and broker-dealer loans vary considerably. For example, broker-dealers may not make unsecured loans to investors for the purchase of securities. *See* 12 C.F.R. § 220.9(a)(3) (1983). When broker-dealers make loans for the purchase of securities, the investor must pledge certain other securities as collateral. *See* 15 U.S.C. § 78g(c) (1982). Banks, however, may make unsecured loans for the purchase of securities. *See* 15 U.S.C. § 78g(d) (1982) (banks not prohibited from making unsecured loan to purchase securities). Banks also may accept any security as collateral for loans made for the purchase of securities. *See id.*

Moreover, the securities industry places rules on broker-dealers that do not apply to banks such as rules requiring broker-dealers to review the transactions of their employees and make periodic examinations of customer accounts to be certain that the broker-dealers and their employees do not violate the federal securities laws.[27] Additionally, broker-dealers are subject to strict rules regulating advertising,[28] bonding requirements,[29] confirmation,[30] and recordkeeping.[31] Finally, broker-dealers may only recommend investments that are suitable for a customer in light of the investor's objectives and financial situation.[32] The securities industry claims that the rules regulating broker-dealers protect investors and that bank customers receive less protection in their securities transactions since banks are not subject to the same regulations.[33] The securities industry also contends that the disparity in regulation between banks and broker-dealers results in an unfair competitive advantage for banks because banks sell securities under a more lenient regulatory scheme.[34] Consequently, the securities industry contends that bank securities activities should be subject to the same regulatory scheme as the SEC imposes on the securities activities of broker-dealers.[35]

Although the banking industry acknowledges that some differences in securities regulation exist between banks and broker-dealers, the banking in-

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27. *See* NASD MANUAL (CCH) ¶2177, at 2109 (1983) (NASD rule requiring members supervise employees); 2 NYSE GUIDE (CCH) ¶2342.16, at 3586-87 (1983) (Exchange members must supervise employees and examine customer accounts); *id.* ¶2405, at 3697 (members must supervise all accounts handled by registered representatives).

28. *See* AMER. STOCK EX. GUIDE (CCH) ¶9490, at 2683 (1983) (broker-dealers' advertisements must be of legitimate business character); *id.* ¶9491A, at 2683 (1983) (member firm's advertising must be approved by a member); 2 NYSE GUIDE (CCH) ¶2472, 2474A, 2479B (1983) (restrictions on unfair or misleading advertising by broker-dealers); NASD MANUAL (CCH) ¶2195, at 2109-38 (NASD's Rules of Fair Practice governing advertising).

29. *See* 17 C.F.R. ¶240.15b10-11 (1983) (some broker-dealers who are not NASD members required to post blanket fidelity bond converting officers and employees of broker-dealer); NASD MANUAL (CCH) ¶2182, 2182A, at 2109-13-2109-15 (1983) (NASD members must post fidelity bond covering officers and employees).

30. *See* 17 C.F.R. § 240.10b-10 (1983) (broker-dealers must send written confirmations for securities transactions complying with detailed requirements).

31. *See* 17 C.F.R. § 240.15b10-6 (1983) (nonmember broker must keep records on customer accounts and all securities transactions).

32. *See* NASD MANUAL (CCH) ¶2152, at 2051 (1983) (NASD suitability rule). The NASD suitability rule requires that all NASD members must have reasonable grounds to believe that a recommendation that the NASD member gives his customer is an investment that is suitable for the customer in light of the customer's financial situation and needs. *See id.;* 17 C.F.R. § 240.15b10-3 (1983) (nonmember broker-dealers may only recommend securities suitable for customer's needs).

33. *See Policy Issues, supra* note 1, at 358-59 (advantageous bank regulations afford fewer protections to bank securities customers than to broker-dealer customers).

34. *See id.* at 356-60 (economic advantages given to banks as result of disparity in regulation).

35. *See id.* at 359-60 (significant bank securities activities should be regulated by the SEC); *see also Securities Activities of Depository Institution: Hearings on S. 1720 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 97th Cong., 2d Sess. 11-12 (1982) (statement of Donald T. Regan, Secretary of Treasury) (banks and nonbank brokers should be subject to equal regulation) [hereinafter cited as *1982 Hearings*].

dustry contends that the present regulatory scheme is sufficient because the banking agencies' regulation of bank securities activities is similar to SEC regulation of broker-dealer securities activities.[36] For example, banks and broker-dealers must comply with similar record examination regulations[37] and similar regulations protecting customers against loss of securities through theft or insolvency.[38] Moreover, the securities activities of banks, like the securities activities of broker-dealers, are within the coverage of the antifraud provisions of the federal securities laws.[39] Consequently, the banking industry prefers to leave the regulation of bank securities activities under the present regulatory scheme of the federal banking agencies.[40]

In support of the banking industry's view that the current regulatory scheme is sufficient, the banking industry relies on a 1977 study of the regulation of bank securities activities conducted by the SEC (Bank Study).[41] In the Bank Study, the SEC rejected a proposal to delete the bank exclusion from the definitions of broker and dealer in the Exchange Act and thereby require banks offering securities services to register with the SEC.[42] The Bank Study concluded that although some changes aimed at improving the regula-

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36. *See Bank Automatic Investment Services* [1973-1978 Transfer Binder] FED. BANKING L. REP. (CCH) ¶96,272, at 81,362 (1974) (letter from Comptroller James E. Smith to G. Duane Veith) (Comptroller contended that bank securities activities are subject to regulations different from but as strict as broker-dealer regulations).

37. *See* 12 U.S.C. § 161 (1982) (bank must report on bank's condition disclosing resources and liabilities to Comptroller of Currency); *id.* § 164 (1982) (bank's failure to report subjects bank to liability); *id.* § 481 (1982) (bank examiners report on banks condition periodically).

38. *See* 12 U.S.C. § 1881-84 (1982) (banks required to install security devices to prevent theft); Spencer, *Regulation of Bank Securities Activities: The Effects of the SEC Bank Study*, 95 BANKING L.J. 616, 624 (1978) (SEC study concluded bank regulation focused on bank solvency adequately protects banks' investors through loss from insolvency).

39. *See* 15 U.S.C. §§ 78g, 77j (1982) (antifraud provisions of securities laws apply to both banks and broker-dealers).

40. *See* Letter from James D. Herrington to SEC 2 (Dec. 29, 1983) (comment letter from Independent Bankers Association of America (IBAA) to SEC) (IBAA argues that SEC should work with federal banking agencies to coordinate bank securities regulatory reform).

41. *See* Securities and Exchange Commission, *Reports on Bank Securities Activities* (1977) [hereinafter cited as *Bank Study*]. *See generally* Spencer, *supra* note 38, at 616-33 (findings and effects of Bank Study). The SEC conducted the Bank Study to analyze the securities services that banks offered, not with a view toward detecting Glass-Steagall violations, but simply to determine to what extent banks participated in the securities market. *See id.* at 617 n.2. The purpose of the Bank Study was to determine if Congress should eliminate the bank exclusion to the definitions of broker and dealer in the Exchange Act. *See id.* at 617; *supra* notes 11-12 (banks excluded from definitions of broker and dealer). The SEC submitted the study to Congress in three separate reports containing an analysis of the extent of bank securities services, comparing the regulations of bank and broker-dealers with respect to investor protection, and setting forth the SEC's conclusions and recommendation. *See id.* at 617-18; *infra* note 43 (SEC's recommendations). The SEC concluded that Congress should maintain the bank exclusion in the definitions of broker and dealer. *See Bank Study*, *supra*, at 305. The SEC believed that regulation of bank securities activities by the SEC would result in duplicative and burdensome regulation on banks. *See id.*

42. *See Bank Study, supra* note 41, at 305.

tion of bank securities activities were necessary to assure investor protection,[43] banking agencies should continue to be the regulators of bank securities services.[44] The Bank Study reasoned that SEC regulation of bank securities activities would result in duplicative regulation since bank securities activities would be subject to both SEC regulation and continued regulation by the banking agencies.[45] The Bank Study recommended that bank regulators improve the recordkeeping and confirmation requirements of bank securities activities, and also recommended that bank regulators adopt personal competency requirements for bank securities personnel.[46] Although the bank regulators have adopted the recommended changes in confirmation and recordkeeping requirements,[47] the bank regulators have refused to adopt personal competency standards.[48]

Despite the banking industry's arguments favoring retention of the present regulatory scheme, disparities between bank securities regulation and broker-dealer regulation continue to exist.[49] The securities industry correctly

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43. *See id.* at 307. In the Bank Study the SEC recommended legislation to improve regulations of bank securities activities concerning confirmations, recordkeeping, and competency of personnel. *See id.* The SEC further suggested that federal banking agencies adopt improved examination procedures to review all bank securities activities. *See id.* at 307-08. Finally, the SEC recommended that federal law require the federal banking agencies to notify the SEC of federal securities laws violations and that federal law should instruct the banking agencies to act to assure the protection of investors. *See id.* at 308.

