Washington and Lee Law Review

Volume 45 | Issue 3 Article 9

Summer 6-1-1988

Destroying the Barriers Between Commercial and Investment Banking: Should Congress Repeal the Glass-Steagall Act?

DESTROYING THE BARRIERS BETWEEN COMMERCIAL AND INVESTMENT BANKING: SHOULD CONGRESS REPEAL THE GLASS-STEAGALL ACT?

Congress enacted the Banking Act of 1933 (Banking Act)[1] in response to the numerous bank failures that occurred during the early stages of the Depression.[2] Congress believed that the bank failures resulted from speculative bank activities caused by the close connection between commercial and investment banking.[3] In the section of the Banking Act commonly

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1. Banking Act of 1933, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

2. *See* 77 CONG. REC. 3837 (1933) (statement of Rep. Steagall) (stating that purpose of Glass-Steagall Act was to protect safety of bank customers' deposits). Congress feared that the substantial number of bank failures would cause the public to lose confidence in the banking system. *See* S. REP. No. 77, 73d Cong., 1st Sess. 6 (1933) (hereinafter 1933 Senate Report) (noting that 2290 banks failed in 1931 and 1456 banks failed in 1932). Congress realized the importance of the public having confidence in the banking system. *See* H.R. REP. No. 150, 73d Cong., 1st Sess. 6-7 (1933) (noting that public was afraid to deposit money in banks and that Congress believed that bank instability would continue until public confidence in banking system returned). Congress realized, further, that the banking system and the economy would fail if the public did not regain confidence in the banking system. *Id.*

3. 1933 Senate Report, *supra* note 2, at 6, 10; *see* 77 CONG. REC. 3907 (1033) (statement of Rep. Koppleman) (stating that chief cause of depression and bank failures was diversion of depositors' money into speculative securities markets). Congress attributed the failure of the Bank of the United States, in particular, to the activities of the bank's securities affiliates. *Hearings Pursuant to S. Res. 71 Before a Subcommittee of the Senate Committee on Banking and Currency*, 71st Cong., 3d Sess. 116-17, 1017, 1068 (1931) (hereinafter 1931 Hearings).

Congress found that securities firms affiliated with commercial banks had engaged in underwriting activities and stock speculation and had maintained a market for the banks' stocks with the banks' own funds. 1933 Senate Report, *supra* note 2, at 10; *see* 77 CONG. REC. 3835 (1933) (remarks of Rep. Steagall) (discussing activities of securities firms affiliated with banks). Additionally, some banks extended excessive credit to the banks' customers to enable the customers to purchase the securities the bank offered. *See* 75 CONG. REC. 9906 (1932) (statement of Sen. Walcott) (noting that excessive use of bank credit by bank customers to engage in stock speculation was a major cause of banks' weakness). Banks also purchased long-term speculative securities for the banks' own accounts, and, therefore, tied up large amounts of the banks' capital. S. REP. No. 584, 72d Cong., 2d Sess. 8 (1932). Congress believed that because of the banks involvement with and ownership of speculative stocks, banks, particularly member banks of the Federal Reserve System, had aggravated the stock market crash. 1933 Senate Report, *supra* note 2, at 6, 8, 10. Accordingly, a primary purpose of Congress in enacting the Glass-Steagall Act was to prevent commercial banks from engaging in investment banking and, therefore, diverting the banks' capital into speculative securities. 75 CONG. REC. 9984 (1932) (statement of Sen. Glass); *see* 77 CONG. REC. 3835 (1933) (statement of Rep. Steagall) (stating that purpose of Glass-Steagall Act was to remove commercial banks from investment activities).

The potential for conflicts of interest between commercial banking and investment banking also concerned Congress. 75 CONG. REC. 9912 (1932) (statement of Sen. Bulkley).

known as the Glass-Steagall Act,[4] Congress attempted to separate commercial banking activities from investment banking activities.[5] Specifically,

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Senator Bulkley noted that a banker that has no investment securities to sell depositors is in a better position to offer disinterested advice and to consider the safety of the depositors' money than a banker that advises a depositor on the advantages of an investment on which the bank is to receive underwriting, distribution, or trading profits. *Id.* For example, a bank that underwrote a failing securities offering may advise depositors to purchase the security. *Id.* The depositors' purchases would save the offering, and the bank would make a commission on the sale as well. *Id.* Congress also had evidence that a securities affiliate might sell excessive holdings through the trust department of an affiliated bank. 1931 Hearings, *supra*, at 237. Some witnesses at the 1931 hearings opined that selling a securities affiliate's holdings through the trust department would be self-dealing and, therefore, in violation of the trustee's duty of loyalty. *Id.*

Congress also feared that because the bank and the securities affiliate are closely associated in the public's mind, public confidence in the bank might decline if the affiliate encountered financial difficulties. 1931 Hearings, *supra*, at 1058, 1063; *see* Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971) (discussing legislative history of Glass-Steagall Act). Congress believed that because public confidence is necessary to the solvency of a bank, the bank may make unsound loans to the bank's securities affiliate to help the affiliate overcome financial woes. 1931 Hearings, *supra*, at 1064. Congress also thought that if the bank's securities affiliate had invested in a company's security, the bank might make credit easily available to that company. *Id.*

4. *See* Clark & Saunders, *Glass-Steagall Revised: The Impact on Banks' Capital Markets, and the Small Investor*, 97 BANKING L.J. 811, 811 n.1 (1980) (noting that popular name "Glass-Steagall" refers to original bills' sponsors, Senator Carter Glass and Congressman Henry Steagall).