44. *See id.* at 305 (SEC should not regulate bank securities activities).

45. *See id.* (SEC regulation of bank securities activities would result in duplicative and burdensome regulation).

46. *See id.* at 307.

47. *See id.* (SEC's recommended changes in bank confirmation and recordkeeping requirements of bank securities activities). In response to the Bank Study's recommendations, the federal banking agencies adopted regulations designed to improve the recordkeeping and confirmation requirements of bank securities activities. *See* 12 C.F.R. § 12.1-.7 (1983) (national banks must send confirmation of securities transaction to customers and maintain customer records); *id.* § 208.8(k) (1983) (state chartered Federal Reserve member banks must maintain records and send notification of securities transactions to customers); *id.* § 344 (1983) (federally insured nonmember banks must maintain adequate records and provide adequate information to customers with respect to securities transactions). Although the banking agencies have adopted these confirmation and recordkeeping requirements to equalize bank and broker-dealer regulations, some present discrepancies exist between bank and broker-dealer regulations. For example, while broker-dealers generally must provide confirmations of securities transactions within five days of a customer's request, federal banking law permits banks to send confirmations within a "reasonable time" following a customer request. *Compare* 17 C.F.R. § 240.10b-10(c) (1983) (broker-dealers must send confirmation within five days of customer request) *with* 12 C.F.R. § 12.5(c) (1983) (national banks may send confirmation within "reasonable time" following customer request); 12 C.F.R § 208.8(k)(4)(iii) (1983) (Federal Reserve member banks must send confirmation within reasonable time); and 12 C.F.R. § 344.5(c) (1983) (insured nonmember bank may mail written confirmation within reasonable time following customer request).

48. *See 1982 Hearings, supra* note 35, at 32 (statement of John S.R. Shad, SEC Chairman) (SEC Chairman noted that bank regulators refused to adopt competency regulations SEC recommended because bank regulators believed that banks' existing examinations were adequate).

49. *See supra* notes 23-32 and accompanying text (disparities in regulation between banks and broker-dealers).

contends that broker-dealers are subject to regulations that provide investors protection while the banking industry is often exempt from similar requirements.[50] For example, stock exchange rules provide that broker-dealer advertising may not be unfair or misleading.[51] Bank regulators place no similar restrictions on securities advertising by banks.[52] Whatever the extent of the disparity between the regulatory schemes of the securities activities of banks and broker-dealers, the policy of investor protection demands that if banks and broker-dealers perform the same extensive securities services, banks and broker-dealers should be subject to the same regulations.[53] The solution for assuring that banks' securities services and broker-dealers are subject to the same rules and regulations is to subject both industries to the same regulatory scheme.[54] Several currently proposed plans would provide for more equitable regulation of securities services and some plans include proposals to permit banks to offer more securities services than the Glass-Steagall Act presently permits.[55]

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50. *See Policy Issues, supra* note 1, at 358-59 (bank securities customers receive less protection than broker-dealer customers because bank securities regulations more lenient than broker-dealer securities regulations). The securities industry claims that the disparities in regulation between banks and broker-dealers that lead to lack of investor protection for bank securities customers arise not only because of differences in statutory regulation, but also because of differences in regulatory procedure and policy as applied by banking regulators and the SEC. *See Banker's Adventures, supra* note 1, at 1529-30 (discrepancies in regulation arise from differences in philosophies and objectives of regulators). For example, the SEC seeks to protect investors by enforcing regulations on the broker's securities practices. *See id.* The government may impose sanctions on broker-dealers for violations of legal or ethical standards such as recordkeeping requirements. *See* 17 C.F.R. § 240.15b10-6 (1983) (recordkeeping requirements for nonmember brokers and dealers). Bank regulators, however, concern themselves primarily with the protection of the stability of the banking system, not with investor protection. *See Adventures in Brokerland, supra* note 1, at 1529 (aim of bank regulations is to protect depositors and assure bank solvency). Additionally, banks enforce their regulations in private to avoid speculation on bank solvency. *See* 12 U.S.C. § 1818(h)(1) (1982) (cease and desist order hearings conducted in private unless public hearing necessary to protect public interest). The SEC, however, enforces its regulations publically with a view toward full disclosure. *See* 15 U.S.C. § 78v (1982) (SEC hearings may be public). SEC procedures, therefore, provide a stronger mechanism for investor protection than bank enforcement procedures.

51. *See* AMER. STOCK EXCHANGE GUIDE (CCH) ¶9490, at 2683 (1983) (broker-dealer advertising must be of legitimate business character); 2 NYSE GUIDE (CCH) ¶2472, 2474A, 2474B, at 4026-30 (1983) (NYSE rules prohibit broker-dealers from engaging in false or misleading advertising).

52. *See 1982 Hearings, supra* note 35, at 32 (statement of John S. R. Shad, SEC Chairman) (banking agencies do not place equivalent regulations with respect to advertising on banks as SEC places on broker-dealers).

53. *See id.* (SEC chairman maintained that interest of consumer protection demanded that banks which actively solicit securities business be subject to same regulation as SEC places on broker-dealers).

54. *See supra* note 19 (proposal advanced by various agencies aimed at equalizing regulations of bank and broker-dealer securities activities).

55. *See id.; see also infra* notes 62-85 and accompanying text (discussion of Deregulation Act); notes 86-133 and accompanying text (discussion of SEC's proposed rule 3b-9); notes 134-58 and accompanying text (discussion of NASD's proposed By-Law's amendment).

One proposal to the problem of disparate regulation between banks and broker-dealers offering similar securities services, supported by the Treasury Department, is to require banks engaging in substantial securities activities to incorporate the securities service separate from the bank as a subsidiary of a bank holding company.[56] Since the bank exemption in the Exchange Act applies only to banks, the separate securities entity would have to register as a broker-dealer with the SEC.[57] The separate entity, therefore, would be subject to the same SEC regulations as other broker-dealers.[58] The Treasury Department's proposal would allow banks to offer additional securities services than the Glass-Steagall Act presently permits, but would require banks offering the additional services to incorporate separately their securities facilities as a subsidiary of a bank holding company.[59] The Treasury Department believes that legislation is necessary to expand bank securities activities so that banks may compete more effectively with investment bankers and broker-dealers.[60] The Treasury Department, however, recognizes that any substantial securities activity conducted by financial institutions should be subject to regulation by the SEC to assure investor protection and uniform regulation.[61]

Accordingly, in July 1983, the Reagan Administration submitted to Con-

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56. *See infra* notes 62-68 and accompanying text (discussion of proposed Deregulation Act); *see also Banker's Adventures, supra* note 1, at 1534-39 (discussion of proposed separate entity plan similar to Treasury Department's proposal).

57. *See infra* notes 65-67 and accompanying text (Deregulation Act would require bank subsidiary to register with SEC); 15 U.S.C. § 78c(a)(4)-(6) (1982) (definitions of broker, dealer and bank); *id.* § 78o (brokers and dealers required to register with SEC); *supra* notes 11-15 and accompanying text (entities within definition of bank need not register with SEC since banks excluded from definitions of broker and dealer).

58. *See infra* note 67 and accompanying text (Deregulation Act would subject bank holding company subsidiary to SEC control).

59. *See infra* notes 64-67 and accompanying text (Deregulation Act would require banks to offer bank securities services through bank holding company subject to SEC regulation). A bank holding company is simply a company that owns a controlling interest in one or more banks. *See* C. GOLEMBE & D. HOLLAND, *supra* note 16, at 144. The Federal Reserve Board regulates bank holding companies. 12 U.S.C. § 1841-50 (1982). A bank holding company may own a controlling interest in a nonbank company if the holding company obtains Reserve Board approval. *See* 12 U.S.C. § 1843(c)(8) (1982) (Board may approve bank holding company acquisition of nonbank subsidiary if subsidiary's business is closely related to banking and proper incident to banking). Bank holding companies wishing to establish a securities affiliate, therefore, must obtain approval from the Federal Reserve Board. *See id.* The Federal Reserve Board recently approved discount brokerage as a generally permissible bank holding company subsidiary activity. *See Securities Brokerage and Margin Lending are Permissible Activities for Bank Holding Companies*, [Current] FED. BANK L. REP. (CCH) ¶99,715, at 87,135 (1983) (Federal Reserve places securities brokerage on list of generally permissible bank holding company subsidiary activities).

60. *See Moratorium Legislation and Financial Institutions Deregulations: Hearings on S. 1609 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 98th Cong., 1st Sess. 70 (1983) (statement of Donald T. Regan, Secretary of Treasury) (legislation necessary to enable banks to compete more effectively in financial services industry) [hereinafter cited as *1983 Hearing*].

61. *See id.* at 76 (federal banking agencies cannot regulate effectively bank securities activities because regulation by banking agencies would place inappropriate supervisory burden on federal government).

gress the Financial Institutions Deregulation Act (Deregulation Act)[62] which would allow banks to offer specific securities services enumerated in the Deregulation Act while placing the regulation of bank securities services within the control of the SEC and on a level with registered broker-dealers.[63] Specifically, the Deregulation Act would expand bank securities powers by permitting subsidiaries of bank holding companies to underwrite and deal in municipal revenue bonds and sponsor and manage mutual funds.[64] Banks could only offer the municipal revenue bond and mutual fund services through a bank holding company subsidiary.[65] The Deregulation Act also would require banks choosing to offer the municipal revenue bond and mutual fund services to transfer the bank's present securities and brokerage services to the bank holding company subsidiary.[66] The Deregulation Act would subject a bank securities affiliate to the regulatory scheme of the SEC because the securities affiliate would not fall within the bank exemption to the Exchange Act's definition of broker and dealer.[67] By subjecting the bank securities activities to the regulatory control of the SEC, the Reagan Administration claims that the Deregulation Act would provide equivalent regulation of banks and broker-dealers and assure bank soundness and integrity, while allowing banks to compete more effectively with broker-dealers by permitting banks to offer securities services which federal law previously prohibited.[68]

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62. S. 1609, 98th Cong., 1st Sess. (July 11, 1983).

63. *See 1983 Hearings, supra* note 60, at 75-78 (statement of Donald T. Regan, Secretary of Treasury) (Deregulation Act permits banks to engage in additional securities activities through bank holding company subsidiary subject to SEC regulation). The Deregulation Act would permit bank or thrift holding companies to underwrite and deal in municipal revenue bonds and sponsor and manage mutual funds through holding company subsidiaries. *See id.* at 75. Additionally, bank holding companies or their subsidiaries could underwrite and deal in insurance and own and sell real estate. *See id.* The Deregulation Act also would direct the Federal Reserve Board to promulgate regulations allowing bank holding companies to engage in additional activities if the Federal Reserve Board determines that activities to be "of a financial nature" or closely related to banking. *See id.* Under the Deregulation Act the SEC would regulate the subsidiaries of the bank holding companies as broker-dealers. *See id.* at 77.

64. *See id.* at 75 (Deregulation Act gives banks authority to underwrite municipal revenue bonds and sponsor mutual funds.

65. *See id.* at 74 (Deregulation Act only permits banks to offer new securities activities through holding company).

66. *See id.* at 75. The Deregulation Act would require banks offering the additional securities activities permitted by the Deregulation Act to do so through a securities subsidiary of a bank holding company or through a bank holding company itself. *See id.* Bank holding companies providing the additional securities services also would have to conduct presently permissible brokerage, underwriting and dealing activities through the holding company subsidiary. *See id.* Banks not engaging in the new securities activities that the Deregulation Act permits, however, could continue to offer any securities activity presently authorized by law through the bank itself. *See id.*

67. *See id.* at 77 (SEC would regulate securities activities of holding company subsidiaries under Deregulation Act); *supra* notes 10-13 and accompanying text (entity not falling within definition of bank must register with SEC because Exchange Act's definition of broker and dealer only excludes banks).

68. *See 1983 Hearings, supra* note 60, at 70 (statement of Donald T. Regan, Secretary of

Opponents of the Deregulation Act claim that Congress intended the Glass-Steagall Act to separate commercial bank activities from securities activities by clearly prohibiting banks from engaging in certain securities activities.[69] The Deregulation Act, however, would permit banks to engage in some securities activities that the Glass-Steagall Act prohibited such as municipal revenue bond underwriting.[70] Opponents also argue that banks will become subject to conflicts of interest between their securities activities and their commercial banking functions which Congress designed the Glass-Steagall Act to alleviate.[71] For example, opponents fear that a bank that has loaned money to a company now suffering financially could assure that the company would have funds to repay the bank by underwriting a new issue of stock for the company.[72] Finally, opponents note that the Deregulation Act will not subject all bank securities activities to SEC regulation.[73] Banks choosing to offer only traditional brokerage services and securities services that the Glass-Steagall Act presently permits could continue to offer the securities services within the bank.[74] Consequently, since the bank would be exempt from SEC registration, banks choosing not to offer the additional securities services that the Deregulation Act permits could continue to operate the bank's traditional securities services free from SEC regulation.[75]

Supporters of the Deregulation Act claim that the proposed Act does not violate the principles of the Glass-Steagall Act since the Act contains safeguards against conflicts of interest between a bank and its securities affiliate.[76] The Deregulation Act only permits securities affiliates to engage in limited securities activities.[77] The Deregulation Act would not authorize securities affiliates to

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Treasury) (Deregulation Act will help to equalize competition in financial services industry without jeopardizing bank safety and soundness); *see also* Whittle, *Financial Industry in Turmoil as Reluctant Congress Stalls on Bank Deregulation Issue*, 1983 Congressional Quarterly 1899, 1905 (1983) (Reagan administration favors Deregulation Act to increase competition in financial services industry while preventing unfair advantage for banks and preserving banking industry stability).

69. *See* Whittle, *supra* note 68, at 1908 (Glass-Steagall Act designed to confine bank affiliate activities to commercial banking functions).

70. *See 1983 Hearings, supra* note 60, at 75 (Deregulation Act permits banks to engage in securities activities that Glass-Steagall Act formerly prohibited).

71. *See* Whittle, *supra* note 68, at 1908 (securities industry argues that bank deregulation would lead to same conflicts of interest between banks and their affiliates that existed in 1920's); *supra* note 3 (discussion of potential conflicts and dangers of bank affiliation with securities firm).

72. *See* Whittle, *supra* note 68, at 1908 (bank underwriting securities to help failing company is one of dangers of bank participation in securities industry).

73. *See 1983 Hearings, supra* note 60, at 75 (statement of Donald T. Regan, Secretary of Treasury) (Deregulation Act would allow bank not engaging in additional securities activities to conduct securities activities through bank without SEC regulation).

74. *See id.* (Deregulation Act allows bank to offer limited securities services through bank).

75. *See id.; supra* notes 10-13 (banks excluded from definitions of broker and dealer and only brokers and dealers must register with SEC).

76. *See 1983 Hearings, supra* note 60, at 86, 103-04 (testimony of Donald T. Regan, Secretary of Treasury) (Deregulation Act maintains line between commerce and banking and provides safeguards against abuses that lead to Glass-Steagall Act).

77. *See id.* at 86 (Deregulation Act only permits banks to increase securities activities by underwriting municipal revenue bonds and sponsoring mutual funds).

underwrite corporate securities so that a bank could not underwrite a corporate securities issue to enable a corporation to repay a loan to the bank.[78] Furthermore, supporters of the Deregulation Act claim that the Deregulation Act would provide equivalent regulation of equivalent bank and broker-dealer securities activities.[79] Additionally, supporters of the Deregulation Act note that the Deregulation Act would avoid duplicative regulation of bank securities activities since the SEC would be primarily responsible for the regulation of bank securities services.[80]

The Deregulation Act is a positive step toward creating equivalent regulation of bank and broker-dealer securities activities, and would help assure complete and equitable regulation of all securities services.[81] Under the Deregulation Act, however, banks could continue to offer a wide range of securities services without regulation by the SEC because a bank not choosing to offer the municipal revenue bond and mutual fund services could continue to offer presently approved securities services, such as public discount brokerage, through the bank.[82] Equality of regulation, however, is necessary to protect investors and prevent unfair advantages to banks even if banks do not receive the authority to offer securities services in addition to the services that banks presently provide.[83] Any federal legislation, therefore, should assure that banks offering substantial securities services such as banks that publically solicit brokerage business or provide investment advice to customers, are subject to the same regulations as the SEC imposes on broker-dealers performing similar services.[84]

Due to congressional disagreement concerning appropriate legislative action with respect to bank deregulation, Congress failed to enact the Deregulation Act.[85] In light of congressional inaction and in response to the increase in bank securities activities the SEC proposed rule 3b-9 in 1983 to subject certain bank securities activities to SEC regulation.[86] The new rule would provide that

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78. *See id.* at 104 (Deregulation Act does not permit banks to underwrite corporate securities).