5. *See* 1933 Senate Report, *supra* note 2, at 10 (stating that separating commercial banks from securities affiliates would strengthen banking industry); 77 CONG. REC. 3385 (1933) (remarks of Rep. Steagall) (stating that Congress intended Glass-Steagall Act to separate commercial banking from investment banking).

The legislative history of the Glass-Steagall Act indicates that Congress intended to use several measures to separate commercial banks from the securities industry. 1933 Senate Report, *supra* note 2, at 9-13. Congress enacted the Glass-Steagall Act to control the use of bank funds for brokers' loans, to restrain banks from making direct loans on securities, and to prevent speculative market loans by banks. *Id.* at 9. Congress intended, further, to separate national and member banks from affiliates and limit loans from parent institutions to affiliates. *Id.* at 10. Congress enacted the Glass-Steagall Act as a mechanism to control and oversee bank holding companies by giving the Federal Reserve Board the power to grant permits allowing the holding company to vote bank stock that the holding company owned. *Id.* Congress believed that the Glass-Steagall Act would strengthen the banking system and, therefore, curb the number of bank insolvencies. *Id.* at 11. Congress also intended to strengthen the Federal Reserve System to enable the Federal Reserve Board better to oversee banking activities. *Id.* at 11-12. Additionally, Congress intended the legislation to protect bank deposits and to restore public confidence in the banking system. *Id.* at 12.

In interpreting the Glass-Steagall Act, the United States Supreme Court has recognized the congressional intent to separate commercial banking from investment banking. *See* Board of Governors of the Fed. Reserve Sys. v. Inv. Co. Inst., 450 U.S. 46, 63 (1981) (noting express congressional intent to separate banks from affiliates engaged in securities activities); Investment Co. Inst. v. Camp, 401 U.S. 617, 629 (1971) (stating that undisputed objective behind Glass-Steagall Act was to prevent commercial banks from engaging in investment banking). The Supreme Court also has noted that in enacting the Glass-Steagall Act, Congress determined that risks are inherent when commercial banks engage in securities activities.

Congress in the Glass-Steagall Act attempted to limit the securities activities of commercial banks and the relationships that commercial banks may establish with investment banks and securities firms by prohibiting banks from underwriting securities and from affiliating with firms engaged in securities activities.[6] During the 1980's, however, courts have upheld banking regulators' liberal interpretations of the Glass-Steagall Act that have allowed banks to engage in securities activities.[7] Some commentators and members of Congress believe that the judicial and administrative interpretations of the Glass-Steagall Act indicate that the provisions of the Glass-Steagall Act are no longer necessary to protect bank depositors and the banking system.[8] Thus, members of Congress currently are attempting to repeal certain sections of the Glass-Steagall Act to abolish the separation between the banking and the securities industries.[9]

I. PROVISIONS OF THE GLASS-STEAGALL ACT

The Glass-Steagall Act refers to five sections of the Banking Act of 1933.[10] Section 16 of the Glass-Steagall Act prohibits national banks from

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Investment Co. Inst. v. Camp, 401 U.S. 617, 630 (1971). Congress believed that these risks outweighed the benefits of competition, convenience, or expertise from commercial banks entering the investment banking industry. *Id.*

6. *See infra* notes 10-16 and accompanying text (discussing provisions of Glass-Steagall Act).

7. *See infra* notes 17-22 and accompanying text (noting that banks may engage in certain securities activities and affiliate with securities firms under some circumstances); *infra* notes 24-97 and accompanying text (discussing court decisions that have upheld banking regulators' rulings that have allowed banks to engage in securities activities and affiliate with securities firms).

8. *See infra* notes 98-114 and accompanying text (discussing reasoning of commentators that support repeal of Glass-Steagall Act).

9. *See* 133 CONG. REC. S12,259 (daily ed. November 20, 1987) (statement of Sen. Proxmire) (introducing Financial Modernization Act of 1987 that would repeal Glass-Steagall Act's separation of commercial banking and investment banking); *infra* notes 140-48 and accompanying text (discussing provisions of Financial Modernization Act of 1987).

10. *See* Hawke, *The Glass Steagall Legacy: A Historical Perspective*, 31 N.Y. L. SCH. L. REV. 255, 255-56 (discussing requirements and prohibitions of Glass-Steagall Act, history of Glass-Steagall Act, and issues that have arisen under Glass-Steagall Act); *see also infra* notes 11-16 and accompanying text (discussing provisions of Glass-Steagall Act).

As originally enacted, the Glass-Steagall Act contained six provisions related to securities activities and affiliations with securities firms by commercial banks. *See* Hawke, *supra*, at 256 (discussing history of Glass-Steagall Act). Section 19 of the original Glass-Steagall Act prohibited, without a permit from the Federal Reserve Board, a bank holding company from voting bank stock that the holding company owns. Banking Act of 1933, § 19(e)(1), 48 Stat. 162, 188 (repealed 1966) (current version at 12 U.S.C. § 61 (1982)). To obtain the permit, the holding company could not own or participate in the management of firms principally engaged in the issuance of securities. *Id.* Section 5 applied the prohibitions of section 19 to banks that were members of the Federal Reserve System (member banks). 12 U.S.C. § 337 (repealed 1966); *see infra* note 14 (discussing significance of member bank).

Congress repealed section 19 of the Glass-Steagall Act and the application of section 19 to member banks in 1966 because Congress believed that the sections were unnecessary

underwriting any public issue of securities or stock.[11] Section 16 also prohibits banks from purchasing stock for the banks' own account.[12] Section 16, however, allows banks to purchase and sell securities solely for the accounts of the banks' customers.[13] Section 5 of the Glass-Steagall Act applies the limitations of section 16 to state banks that are members of the Federal Reserve System (member banks).[14] Sections 20 and 32 of the Glass-Steagall Act prohibit affiliations between Federal Reserve member banks and firms engaged principally in securities activities.[15] Section 21 of the Glass-Steagall Act prohibits any person or firm engaged in issuing, underwriting, selling, or distributing securities from engaging in the business of receiving customers' deposits.[16]

II. THE LIMITS OF THE GLASS-STEAGALL ACT

Courts have upheld banking regulators' interpretations of the Glass-Steagall Act allowing banks to conduct various securities related services.[17]

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in light of section 4 of the Bank Holding Company Act of 1966 (BHC Act). *See* Act of July 1, 1966, Pub. L. No. 89-485, § 13(g), 80 Stat. 236, 243 (repealing § 19 of Glass-Steagall Act); S. REP. No. 1179, 89th Cong., 2d Sess. 12, *reprinted in* 1966 U.S. CODE CONG. & AD. NEWS 2385, 2396 (discussing Congress' reasoning in repealing § 19). Congress questioned the usefulness of section 19 in view of the BHC Act. *Id.* Congress also believed that repeal of section 19 of the Glass-Steagall Act would remove any confusion resulting from two sets of laws that regulate the same subject but with different definitions of bank holding company. *Id.* Section 4 of the BHC Act prohibits a bank holding company from engaging in nonbank activities or from acquiring or retaining voting shares of a company that is not a bank. *See* Act of July 1, 1966, Pub. L. No. 89-485, § 13(g), 80 Stat. 236, 243 (repealing § 19 of Glass-Steagall Act and § 5's application of § 19 of Glass-Steagall Act to member banks); *infra* note 25 (discussing § 4 of BHC Act and exception to § 4 for activities that are closely related to banking).

11. 12 U.S.C. § 24, (para. 7) (1982).

12. *Id.* Section 16 of the Glass-Steagall Act permits national banks to purchase investment securities if purchased solely for the banks' own accounts. *Id.* Section 16 defines investment securities as marketable debt obligations, subject to further definitions and regulations issued by the Comptroller of the Currency. *Id.* Banks may not purchase, however, shares of the stock of any corporation. *Id.*

13. *Id.*

14. 12 U.S.C. § 335 (1982). Banks that choose to become members of the Federal Reserve System are under the jurisdiction of the Board of Governors of the Federal Reserve System. *Id.* §§ 221, 248 (1982); *see infra* note 89 (noting that federal regulations divide banks into three separate categories).

15. 12 U.S.C. §§ 377, 78 (1982). Section 20 of the Glass-Steagall Act prohibits relationships between banks that are members of the Federal Reserve System and firms engaged principally in the public sale or distribution of securities. *Id.* § 377. Section 32 prohibits interlocking management and employee relationships between member banks and firms primarily engaged in securities activities. *Id.* § 78; *see* Hawke, *supra* note 10, at 258, 263-64 (discussing terms "engaged principally" and "primarily engaged" as used in Glass-Steagall Act).

16. 12 U.S.C. § 378(a)(1) (1982). Section 21 of the Glass-Steagall Act states, however, that the section does not prohibit member banks from engaging in activities explicitly permitted under section 16. *Id.*; *see supra* notes 11-13 and accompanying text (discussing activities prohibited by and permitted under § 16).

17. *See infra* notes 18-22 and accompanying text (noting that courts have upheld

First, subsidiaries of bank holding companies may offer discount stock and bond brokerage services.[18] Second, bank holding companies may provide, through nonbank subsidiaries, investment advice and brokerage services to institutional customers.[19] Third, nonbank subsidiaries of bank holding companies may underwrite and deal in mortgage-backed securities and consumer-receiver-related securities.[20] Fourth, banks may engage in the private placement of commercial paper.[21] Fifth, state banks that are not members of the Federal Reserve System may have subsidiary relationships with securities firms.[22]

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banking regulators' interpretations of Glass-Steagall Act that allow banks to engage in securities related activities and affiliate with firms that engage in securities activities); *infra* notes 23-97 and accompanying text (discussing court decisions that have upheld banking regulators' interpretations of Glass-Steagall Act that allow banks to engage in securities activities and affiliate with securities firms).

18. *See* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 216-21 (1984) (Schwab) (holding that affiliation between bank holding company and discount broker does not violate Glass-Steagall Act). The brokerage services consisted of executing the purchase and sell orders for securities placed by the brokers' customers. *Schwab*, 468 U.S. at 209 n.2; *see infra* notes 23-41 and accompanying text (discussing *Schwab* decision).

19. *See* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 821 F.2d 810, 811 (D.C. Cir. 1987) (NatWest) (holding that providing combined brokerage services and investment advice to institutional customers, through a bank holding company subsidiary, did not violate Glass-Steagall Act), *cert. denied*, 108 S.Ct 697 (1988). The proposal in *NatWest* defined the term "institutional customers" as banks, insurance companies, corporations, or employee benefit plans with assets greater than five million dollars that regularly invest in types of securities to which investment advice is regularly given, or as a person that, at the time of receiving brokerage services or investment advice, has a net worth greater than five million dollars. *NatWest*, 821 F.2d at 811 n.3; *see infra* notes 44-53 and accompanying text (discussing *NatWest* decision).