79. See id. at 77 (Deregulation Act would end controversy over unequal regulatory treatment of bank and broker-dealer securities activities).

80. *See id.* (Deregulation Act would avoid duplicative regulation since federal banking agencies would no longer be primarily responsible for regulation of bank securities activities).

81. *See id.* (Deregulation Act would end controversy of unequal regulatory treatment of bank and broker-dealer securities activities).

82. *See id.* at 75 (Under Deregulation Act bank choosing to offer only presently authorized securities services could do so through bank).

83. *See supra* note 53 and accompanying text (SEC Chairman contends that interest of investor protection demands equivalent regulation of bank and broker-dealer securities services).

84. *See Policy Issue, supra* note 1, at 359-60 (securities industry argues that SEC should regulate increased bank securities activities in addition to broker-dealers).

85. *See Banking Deregulation,* 1983 Congressional Quarterly 2470-71 (1983) (Congress failed to pass Deregulation Act).

86. *See SEC Bank Registration Proposal, supra* note 5, at 86,326 (SEC's proposed rule subjects banks performing certain activities to SEC regulation); *see also Definition of Bank for Purposes of Sections 3(a)(4) and (5) of the Act,* 2 FED. SEC. L. REP. (CCH) § 21,260, at 15,603-3 (Nov. 8, 1983) (text of proposed rule 3b-9).

for purposes of the definitions of "broker" and "dealer" in sections 3(a)(4) and 3(a)(5) of the Exchange Act, the term "bank" would not apply to banks engaging in certain securities activities.[87] Under the proposed rule, a bank that solicits brokerage business publicly, underwrites or deals in securities other than exempted or municipal securities, or receives transaction-related compensation for brokerage services for accounts to which the bank provides advice, would not qualify for the bank exemption under the Exchange Act and thus would be subject to SEC regulation.[88] For example, numerous banks offering publicly advertised brokerage services no longer would be exempt from the SEC registration requirements.[89] Since proposed rule 3b-9 would place broker-dealers and many bank securities services under the same regulations, proposed rule 3b-9 would help assure investors using bank securities services of SEC regulatory protection and would end the competitive advantage that banks have enjoyed over broker-dealers.[90]

The SEC claims that proposed rule 3b-9 is necessary to assure investor protection, to maintain a fair and orderly securities market, and to provide effective regulation of the securities market.[91] Since rule 3b-9 would subject

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87. *See SEC Bank Registration Proposal, supra* note 5, at 86,326 (only banks performing specified securities activities must register with SEC under proposed rule 3b-9). Proposed rule 3b-9 would provide that banks engaged in three securities activities would no longer be termed "banks" for purposes of the Exchange Act and, therefore, would have to register with the SEC as brokers. *Id.; supra* notes 10-13 and accompanying text (brokers and dealers must register with SEC but definitions of broker and dealer exclude banks). First, the proposed rule would require banks that engage in the public solicitation of brokerage services to register with the SEC. *See SEC Bank Registration Proposal, supra* note 5, at 86,328. Numerous banks today which publically promote the bank's discount brokerage services, therefore, would be subject to SEC regulation. Under the proposed rule, banks performing limited accommodation services would not have to register with the SEC if the banks did not publically solicit the accommodation services. *See id.* Secondly, the proposed rule would provide that banks which receive transaction-related compensation for providing brokerage services for trusts, or as managing agency, or for accounts to which the bank provides investment advice could no longer take advantage of the Exchange Act bank exclusion. *See id.* The SEC realizes that the propriety of banks providing investment advice is an unsettled issue, and thus the SEC expresses no opinion concerning the legality of banks providing investment advice. *See id.* n.16; *supra* note 6 (legality of bank investment advisory service debatable). Finally, the proposed rule mandates that any bank which underwrites or deals in securities other than exempted or municipal securities would be subject to SEC regulation. *See SEC Bank Registration Proposal, supra* note 5, at 86,328. Banks dealing in municipal securities presently must register with the SEC. *See* 15 U.S.C. § 78o(4)(a) (1982) (municipal securities dealer must register with SEC). Broker-dealers effecting transactions in only exempted securities, however, are exempt for registration. *See* 15 U.S.C. § 78o(3)(b) (1982) (registration requirements of Exchange Act do not apply to broker or dealer in exempted securities).

88. *See SEC Bank Registration Proposal, supra* note 5, at 86,326 (banks performing listed activities subject to SEC registration under proposed rule); *supra* note 87 (discussion of bank securities activities subjecting banks to SEC regulation under proposed rule 3b-9).

89. *See SEC Bank Registration Proposal, supra* note 5, at 86,326 (SEC proposed rule 3b-9 would require banks soliciting brokerage business to register with SEC).

90. *See id.* (SEC believes rule 3b-9 would assure reasonably complete and effective regulation of securities market).

91. *See id.* (SEC contends rule 3b-9 is necessary to protect investors and create a fair securities market).

banks engaged in specified securities activities to SEC regulation, identical standards would control both bank and broker-dealer securities activities.[92] The SEC reasons that a change in the Exchange Act is appropriate because Congress did not foresee that banks would perform the kinds of securities activities that banks offer today when Congress enacted the bank exclusion to the Exchange Act's definitions of broker and dealer.[93] The SEC notes that banks now provide brokerage services that are identical to the services that registered broker-dealers traditionally have offered.[94] Moreover, the SEC contends that no authority exists that Congress intended to exempt institutions offering extensive securities services from SEC registration.[95]

The SEC relies on introductory language to the Exchange Act's definitional section which states that the Act's definitions are applicable "unless the context otherwise requires" for legal authority to exclude banks offering extensive securities services for the Exchange Act's definition of a bank.[96] The

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92. *See id.* (banks offering securities activities that proposed rule 3b-9 lists would be subject to same rules and regulations as broker-dealers performing same activities).

93. *See id.* at 86,327 (SEC claims that Congress did not contemplate that banks would engage in the securities activities that the proposed rule cites when Congress enacted the bank exclusion). The SEC notes that, although the legislative history of the Exchange Act's bank exclusion is not extensive, the legislative history demonstrates that Congress did not foresee that banks would offer the types of securities services that banks offer today. *See id.* n.12; *see also Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73 Cong., 2d Sess. 86-87, 686-87 (1934) *reprinted in* 8, 9 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, item 23 (1973) (statement of Thomas C. Corcoran, one of drafters of Exchange Act). The legislative history concerning the bank exclusion emphasizes that Congress did not intend a bank that merely acts as agent in effecting securities transaction should not fall under SEC regulation. *See id.* at 86. The legislative history, however, shows that Congress viewed bank securities activities as extremely limited. *See id.* Congress believed banks could only transmit a customer order to a broker, but banks could not carry on the business of dealing in securities. *See id.* The scant legislative history of the bank exclusion in the Exchange Act, therefore, supports the SEC's position that Congress did not believe that banks would engage in the general brokerage business similar to the activities of registered broker-dealers. *See id.*

94. *See SEC Bank Registration Proposal, supra* note 5, at 86,327 (some bank services indistinguishable from broker-dealer services); *supra* note 1 (discussion of securities services banks offer).

95. *See SEC Bank Registration Proposal, supra* note 5, at 86,327 (SEC notes that no evidence exists that Congress intended to exempt banks performing same functions as brokers from SEC registration); *see also supra* note 93 (Exchange Act's legislative history shows Congress envisioned only limited securities activities for banks). The SEC emphasizes that banks have expanded their securities services considerably since the 1977 Bank Study. *See id.* at 86,327. Although the Bank Study rejected a proposal to delete the Exchange Act's bank exclusion, the SEC contends that the Study's conclusion that banks offering securities services should not have to register with the SEC resulted from the limited nature of bank securities activities at the time of the Study. *See Bank Study, supra* note 41, at 343. Accordingly, the SEC recognized that increased securities activities by banks could affect the SEC's conclusions. *See id.; supra* notes 41-43 and accompanying text (SEC's conclusions and recommendations in Bank Study).