20. *See* Securities Ind. Ass'n v. Board of Governors of the Fed. Reserve Sys., 839 F.2d 47, 60 (2d Cir. 1988) (Citicorp) (holding that § 20 of Glass-Steagall Act does not prohibit bank holding companies' affiliates from underwriting and dealing in mortgage-backed securities and consumer-receiver-related securities if revenues from underwriting do not exceed 5% of gross revenues of subsidiary); *see also infra* notes 55-64 and accompanying text (discussing *Citicorp* decision). Consumer-receiver-related securities (CRRs) are securities that consist of debt obligations secured by or representing an interest in a diversified pool of loans to or receivables from a consumer. [Current] FED. BANKING L. REP. (CCH) § 87,021 (July 14, 1987). The collateral for most CRRs is automobile receivables. *Id.* Credit card receivables, however, have secured some CRRs. *Id.* Mortgage-backed securities are securities that consist of debt obligations secured by or representing an interest in residential real estate. [Current] FED. BANKING L. REP. (CCH) § 86,957 (July 1, 1987). A pool of one to four residential mortgages normally secures mortgage-backed securities. *Id.*

21. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 807 F.2d 1052, 1062 (D.C. Cir. 1986) (Bankers Trust II), *cert. denied*, 107 S.Ct 3328 (1987); *see infra* notes 66-86 and accompanying text (discussing *Bankers Trust II* and noting that United States Supreme Court previously has held that commercial paper constitutes a security for purposes of Glass-Steagall Act).

22. *See* Investment Co. Inst. v. Federal Deposit Ins. Corp., 815 F.2d 1540, 1546 (D.C. Cir.), *cert. denied*, 108 S.Ct. 143 (1987) (holding that affiliation between state-chartered, nonmember banks and securities firms does not violate Glass-Steagall Act); *infra* notes 89-

In *Securities Industry Associa ion v. Board of Governors of the Federal Reserve System (Schwab)*[23] the United States Supreme Court considered whether the acquisition by BankAmerica Corp. (BAC) of the Charles Schwab Corp. (Schwab) would violate section 20 of the Glass-Steagall Act.[24] BAC, a bank holding company, applied to the Federal Reserve Board (Board) for permission to acquire Schwab.[25] Schwab engaged in retail discount brokerage through a wholly owned subsidiary, Charles Schwab & Co.[26] At the Board ordered hearings before an Administrative Law Judge (ALJ) the Securities Industry Association (SIA) opposed BAC's application.[27] Nevertheless, the ALJ recommended that the Board approve BAC's acquisition of Schwab.[28] The Board, after review of the ALJ's recommendation, authorized BAC's acquisition of Schwab.[29] The SIA appealed the Board's approval of the acquisition to the United States Court of Appeals for the Second Circuit.[30] On appeal, the Second Circuit held that the Board acted within its statutory authority by approving BAC's acquisition of Schwab.[31] Accordingly, the Second Circuit affirmed the Board's order.[32] Subsequently, SIA appealed to the United States Supreme Court.[33]

On appeal, the Supreme Court in *Schwab* noted that section 20 of the Glass-Steagall Act barred BAC's acquisition if Schwab engaged principally

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97 and accompanying text (discussing *Investment Co. Inst.* decision and noting that member banks cannot maintain such affiliations); *see also* note 135 and accompanying text (noting that Competitive Equality in Banking Act of 1987 placed moratorium on nonmember banks affiliating with securities firms until March 1, 1988 by imposing §§ 20 and 32 of Glass-Steagall Act on nonmember banks).

23. 468 U.S. 207 (1984).

24. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 216-21 (1984) (Schwab). The Unites States Supreme Court in *Schwab* considered whether the Federal Reserve Board (Board) had the authority under the Bank Holding Company Act (BHC Act) to approve BankAmerica Corp. (BAC)'s acquisition of Schwab. *Id.* at 210-16. Section 4 of the BHC Act prohibits a bank holding company from acquiring a nonbank entity unless the BHC Act specifically exempts the acquisition. 12 U.S.C. § 1843 (1982). Section 4(c)(8) of the BHC Act allows bank holding companies to engage in nonbanking activities that are "so closely related to banking . . . as to represent a proper incident thereto." *Id.* § 1843(c)(8). The *Schwab* Court determined that the Board properly applied section 4(c)(8) to BAC's acquisition of Schwab and held that the Board had authority to approve BAC's acquisition of Schwab. *Schwab*, 468 U.S. at 216.

25. *Schwab*, 468 U.S. at 209. The Supreme Court in *Schwab* noted that BAC operates one subsidiary bank, Bank of America, and that Bank of America is a member bank. *Id.* at 210 n.1.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 716 F.2d 92, 95 (2d Cir. 1983).

32. *Id.*

33. *Schwab*, 468 U.S. at 209.

in the issue, flotation, underwriting, public sale, or distribution of securities.[34] The Court found that Schwab did not engage in any traditional underwriting activities.[35] The Court noted that Schwab acted solely as an agent for its customers.[36] Thus, the Court reasoned that because Schwab did not engage in underwriting or dealing in securities, the terms "issue," "flotation," "underwriting," and "distribution" did not apply to Schwab.[37] The Court interpreted the term "public sale" to refer to the activities described by the terms "issue," "flotation," "underwriting," and "distribution and to exclude the retail brokerage activities of Schwab."[38] The Court also noted that section 32 and section 20 of the Glass-Steagall Act contain identical language and that the Board's longstanding interpretation of section 32 excluded the activities of Schwab.[39] The Court held, therefore, that section 20 did not prohibit a subsidiary of a bank holding company from offering the brokerage services offered by Schwab.[40] Accordingly, the Supreme Court permitted affiliation between a bank holding company and a brokerage firm that buys and sells securities for the brokerage firm's customers without giving the customers investment advice.[41]

Although the Supreme Court in *Schwab* held that a bank holding company may acquire a subsidiary engaged solely in providing brokerage services, the Court did not address the question of whether a subsidiary also could provide investment advice.[42] In *Securities Industry Association v. Board of Governors of the Federal Reserve System* (*NatWest*)[43] the

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34. *Id.* at 216. The Supreme Court in *Schwab* noted that section 20 of the Glass-Steagall Act deals with bank affiliates. *Id.* The Court noted, further, that subsidiaries of bank holding companies are bank affiliates because of the bank holding company's ownership of a bank. *Id.* Additionally, the *Schwab* Court noted that section 16 did not apply to BAC because section 16 only applies to banks and does not apply to bank holding companies. *Id.* at 218 n.20; *see supra* notes 11-13 and accompanying text (discussing provisions of § 16 of Glass-Steagall Act).

35. *Schwab*, 468 U.S. at 218.

36. *Id.* The Supreme Court in *Schwab* noted that an underwriter normally buys and sells securities as a principal, and a broker executes orders for the purchase or sale of securities as an agent for the broker's customers. *Id.* at 217-18.

37. *Id.* at 217. The *Schwab* Court stated that Schwab did not issue or float securities. *Id.* The Court also reasoned that underwriting and distributing securities apply to functions distinct from the functions of a securities broker. *Id.* The Court noted that most securities firms act as underwriters and dealers, as well as brokers. *Id.* at 218 n.18. The Court reasoned, however, that Schwab was different from most securities firms because Schwab engaged solely in the brokerage business and did not underwrite or deal in securities. *Id.*

38. *Id.*

39. *Id.* at 218-19. The *Schwab* Court noted that Congress enacted the sections for the same purpose and that the sections are part of the same statute. *Id.*

40. *Id.* The *Schwab* Court reasoned that because the Board had interpreted the term "public sale" as used in section 32 to exclude brokerage services, the Court should interpret "public sale" in section 20 to exclude the brokerage services offered by Schwab. *Id.*

41. *Id.* at 221.

42. *See supra* note 40 and accompanying text (noting that *Schwab* Court only held that § 20 of Glass-Steagall Act did not prohibit bank affiliates from offering brokerage services).

43. 821 F.2d 810 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct 697 (1988).

United States District Court for the District of Columbia Circuit considered whether section 20 of the Glass-Steagall Act prohibited a bank from providing investment advice combined with brokerage services to institutional customers through a subsidiary.[44] National Westminster Bank PLC and its subsidiary NatWest Holdings, Inc. (collectively NatWest) applied to the Board for permission to provide investment advice and brokerage services to institutional customers through a subsidiary, County Services Corporation (CSC).[45] The Board approved NatWest's application.[46] Disagreeing with the Board's approval of the application, the SIA petitioned the District of Columbia Circuit for review.[47]

On review, the *NatWest* court noted that in *Schwab* the Supreme Court had held that the offering of discount brokerage services by an affiliate of a commercial bank did not violate section 20.[48] The *NatWest* court noted, further, that the Supreme Court has held that the independent provision of investment advice by a bank did not violate section 21 of the Glass-Steagall Act.[49] The D.C. Circuit agreed with the Board and similarly determined that in providing the combination of brokerage services and investment advice, CSC would act as an agent for its customers and not as a principal in buying and selling securities.[50] The court also determined that CSC would not offer securities to the public as an underwriter for the securities issuer.[51] The court reasoned, therefore, that CSC's activities

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44. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 821 F.2d 810, 811 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct 697 (1988) (NatWest). The *NatWest* court noted that section 20 of the Glass-Steagall Act prohibits a bank from affiliating with firms engaged in the public sale of securities. *Id.* The court reasoned, therefore, that the dispositive issue was whether NatWest's combined offering of investment advice and brokerage services would constitute a public sale. *Id.*

45. *Id.* at 811. The *NatWest* court noted that CSC would hold itself out as a corporate entity separate and distinct from NatWest. *Id.* at 812.

46. *Id.* at 812. The Board in *NatWest* reasoned that the combination of investment advice and brokerage services would not constitute a public sale of securities under sections 20 and 32 of the Glass-Steagall Act. *Id.* The Board also determined that section 4(c)(8) of the Bank Holding Company Act permitted NatWest's acquisition of CSC as a proper incident to banking. *Id.*; *see* 12 U.S.C. § 1843(c)(8) (1982) (allowing bank holding companies to engage in activities that are proper incidents to banking). The Board concluded that NatWest's ownership of CSC would not violate section 20 because the combination of investment advice and brokerage services would not constitute a public sale. *National Westminster Bank PLC*, 72 FED. RES. BULL. 584, 592 (1986).

47. *Natwest*, 821 F.2d at 812-13.

48. *NatWest*, 821 F.2d at 813.

49. *Id.*

50. *Id.* at 814.

51. *Id.* The *NatWest* court reasoned that by providing investment advice, NatWest would not transform CSC's provision of brokerage services into a public sale. *Id.* The court noted that providing investment advice may be an attribute of an underwriter. *Id.* Nevertheless, the court reasoned that advising does not necessarily imply underwriting. *Id.* The court distinguished underwriting activities from the activities of NatWest because underwriters either purchase as a principal securities from an issuer or act as the issuer's agent. *Id.* The court noted that CSC would not engage in either activity. *Id.*; *see supra* note 50 and

would not constitute a public sale as defined by the *Schwab* Court.[52] Accordingly, the D.C. Circuit held that NatWest's acquisition of CSC did not violate the Glass-Steagall Act and denied SIA's petition for review.[53]