96. 15 U.S.C. § 78c (1982); *see SEC Bank Registration Proposal, supra* note 5, at 86,326-27 (SEC claims language of Exchange Act provides SEC authority to redefine "banks" for purposes of Exchange Act's bank exclusion).

SEC maintains that this introductory language, coupled with the SEC's authorization to define terms in the Act if the SEC's definition is consistent with the Act's purposes,[97] provides sufficient authority for the SEC to redefine the term "bank" for purposes of the Exchange Act's bank exclusion.[98] The SEC reasons that Congress designed the Exchange Act's registration requirements to provide effective regulation of the securities market and excluded banks from the Act's registration requirement because Congress believed banks would engage in only limited securities activities.[99] Since banks now offer securities services comparable to broker-dealer services, the SEC contends that the policy of investor protection requires the SEC to regulate banks offering extensive securities services.[100]

To support the SEC's plan to expand the SEC's regulatory authority of securities activities to encompass banks engaged in extensive securities services, the SEC relies on *Marine Bank v. Weaver*.[101] The SEC cites *Weaver* for the proposition that the SEC may examine factors outside the Exchange Act, such as the current regulatory scheme of bank securities activities in light of the congressional intent of assuring investor protection by providing SEC regulation of substantial securities activities, to determine whether banks engaged in substantial securities activities fall within the bank exclusion to the Exchange Act's definitions of broker and dealer.[102] In *Weaver*, the Supreme Court addressed the issue of whether a bank certificate of deposit is a security within the meaning of the Exchange Act and thus subject to the antifraud provisions of the federal securities laws.[103] Although the Court recognized that the

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97. *See* 15 U.S.C. § 3b (1982) (SEC has authority to define terms in Exchange Act if consistent with purposes of Act).

98. *See SEC Bank Registration Proposal, supra* note 5, at 86,326-27 (SEC explains legal justification for proposed rule 3b-9).

99. *See id.* at 86,327.

100. *See id.*

101. 455 U.S. 551 (1982).

102. *See SEC Bank Registration Proposal, supra* note 5, at 86,327 n.15 (SEC cites *Weaver* for legal authority to adopt rule 3b-9).

103. *See* 455 U.S. at 555. (Supreme Court held certificate of deposit not a security for purposes of antifraud provisions of federal securities laws). In *Marine Bank v. Weaver*, the Weavers pledged a federally insured certificate of deposit as security for a loan from Marine Bank (Marine) to the Columbus Packing Company (Columbus) and guaranteed Columbus' loan. *Id.* at 533. The Weavers' contract with Columbus provided that the Weavers would receive 50% of Columbus' net profits and $100 a month for guaranteeing the loan. *Id.* Columbus, however, owed money to Marine. *Id.* The Weavers believed that Columbus would use the loan as working capital, but instead Marine applied a portion of the loan to pay Columbus' debt. *Id.* The Weavers claimed that Marine encouraged them to guarantee Columbus' loan without disclosing that Columbus owed debts to Marine or without disclosing Marine's intentions to apply the proceeds of the loan to repay Columbus' overdue obligations. *Id.* at 554. Columbus later became bankrupt to Marine. *Id.* at 553-54. The Weavers claimed that the bank violated § 10(b) of the Exchange Act by deceiving the Weavers with respect to Columbus' loan. *Id.* Section 10b of the Exchange Act prohibits manipulative or deceptive practices in connection with the purchase or sale of any security. *Id.* at 554; *see* 15 U.S.C. § 78(j)(b) (1982) (Section 10b of Exchange Act). The Supreme Court held that the certificate of deposit was not a security for purposes of the Exchange Act and, consequently, denied the Weavers relief of their federal securities laws claims. *See* 455 U.S. at 559.

Exchange Act's definition of security includes instruments commonly considered to be within the concept of security in the commercial world, the Court concluded that the bank certificate of deposit in *Weaver* was not a security for purposes of the Exchange Act.[104] The Court noted that the Exchange Act definitions do not apply if the "context otherwise requires."[105] Consequently, the Court examined factors outside the Exchange Act's definition of security to determine if Congress intended instruments such as bank certificates of deposits to qualify as securities and, therefore, receive the protection of the federal securities laws.[106] The Court stated that, unlike common securities, federal banking regulations and federal insurance already protect the deposits of holders of certificates of deposits.[107] According to the Court, the "unless the context otherwise requires" language in the Exchange Act mandated a finding that a bank certificate of deposit, which seemed to fall within the Exchange Act's definition of a security, was not a security because banking regulations outside the Exchange Act already adequately protect certificate holders against fraud.[108] The SEC relies on *Weaver* to argue that since Congress did not intend the banks to engage in extensive securities activities without SEC regulation, the SEC may find that banks offering substantial securities services do not fall within the bank exclusion in the Exchange Act.[109]

In addition to *Weaver*, the SEC relies on *Securities and Exchange Commission v. Variable Annuity Life Insurance Company of America*[110] to sup-

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104. *See id.* at 559. (Supreme Court held certificate of deposit in *Weaver* not security). In *Weaver,* the Supreme Court examined the Exchange Act's definition of security and prior court decisions interpreting the Act's definition of security to determine if the certificate of deposit fell within the definition of security. *See* 455 U.S. at 555-59; 15 U.S.C. § 78c(a)(10) (1982) (Exchange Act's definition of security). The court noted that the Exchange Act's definition of "security" is extremely broad and generally applies to instruments that, in the commercial world, have a character falling within the ordinary concept of security. *See* 455 U.S. at 556. The Court, however, noted that the definitions in the Exchange Act apply "unless the context otherwise requires." *See id.* The Court, therefore, reasoned that a certificate of deposit which has characteristics of a security should not be termed a security if the context otherwise requires. *See id.* at 558-59. The Court then noted that the debt represented by a certificate of deposit, unlike a common security such as a long-term debt obligation, receives protection from the regulations of the federal bank agencies and federal deposit insurance. *See id.* at 557-58. Holders of federally secured certificates of deposit, therefore, do not need the protection of the federal securities laws to assure payment. *See id.* at 558. The Court thus concluded that a bank certificate of deposit is not a security under the Exchange Act because the holders of certificates of deposit receive adequate protection under the federal banking laws. *See id.* at 559.

105. *See id.* at 556. (*Weaver* Court stated that consideration of "unless the context otherwise requires" language important in determining scope of Exchange Act definitions).

106. *See id.* at 556-59 (Court examined federal banking laws applicable to certificates of deposit to determine whether certificates of deposit were securities).

107. *See id.* at 558 (banks issuing certificates of deposit are subject to comprehensive federal regulations and bank deposits are federally insured).

108. *See id.* at 558-59 (unnecessary to include certificates of deposit in Exchange Act's definition of security because federal banking laws already protect deposits).

109. *See SEC Bank Registration Proposal, supra* note 5, at 86,327 n.13 (SEC cites *Weaver* to support SEC's authority to promulgate proposed rule 3b-9).

110. 359 U.S. 65 (1959).

port the proposition that the SEC has legal authority to change the Exchange Act's definition of a bank.[111] In *Variable Annuity Life Insurance Company*, the Court considered whether variable annuity contracts were securities under the Securities Act of 1933 or whether the contracts were life insurance contracts.[112] The Court held that the contracts were securities subject to the registration requirements of the Securities Act of 1933.[113] In a concurring opinion, Justice Brennan maintained that the scope of exclusions to the federal securities laws depends on the regulatory purposes of the federal securities laws.[114] The SEC relies on Justice Brennan's concurrence in *Variable Annuity Life Insurance Company* to argue that the SEC must examine the scope of the bank exclusion in the Exchange Act in light of the Exchange Act's purpose of assuring investor protection by subjecting extensive securities activities to SEC regulation.[115] Since banks now engage in extensive securities activities beyond the activities that Congress envisioned when Congress enacted the bank exclusion, the Exchange Act's regulatory purpose of providing protection to securities investors mandates rule 3b-9's proposed modification to the Act's definition of bank so that substantial bank securities activities will be subject to the SEC registration requirements.[116]

The SEC's legal basis for proposed rule 3b-9 is questionable. Sections

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111. *See SEC Bank Registration Proposal, supra* note 5, at 86,327 n.13 (SEC cites *Variable Annuity Life Insurance Company* for proposition that scope of exclusion to federal securities laws depends on purposes of securities laws); 359 U.S. 65 (1959) (*Variable Annuity Life Ins. Co.*).

112. *See SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959). In *SEC v. Variable Annuity Life Ins. Co.*, the SEC sought to enjoin the defendants from offering so-called "annuity contracts" to the public without registration under the Securities Act of 1933 (Securities Act). *See id.* at 67. The defendants claimed that the contracts were insurance or annuity contracts and, therefore, exempt from the registration requirements of the Securities Act. *See id.* at 67. The Court held that the contracts were securities even though the contracts were termed "insurance" or "annuity" contracts because the investment features of the contracts more closely resembled risk securities than insurance. *See id.* at 69-73.

113. *See id.* (Court held contracts were securities subject to registration requirements of Securities Act).

114. *See id.* at 76 (Brennan argued that Court must analyze regulatory and protective purposes of federal securities laws to determine application of securities laws).

115. *See SEC Bank Regulation Proposal, supra* note 5, at 86,327 n.13 (SEC's case support for proposed rule 3b-9). The SEC contends that the purpose of the registration requirements in the Exchange Act is to protect investors by providing effective regulation of the securities market. *See id.* at 86,327. The SEC believes that Congress exempted banks from the registration requirements of the Exchange Act because of the limited nature of bank securities activities. *See id.* Relying on *Variable Annuity Life Insurance Company,* however, the SEC may argue that the scope of the bank exclusion to the definitions of broker and dealer in the Exchange Act depends on the congressional purpose in enacting the bank exclusion. *See id.* at 86,327 n.19. Consequently, since banks now engage in substantial securities activities which frustrate the purpose underlying the bank exclusion, the SEC may need to redefine the term "bank" for purposes of the bank exclusion. *See id.* at 86,327. Under proposed rule 3b-9, the SEC will regulate banks engaging in substantial securities activities and thus provide effective regulation of the securites market. *See id.* At the same time, rule 3b-9 will maintain the bank exclusion for banks that only offer accommodation services as contemplated by Congress when it enacted the bank exclusion. *See id.*

116. *See id.* (SEC needs to regulate substantial bank securities activities to assure effective regulation of securities market).

3(a)(4) and 3(a)(5) of the Exchange Act clearly exclude banks from SEC regulation by excluding banks from the Exchange Act's definitions of broker and dealer.[117] The SEC cites no authority to directly support the proposition that the SEC has the power to amend a clear statutory exemption without congressional approval.[118] Furthermore, the cases that the SEC relies on do not support necessarily the SEC's position.[119] For example, the Court in *Weaver* relied on factors outside the securities laws such as the bank regulatory system to exclude certificates of deposit from the definition of security and, therefore, narrowed the authority of the SEC because the SEC could not regulate certificate of deposit transactions.[120] *Weaver*, thus, does not support the proposition that the SEC has discretion to examine factors outside the securities laws to expand the SEC's regulatory authority.[121] Proposed rule 3b-9 would expand greatly the authority of the SEC by requiring many banks not subjected presently to SEC authority to register with the SEC.[122] Furthermore, while the *Variable Annuity Life Insurance Company* decision supports the proposition that the scope of exclusions in the federal securities laws depends on the purposes of the securities laws, the case does not grant the SEC the power to expand its regulatory authority by deleting an express statutory exemption under the federal securities laws.[123] Therefore, neither the language of the Exchange Act nor the cases cited by the SEC provide conclusive authority for the proposition that the SEC may change the Exchange Act's definition of bank and require banks engaged in substantial securities activities to register with the SEC.[124]

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117. 15 U.S.C. § 78c(a)(4), (5) (1982) (definitions of broker and dealer in Exchange Act expressly exclude banks).

118. *See* Letter from Douglas Ginsburg to SEC 8-9 (Dec. 30, 1983) (comment letter from Justice Department to SEC concerning proposed rule 3b-9) [hereinafter cited as *Justice Letter*]. The Justice Department's comment letter on proposed rule 3b-9 concludes that the SEC's authority to promulgate rule 3b-9 is unclear because the SEC has no express authority to modify Exchange Act definitions to expand the SEC's regulatory authority. *See id.* Additionally, the Justice Department believes that the SEC's authority to issue rule 3b-9 is questionable because no cases exist that directly support the SEC's position. *See id.* Consequently, the Justice Department contends that the SEC's reliance on statutory authority for rule 3b-9 raises doubts about the SEC's legal authority to promulgate the proposed rule. *See id.*

119. *See infra* notes 120-23 and accompanying text (discussion of weaknesses in SEC's case support for authority to promulgate proposed rule 3b-9).

120. *See Weaver*, 455 U.S. at 558-59 (Court examined federal banking laws protecting deposits to determine that certificate of deposit is not security); *supra* notes 103-10 and accompanying text (discussion of *Weaver*).

121. *See* Letter from James D. Herrington to SEC 2 (Dec. 29, 1983) (comment letter from Independent Bankers Association of America (IBAA) to SEC) (IBAA argued *Weaver* does not give SEC authority to expand SEC's regulatory authority).

122. *See SEC Bank Registration Proposal*, *supra* note 5, at 86,327 (proposed rule 3b-9 will subject banks engaging in securities activities of type described by the proposed rule to SEC regulatory requirements).

123. *See Justice Letter*, *supra* note 118, at 8-9. (*Variable Annuity Life Ins. Co.* does not directly support SEC's claim that it has authority to delete express statutory exemption in Exchange Act).

124. *See supra* notes 117-23 and accompanying text (SEC's legal authority to promulgate proposed rule 3b-9 is doubtful).

Although the SEC's authority to amend the Exchange Act's bank exclusion is unclear, the Exchange Act's underlying policy of investor protection supports action by the SEC.[125] Congress enacted the Exchange Act's requirement that the SEC regulate broker-dealers to protect investors.[126] Congress excluded banks from the Act's definitions of broker and dealer because Congress believed that the Glass-Steagall Act only permitted banks to engage in extremely limited securities services.[127] Now that banks provide securities services that are identical to broker-dealers, the SEC should regulate bank securities activities to assure equality of regulation between banks and broker-dealers.[128] If all of the rules and regulations of the Exchange Act are necessary for the protection of investors, then the rules and regulations should apply equally to substantial securities services regardless of whether a bank or broker-dealer effects the securities transaction.[129] Proposed rule 3b-9, therefore, would protect investors by uniformly regulating both banks and broker-dealers offering extensive securities services.[130] Proposed rule 3b-9 would be consistent with the Glass-Steagall Act, however, because the Exchange Act would continue to exempt banks that offer only limited brokerage service as an accommodation to their customers from SEC registration because banks performing only limited brokerage services would continue to come within the Exchange Act's bank exclusion to the definitions of broker and dealer.[131] Since the SEC does have limited legal support for proposed rule 3b-9, in the absence of congressional action, the proposed rule would provide necessary protection to investors in the securities market by equalizing the regulatory schemes of bank and broker-dealer securities activities.[132] Immediate action by the SEC through rule 3b-9 would provide adequate regulation of bank

125. *See* Letter from Matthew P. Fink to George A. Fitzsimmons 4-5 (Dec. 29, 1983) (comment letter from Investment Company Institute to SEC concerning proposed rule 3b-9). In a comment letter to the SEC, the Investment Company Institute (ICI) argues that Congress never intended to permit banks to engage in the brokerage business to the extent that banks participate today. *See id.* at 3. The ICI, therefore, maintains that banks violate the Glass-Steagall Act by offering extensive securities activities. *See id.* at 3-4. The ICI believes that the SEC should bring actions to force banks to cease the bank brokerage services that banks offer today. *See id.* at 4. As a secondary measure, the ICI argues that the SEC's duty to protect investors in the securities market mandates the SEC to require banks to register as broker-dealers. *See id.* at 4. Without SEC regulation, the ICI claims that bank securities customers will not receive adequate protection in securities transactions. *See id.*

126. *See* L. Loss, *supra* note 9, at 684-85 (statutory regulation necessary to protect investors).

127. *See supra* note 93 and accompanying text (SEC argues that Congress enacted bank exclusion on premise that banks permitted to engage in few securities activities).

128. *See SEC Bank Registration Proposal, supra* note 5, at 86,327 (SEC argues that increased bank securities activities requires SEC regulation).