While the *Schwab* and *NatWest* courts have upheld federal banking regulators' decisions allowing bank holding companies to establish subsidiaries that offer brokerage services and investment advice, courts also have decided that these subsidiaries may underwrite securities which banks may not underwrite (bank ineligible securities).[54] In *Securities Industry Association v. Board of Governors of the Federal Reserve System (Citicorp)*[55] the United States Court of Appeals for the Second Circuit considered whether section 20 of the Glass-Steagall Act prohibits a nonbank subsidiary of a bank holding company from underwriting and dealing in mortgage-backed securities and consumer-receiver-related securities.[56] The Board approved the applications of seven bank holding companies to underwrite and deal in mortgaged-backed securities and consumer-receivable-related securities.[57] The Board required, however, that the revenue from underwriting these securities must not exceed five percent of the subsidiaries' gross revenue.[58] Disagreeing with the Board's approval of the applications, the SIA petitioned the Second Circuit for review of the Board's decision.[59]

On review, the Second Circuit noted that section 20 prohibits banks from establishing subsidiaries that engage principally in the underwriting of bank ineligible securities.[60] The court reasoned, however, that the legislative history of the Glass-Steagall Act indicates that Congress did not intend section 20 to prohibit bank subsidiaries from underwriting

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accompanying text (noting that CSC, as principal, would not buy securities from issuer or offer securities to customers as issuer's agent). The court noted, further, that CSC would not have any financial incentive to advise a customer to purchase a particular company's security. *NatWest*, 821 F.2d at 817. CSC's commission related only to the number of shares traded and not from trading a particular company's shares. *Id.*

52. *NatWest*, 821 F.2d at 814.

53. *Id.* at 811. The *NatWest* court noted that the hazards that exist when banks affiliate with securities firms were unlikely to occur with CSC. *Id.* at 818; *see supra* note 3 (discussing legislative history of Glass-Steagall Act and noting that Congress intended Glass-Steagall Act to prevent hazards from banks affiliating with securities firms).

54. *See supra* notes 24 & 42 and accompanying text (noting that courts have considered whether bank holding companies may affiliate with firms that offer brokerage services or establish subsidiaries that offer investment advice and brokerage services); *infra* notes 55-64 and accompanying text (discussing Second Circuit's consideration of whether subsidiary of bank holding company may underwrite and deal in mortgage-backed securities and consumer-receiver-related securities).

55. 839 F.2d 47 (2d Cir. 1988).

56. Securities Ind. Ass'n v. Board of Governors of the Fed. Reserve Sys., 839 F.2d 47, 50 (2d Cir. 1988) (Citicorp).

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 52; *see supra* note 15 and accompanying text (discussing provisions of § 20).

securities that section 16 allowed banks to underwrite.[61] The court concluded, therefore, that the engaged principally test in section 20 applies only to underwriting and dealing in bank ineligible securities and not to all securities activities.[62] The court concluded, further, that the Board's five percent limitation on gross revenue from underwriting bank ineligible securities was a reasonable interpretation of the term "engaged principally".[63] The court held, therefore, that section 20 did not prohibit subsidiaries of bank holding companies from underwriting bank ineligible securities up to five percent of the subsidiaries' gross revenue.[64]

In addition to deciding that subsidiaries of bank holding companies may underwrite bank ineligible securities, courts also have decided that certain activities directly engaged in by banks do not constitute the securities activities prohibited by the Glass-Steagall Act.[65] In *Securities Industry Association v. Board of Governors of the Federal Reserve System* (*Bankers Trust II*)[66] the United States Court of Appeals for the District of Columbia Circuit considered whether the private placement of commercial paper by Bankers Trust Company (Bankers Trust), a member bank, violated sections 16 and 21 of the Glass-Steagall Act.[67] The SIA petitioned the Board for a ruling to determine whether Bankers Trust violated sections 16 and 21 of the Glass-Steagall Act by engaging in the private placement of commercial paper.[68] The Board ruled that commercial paper was not a security under the Glass-Steagall Act and thus determined that Bankers Trust did not violate sections 16 and 21 of the Glass-Steagall Act.[69]

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61. *Citicorp*, 839 F.2d at 52. The *Citicorp* court noted that section 16 of the Glass-Steagall Act permits banks to underwrite and deal in certain governmental securities. *Id.*

62. *Id.* at 53.

63. *Id.* at 54. The *Citicorp* court noted that the Board had determined that the term "engaged principally" denoted substantial activity. *Id.* The *Citicorp* court concluded that the Board's determination that five percent of gross revenue constituted substantial activity was reasonable. *Id.*

64. *Id.* at 55.

65. *See supra* note 54 and accompanying text (noting that courts have considered whether subsidiaries of bank holding companies may underwrite and deal in bank ineligible securities); *infra* notes 67-86 and accompanying text (discussing D.C. Circuit's consideration of whether bank may engage in private placement of commercial paper).

66. 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 107 S.Ct. 3328 (1987).

67. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 807 F.2d 1052, 1055 (D.C. Cir. 1986) (Bankers Trust II), *cert. denied*, 107 S.Ct. 3328 (1987). The United States Court of Appeals for the D.C. Circuit in *Bankers Trust II* noted that in the private placement of commercial paper Bankers Trust advises commercial paper issuers of the interest rates and maturities that institutional investors will accept, solicits purchasers for the paper, and places the issue of paper with the purchaser. *Id.* The D.C. Circuit noted, further, that Bankers Trust receives a commission from the services, but that Bankers Trust does not purchase or repurchase the paper for its own account or make or collateralize loans with the paper that Bankers Trust places. *Id.*

68. *Id.* at 1055; *see supra* notes 11-13 and accompanying text (discussing provisions of § 16); *supra* note 16 and accompanying text (discussing provisions of § 21).

69. *Bankers Trust II*, 807 F.2d at 1055.