129. *See id.* at 86,326 (SEC argues that banks and broker-dealers performing same activities should be subject to same regulations).

130. *See id.* (proposed rule 3b-9 would protect investors).

131. *See id.* at 86,328 (banks could perform orders handling services for customers without registering as broker-dealers).

132. *See id.* at 86,326 (proposed rule would protect investors through equivalent regulation of bank and broker-dealer securities services); *supra* notes 96-116 (discussion of SEC's legal justification for proposed rule 3b-9).

securities activities until Congress enacts a solution to the problem of inadequate regulation of extensive bank securities activities.[133]

Like the SEC, the National Association of Securities Dealers (NASD)[134] has refused to wait for Congress to act and has proposed an amendment to the NASD By-Laws which would require some bank employees to register with the NASD as NASD representatives subject to NASD regulations.[135] The NASD is a private self-regulatory organization whose rules govern all over-the-counter securities transactions, whether or not the transaction is effected by a stock exchange member.[136] The proposed NASD By-Laws amendment would require bank employees who solicit or receive orders from bank customers for the purchase or sale of a security and who, because of a contractual arrangement with a NASD member, refer the transaction to the NASD member in return for compensation, to register as representatives of the NASD

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133. *See SEC Bank Registration Proposal, supra* note 5, at 86,326 (SEC supports congressional action but believes proposed rule 3b-9 necessary to protect investors pending action by Congress). While proposed rule 3b-9 would help protect securities investors pending congressional action, problems exist with the SEC's plans to subject bank securities activities to SEC regulation through proposed rule 3b-9. For example, the SEC's plan would place responsibility for regulation of bank securities activities with the SEC, thereby creating duplicative regulation of banks securities activities since banks would also be subject to regulation by the banking agencies. *See* Letter from James D. Herrington to SEC 2 (Dec. 29, 1983) (comment letter of Independent Bankers Association of America (IBAA) to SEC concerning rule 3b-9). Moreover, passage of rule 3b-9 apparently would create conflicts between banking agencies and the SEC. *See id.* The mere proposal of rule 3b-9 has caused significant tension between the SEC and federal banking regulators. *See SEC Rush on Turf Ruffled Regulators of Bank Agencies,* Legal Times, Nov. 14, 1983, at 1.

Another problem with proposed rule 3b-9 concerns how the proposed rule will affect small banks or banks that offer a limited amount of securities business. *See SEC Bank Registration Proposal, supra* note 5, at 86,326 (small bank may suffer hardship under rule). The SEC has requested comments on whether to exclude from rule 3b-9 banks that limit their securities activities to referrals of bank customers to registered broker-dealers or banks that engage in only a small number of securities transactions. *See id.* at 86,328. While the banking industry supports an exclusion from rule 3b-9 of banks that offer only limited securities services, the securities industry contends that banks should not escape registration with the SEC when broker-dealers engaging in similar activities must register. *See* Letter from Edward I. O'Brien to George A. Fitzsimmons 4 (Dec. 23, 1983) (comment letter from Securities Industry Association to SEC concerning proposed rule 3b-9). The securities industry claims that the minimal cost of SEC registration should not justify an exemption for banks with a small securities business. *See id.*

134. The NASD is a self-regulatory agency governing the over-the-counter securities market. *See* S. JAFFEE, BROKER-DEALERS AND SECURITIES MARKETS 239 (1977). Although not required, most broker-dealers serving the public are members of the NASD. L. Loss, *supra* note 9, at 674. The NASD By-Laws require that persons that the NASD By-Laws term "representatives" must register with the NASD. NASD MANUAL (CCH) ¶1102A, at 1052 (1983) (NASD By-Laws require representatives to register with the NASD). A representative is a person engaged in the securities business for a member. *See id.* Under the NASD By-Laws, representatives must pass qualification examinations and must adhere to NASD rules and regulations. *See id.* at 1052-54 (NASD qualification standards).

135. NASD NOTICE TO MEMBERS 83-72 (Dec. 20, 1983) (containing text of proposed amendments to NASD By-Laws).

136. *See* S. JAFFEE, *supra* note 134, at 239 (NASD is self-regulatory agency supervising over-the-counter securities market).

member.[137] Furthermore, bank employees who give customers investment advice subject to an agreement between the bank and the NASD member where the member compensates the bank or the bank employee for any orders received as a result of the bank's advice would be required to register as representatives.[138] Under the NASD By-Laws, a person required to register as a representative of a NASD member must adhere to NASD rules and is subject to disciplinary action for violations of the organization's rules.[139] Registered representatives also must meet qualification standards including passing a written qualification examination.[140] The only persons that the NASD By-Laws presently require to register are persons, such as employees of members, who solicit or conduct business in securities for a member and who the member directly compensates for those activities.[141] The NASD's proposed amendment, therefore, would extend the definition of representative to include persons who, if they were employees of members, would be representatives and required to register with the NASD.[142] Since NASD members have supervisory responsibility for their representatives, the effect of the proposed amendment would be to require the NASD member to register the bank employee as a representative of the member.[143] The proposed amendment would affect banks because a bank employee who solicits or receives customer orders or who provides investment advice in connection with an agreement with a

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137. *See* NASD NOTICE TO MEMBERS 83-72, at 2-3 (Dec. 20, 1983). Under the NASD's proposal to amend the NASD By-Laws, securities employees of banks would have to register with the NASD representatives if the bank maintains a relationship with a NASD member where the bank agrees to refer the bank's customers to the NASD member for execution of securities transactions and the member agrees to compensate the bank or the bank securities employee. *See id.* at 3. Recently, many banks have entered the discount brokerage business, for example, through joint ventures with broker-dealers. *See Comptroller's New Reading, supra* note 1, at 1313. Often these banks establish a relationship with the broker-dealer whereby the bank transmits customer orders to the broker-dealer and receives compensation for the service. *See* Letter from James D. Herrington to George Fitzsimmons (Dec. 29, 1983) (comment letter of IBHA to SEC concerning proposed rule 3b-9). Under the NASD's proposed By-Laws amendment, therefore, many bank securities personnel would have to register with the NASD as registered representatives of the NASD member with whom the bank has a compensation agreement. *See* NASD NOTICE TO MEMBERS 83-72, at 3 (Dec. 20, 1983).

138. *See* NASD NOTICE TO MEMBERS 83-72, at 4 (Dec. 20, 1983) (NASD proposal encompasses bank personnel who give investment advice or make securities investment recommendations to public customers).

139. *See id.* at 2 (NASD representatives subject to same obligations as NASD members).

140. *See* NASD MANUAL (CCH) ¶1102A, at 1055 (1983) (NASD By-Law's section governing qualification examinations for registered agents).

141. *See id.* at 1052 (definition of representative). The NASD By-Laws presently define "representative" as a person engaged in the investment banking or securities business for a NASD member "including the functions of supervision, solicitaion, or conduct of business in securities." *Id.* The NASD has applied the definition, however, only to persons directly compensated by NASD members for the representative's securities activities. *See* NSAD NOTICE TO MEMBERS 83-72, at 2 (Dec. 20, 1983).

142. *See* NASD NOTICE TO MEMBERS 83-72, at 2 (Dec. 20, 1983) (NASD proposal would encompass bank employees who would be representatives if NASD member employees).

143. *See id.* at 4 (NASD member must register bank securities employees as representatives to assure investors protection under NASD rules and federal securities laws).

NASD member, would be subject to NASD qualification standards and subject to disciplinary action for violations of NASD rules.[144]

The NASD contends that to effectively regulate the over-the-counter securities market, any bank employee that solicits or receives securities business for NASD members where the member later compensates the bank should be subject to NASD qualification examinations and NASD rules.[145] The NASD, therefore, maintains that the public interest requires that bank employees who perform the same functions as employees of NASD members should be subject to NASD rules and regulations.[146] The NASD also claims that the proposed amendment would increase investor protection in the securities market by assuring that bank employees within the amended definition of representative meet NASD qualifications standards.[147]

The NASD proposed amendment is another positive step towards assuring more complete and equitable regulation of the securities market.[148] Bank employees who perform similar services as NASD representatives should be subject to equivalent regulations to assure investor protection.[149] Presently, bank employees who solicit securities business in connection with an arrangement with a registered broker-dealer are not subject to NASD qualification

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144. *See id.* (scope of NASD proposal covers some bank employees and subjects bank employees to NASD rules and standards).