In *Securities Industry Association v. Board of Governors of the Federal Reserve System* (*Bankers Trust I*)[70] the United States Supreme Court, however, overruled the Board and held that commercial paper was within the term "securities" under the Glass-Steagall Act.[71] The Court remanded the case to the Board to resolve the issue of whether Bankers Trust's placement of commercial paper constituted the underwriting prohibited by section 16 of the Glass-Steagall Act.[72] On remand, the Board found that Bankers Trust's placement constituted the selling solely for the account of customers, an activity that section 16 of the Glass-Steagall Act specifically permits.[73] In *Bankers Trust II* the SIA petitioned the United States District Court for the District of D.C. for review of the Board's decision on remand from *Bankers Trust I*.[74] On review, the district court granted SIA summary judgment holding that Bankers Trust's activities involved the underwriting and distribution prohibited by section 21 of the Glass-Steagall Act.[75] Bankers Trust appealed to the United States Court of Appeals for the D.C. Circuit.[76]

On appeal, the D.C. Circuit determined that section 21 applied only if section 16 prohibited the securities' activities.[77] The court rejected the argument of the SIA that section 21's prohibition on selling or dealing in securities applied to activities permitted by section 16.[78] The court examined the legislative history of section 21 and determined that Congress did not intend section 21 to apply to activities permitted by section 16.[79] Thus, the court stated that if section 16 permitted Bankers Trust's activities, the court did not have to determine whether section 21 prohibits the activities.[80]

The D.C. Circuit noted that the Glass-Steagall Act did not define the term "underwriting" as used in section 16 and stated that the legislative history of the Glass-Steagall Act did not clarify the term.[81] The court

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70. 468 U.S. 137 (1984).

71. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 137, 160 (1984) (Bankers Trust I).

72. *Id.* at 160 n.12. The United States Supreme Court in *Bankers Trust I* noted that because the D.C. Circuit had concluded that commercial paper was not a security, the D.C. Circuit had not considered whether Bankers Trust's activity constituted issuing, distributing, or underwriting as prohibited by the Glass-Steagall Act. *Id.* Thus the *Bankers Trust I* Court expressed no opinion on that issue. *Id.*

73. *Bankers Trust II*, 807 F.2d at 1055.

74. *Id.*

75. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 627 F.Supp. 695 (D.D.C. 1986).

76. *Bankers Trust II*, 807 F.2d at 1055.

77. *Id.* at 1057. The *Bankers Trust II* court noted that section 21 logically cannot prohibit what section 16 permits. *Id.*

78. *Id.*

79. *Id.* at 1057-58. The *Bankers Trust II* court noted that Congress amended section 21 to clarify the relationship between sections 16 and 21. *Id.* at 1055. The court reasoned that the amendment implied that courts must read sections 16 and 21 together. *Id.*

80. *Id.* at 1057.

81. *Id.* at 1062.

examined the contemporaneous securities legislation to determine the meaning that Congress attached to the term "underwriting" in the Glass-Steagall Act.[82] The court concluded that Congress intended the term "underwriting" to apply to public offerings.[83] Additionally, the court examined the legislative history of the Glass-Steagall Act to determine whether Bankers Trust's private placement of commercial paper frustrated the underlying purpose of the Glass-Steagall Act.[84] The court concluded that private placement of commercial paper did not thwart Congress' intent to eliminate risks in the banking industry.[85] Accordingly, the D.C. Circuit reversed the district court's judgment and reinstated the Board's decision that Banker's Trust private placement of commercial paper did not constitute underwriting and thus did not violate the Glass-Steagall Act.[86]

Although the Supreme Court in *Schwab* and the Courts of Appeal in *NatWest*, *Citicorp*, and *Bankers Trust II* considered the effect of the Glass-Steagall Act on subsidiaries of member banks and the securities activities of member banks, the courts did not address the issue of whether the Glass-Steagall Act prohibited nonmember banks from establishing subsidiaries that engage in securities activities.[87] In *Investment Company Institute v. Federal Deposit Insurance Corp*[88] the United States Court of Appeals for the D.C. Circuit considered whether state-chartered banks that are not members of the Federal Reserve System may maintain subsidiaries that engage in securities activities.[89] In *Investment Company*

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82. *See id.* at 1062-64 (examining Securities Act of 1933 and Securities Exchange Act of 1934 and noting that Supreme Court in *Bankers Trust I* had examined the definition of "security" in contemporaneous legislation to determine meaning of term "security" in Glass-Steagall Act).

83. *Id.* at 1064. The *Bankers Trust II* court concluded that the Securities Act of 1933 and the Securities Exchange Act of 1934 made clear that Congress understood the term "underwriting" to mean a public offering. *Id.* The court concluded that the distinction between public and private offerings was consistent with Congress' intent in enacting the Glass-Steagall Act. *Id.* at 1066.

84. *Id.* at 1065-66.

85. *Id.* at 1066; *see supra* notes 2-5 and accompanying text (discussing legislative history of Glass-Steagall Act and noting intent of Congress in enacting Glass-Steagall Act).

86. *Bankers Trust II*, 807 F.2d at 1055.

87. *See supra* notes 24, 42, 54 & 65 and accompanying text (noting that courts have considered effect of Glass-Steagall Act on member banks); *infra* notes 89-97 and accompanying text (discussing D.C. Circuit's consideration of effect of Glass-Steagall Act on nonmember banks).

88. 815 F.2d 1540 (D.C. Cir.), *cert. denied*, 108 S.Ct. 143 (1987).