145. *See id.* at 3-4 (NASD argues that bank securities employees should register with NASD to assure investor protection). The NASD limits the extension of the definition of "representative" in the NASD's proposed amendment to employees of financial institutions who engage in the activities which the proposal cites and where the financial institution has entered into an arrangement with a NASD member by which the bank employee's activity furthers the securities business of the NASD member. *See id.* Bank employees, therefore, must perform the securities services on behalf of NASD members before the NASD proposal would require the bank employee to register with the NASD. *See id.* The NASD maintains that bank employees who perform securities business for NASD members should not be exempt from NASD rules and qualification standards simply because the bank employees are not employees of the NASD member. *See id.* The NASD believes that banks' increased securities activities in recent years warrants the proposed amendment because presently no restrictions exist on the ability of bank personnel to engage in the activities normally performed by NASD registered representatives. *See id.*

146. *See id.* at 3 (impact on public on person soliciting or receiving business for member or for compensation is same if person is employee of NASD member or employee of bank).

147. *See id.* (lack of qualification standards for bank securities employees could expose bank securities customer to risk of harm). The NASD registration requirement resulting from the NASD's proposed amendment would not impose qualification standards on all bank employees engaged in the securities business. *See id.* at 4-5. For example, bank employees transacting securities business with a NASD member that does not result in compensation other than a set fee by the member to the bank would not have to register as representatives with the NASD. *See id.* at 4. Employees engaged in the conventional securities activities of banks, such as managing a bank's trust department, also would not have to register with the NASD. *See id.* Additionally, the NASD proposal does not apply to arrangements between NASD members and registered broker-dealers. *See id.* at 5.

148. *See id.* at 3 (NASD proposal would promote equitable securities trade and help protect investors and public interest); *infra* notes 149-58 and accompanying text (arguing NASD proposal helpful in effectively regulating securities market).

149. *See supra* notes 53-54 and accompanying text (personnel performing same securities services should be subject to equivalent regulation).

standards.[150] If the bank employee performed the same function but was an employee of the broker-dealer instead of the bank, the employee would be a representative of the broker-dealer and required to register with the NASD.[151] In fact, the NASD proposal may not go far enough since bank employees who supervise the bank's securities personnel would not fall within the NASD's proposed new definition of representative.[152] The securities industry believes that the NASD By-Laws should require bank supervisors of bank securities personnel to register with the NASD since presently, supervisors of NASD representatives must register with the NASD.[153] Registration of bank employees responsible for the supervision of bank securities personnel, therefore, would equalize NASD regulation of bank and broker-dealer securities personnel.[154] Moreover, under the NASD's present proposal to extend the definition of representative, NASD members apparently have responsibility for assuring that the bank employees comply with NASD regulations.[155] Since the bank securities personnel and the NASD members operate separate business entities, the NASD members will have difficulty supervising the bank securities personnel.[156] If bank supervisors were registered with the NASD, the bank supervisors would be responsible for overseeing their own bank securities personnel to assure compliance with NASD rules and regulations.[157] In order to further the goal

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150. *See* NASD NOTICE TO MEMBERS 83-72, at 4 (Dec. 20, 1983) (proposal only covers employees of bank who would be NASD representative if they were employees of NASD member).

151. *See id.*

152. *See id.* at 2 (NASD proposal only affects bank employees who solicit or receive securities business or who offer securities advice on behalf of member). Under the NASD By-Laws, the definition of "representative" includes a person who engages in the securities business and functions as a supervisor in an association with a NASD member. *See* NASD MANUAL (CCH) ¶ 1102A, at 1052 (1983) (definition of representative). A person who supervises securities personnel for a NASD member, therefore, also has to register with the NASD. *See id.* Under the NASD's proposal, however, bank employees responsible for the supervision of bank securities personnel would not have to register as representatives with the NASD. *See* NASD NOTICE TO MEMBERS 83-72, at 4 (Dec. 20, 1983) (only bank employees acting in furtherance of arrangement with NASD member required to register under NASD proposal).

153. *See* Letter from Donald J. Crawford to S. William Broka 2-3 (Jan. 11, 1984) (Security Industry Associations's (SIA) comment letter to NASD concerning NASD's proposed amendment to By-Laws) (arguing that NASD definition of representative should include bank personnel who supervise employees engaged in securities business) [hereinafter cited as Crawford letter]. The SIA contends in its comment letter concerning the proposed amendment to the NASD By-Laws that the supervisory personnel of bank employees would have to register with the NASD if the supervisors were employees of NASD members instead of the bank. The SIA, therefore, claims that to equalize regulations the NASD should require bank supervisory personnel to register with the NASD as representatives. *See id.*

154. *See id.* (registration of bank securities personnel supervisor necessary for effective regulation of securities market).

155. *See* NASD NOTICE TO MEMBERS 83-72, at 3-4 (Dec. 20, 1983) (NASD proposal requires NASD members to register and be responsible for bank securities personnel).

156. *See* Crawford letter, *supra* note 153, at 2-3 (securities industry argues NASD proposal unrealistic in that it requires NASD member employees to supervise bank personnel in another office).

157. *See id.* at 2 (SIA notes that bank supervisors better able to supervise their employees than NASD member supervisors).

of increased consumer protection, therefore, the NASD should modify the amendment to include within the definition of representative nonmember employees responsible for the supervision of the activities of nonmember securities personnel.[158]

Bank involvement in the securities market has increased in recent years to a level where some action is necessary to assure effective regulation of bank securities activities.[159] While the courts have not determined the permissible scope of bank securities activities under the Glass-Steagall Act, banks undoubtedly will continue to be active participants in the securities market.[160] In order to assure protection for bank securities customers, bank securities activities should be subject to the same regulation as broker-dealer services.[161] Presently, however, the regulatory schemes controlling bank and broker-dealer securities activities vary.[162] Congressional legislation requiring banks to conduct all substantial bank securities activities through a bank holding company would end the problem of disparate regulation between banks and broker-dealers because the SEC would regulate the securities activities of the holding company affiliate.[163] Absent congressional action, the SEC's proposed rule 3b-9 would help to assure that most bank and broker-dealer securities activities receive equal regulatory treatment.[164] Although the SEC's legal authority to adopt its proposed rule is questionable, the rule represents positive action to equalize the regulation of bank and broker-dealer securities activities.[165] Similarly, the NASD's proposal to amend its By-Laws would help assure investor protection and equality of regulation by requiring bank securities personnel to register with the NASD as representatives subject to the NASD's rules and regulations.[166] The NASD should consider amending its proposal, however, to require that bank supervisors of bank securities personnel also register as representatives with the NASD.[167] While congressional action would assure a more complete solution to the problem of the inadequate regulation of bank securities activities,[168] passage of congressional legislation could take

158. *See id.* at 3 (securities industry recommends change in NASD proposal to require bank supervisors of securities employees to register with NASD as representatives).

159. *See supra* notes 1-3 and accompanying text (discussing recent increase in banks securities activities).

160. *See supra* note 9 and accompanying text (present debate concerning permissible bank securities activities).

161. *See supra* notes 53-54 and accompanying text (interest of investor protection mandates equivalent regulation for equivalent securities services).

162. *See supra* notes 22-35, 49-52 and accompanying text (disparities exist between regulation of bank and broker-dealers securities activities).

163. *See supra* notes 82-84 and accompanying text (placing bank securities activities in bank holding company subsidiary under SEC regulation would help assure equality of regulation and investor protection).

164. *See supra* notes 85-95 and accompanying text (discussion of SEC's proposed rule 3b-9).

165. *See supra* notes 96-133 and accompanying text (discussion of SEC's legal authority for proposed rule 3b-9).

166. *See supra* notes 134-51 and accompanying text (discussion of NASD proposal).

167. *See supra* notes 152-58 and accompanying text (suggested change in NASD proposal).

168. *See supra* notes 8-52 and accompanying text (comparison of regulation of bank and

time. Meanwhile, the adoption of the SEC's proposed rule 3b-9 or the NASD's proposed By-Laws amendment would further the Exchange Act's purpose of protecting investors in the securities market by equalizing the regulatory control on bank and broker-dealer securities activities.[169]

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broker-dealer securities services); *supra* notes 62-84 and accompanying text (proposed Deregulation Act).

169. *See supra* notes 85-95 and accompanying text (SEC's proposed rule 3b-9 would help equalize bank and broker-dealer securities regulation); *supra* notes 137-47 and accompanying text (NASD proposal would equalize securities regulation and help insure investor protection).