89. Investment Co. Inst. v. Federal Deposit Ins. Corp., 815 F.2d 1540, 1542 (D.C. Cir.), *cert. denied*, 108 S.Ct. 143 (1987). The United States Court of Appeals for the D.C. Circuit in *Investment Co. Inst.* noted that federal regulations divide banks into three distinct categories. *Id.* The Board of Governors of the Federal Reserve System governs banks that choose to become members of the Federal Reserve System. *Id.* National banks are within the jurisdiction of the Comptroller of the Currency. *Id.* The Federal Deposit Insurance Corporation regulates insured state-chartered banks that are not members of the Federal Reserve System. *Id.*

Institute the Investment Company Institute (ICI) filed a petition for review of a Federal Deposit Insurance Corporation (FDIC) regulation that allowed insured nonmember banks to maintain subsidiaries that engage in securities activities.[90] The ICI also filed a suit seeking to enjoin the FDIC from enforcing the regulation in the United States District Court for the District of Columbia.[91] The district court granted summary judgment against the ICI.[92] The D.C. Circuit considered the case both on appeal from the district court's grant of summary judgment and on the original petition for review.[93] On review, the D.C. Circuit noted that only section 21 of the Glass-Steagall Act regulates nonmember banks.[94] The court stated that section 21 bars securities firms from receiving deposits, but does not address whether nonmember banks may establish affiliations with firms that engage in securities activities.[95] The court reasoned that to interpret section 21 to prohibit nonmember banks from having affiliates engaged in securities activities would be inconsistent with other sections of the Glass-Steagall Act.[96] Accordingly, the *Investment Company Institute* court held that the FDIC regulation allowing nonmember banks to have affiliates and subsidiaries engaged in securities activities did not violate section 21 of the Glass-Steagall Act.[97]

III. THE CONTROVERSY OVER THE GLASS-STEAGALL ACT

A. *Support for the Repeal of the Glass-Steagall Act*

Some commentators and members of Congress, noting the judicial and administrative decisions that have allowed banks to engage in securities

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90. *Id.* at 1543.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.* at 1547.
95. *Id.*
96. *Id.* In *Investment Co. Inst.* the ICI argued that section 20 of the Glass-Steagall Act, which allows banks to affiliate with firms doing limited securities work, is a special exception to section 21 for member banks. *Id.* The ICI argued, further, that nonmember banks cannot maintain any affiliate relationships with securities firms. *Id.* The D.C. Circuit stated that because Congress did not intend section 21 to extend to activities of affiliates, Congress did not indicate that section 20 was an exception to section 21. *Id.* at 1548. The court reasoned, therefore, that under the ICI's argument member banks would be subject to less stringent regulation than nonmember banks. *Id.* The court stated that because the legislative history of the Glass-Steagall Act indicates that Congress was unsure whether Congress had the power to regulate nonmember banks, the result under the ICI's argument would be irrational. *Id.* The court rejected, therefore, the ICI's argument as unsupported by the legislative history of the Glass-Steagall Act. *Id.*
97. *Id.* at 1550; *see infra* note 135 and accompanying text (noting that Competitive Equality in Banking Act of 1987 prohibited affiliations between nonmember banks and securities firms until March 1, 1988 by imposing §§ 20 and 32 of Glass-Steagall Act on nonmember banks).

activities, have called for the repeal of the Glass-Steagall Act.[98] Some of those in favor of repealing the Glass-Steagall Act also believe that the Glass-Steagall Act was not essential to protect bank depositors and the banking system.[99] Additionally these commentators and members of Congress believe that the Glass-Steagall Act is no longer necessary because of the many changes that have occurred in the banking and securities industries since the passage of the Glass-Steagall Act.[100]

Commentators argue that the Glass-Steagall Act does not add stability to the banking system because of the numerous judicially and administratively created exceptions to the Glass-Steagall Act.[101] Commentators reason that the activities permitted under the exceptions to the Glass-Steagall Act are as risky or riskier than the activities prohibited by the Glass-Steagall Act.[102] Commentators note that, in addition to the various exceptions to the Glass-Steagall Act, the Glass-Steagall Act does not prohibit banks from underwriting securities issued in foreign countries.[103] Representatives of the banking industry argue, therefore, that because banks may make loans to American corporations and underwrite and distribute these corporations' bonds abroad, the prohibition by the Glass-Steagall Act on underwriting and distributing bonds in the United States is illogical.[104]

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98. *See, e.g.*, Friedman & Freisen, *A New Paradigm for Financial Regulation: Getting From Here to There*, 43 MD. L. REV. 413 (1984) (discussing need to alter regulatory scheme of Glass-Steagall Act); Longstreth, *Glass-Steagall: The Case For Repeal*, 31 N.Y.L. SCH. L. REV. 281 (1986) (arguing for repeal of Glass-Steagall Act); Note, *Restrictions on Bank Underwriting of Corporate Securities: A Proposal for More Permissive Regulation*, 97 HARV. L. REV. 720 (1984) (arguing for lessening of restrictions on commercial banks to allow banks to engage in wider array of securities activities through securities affiliates of bank holding companies); 133 CONG. REC. S16,659 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire) (introducing bill to repeal §§ 20 and 32 of Glass-Steagall Act); *infra* notes 99-105 and accompanying text (discussing reasoning of commentators that believe that Congress should repeal Glass-Steagall Act); *supra* notes 23-97 and accompanying text (discussing court decisions upholding banking regulators' interpretations of Glass-Steagall Act that allow banks to engage in securities activities and affiliate with securities firms).

99. *See infra* notes 106-09 and accompanying text (discussing reasoning of commentators that believe that the Glass-Steagall Act was not the main factor in protecting bank deposits and restoring stability to banking system).

100. *See infra* notes 110-14 and accompanying text (discussing reasoning of commentators who believe that because of growth and changes in banking and securities industries, Glass-Steagall Act is no longer necessary).

101. *See* Longstreth, *supra* note 98, at 284 (arguing that because of exceptions to Glass-Steagall Act, no one can reasonably believe that Glass-Steagall Act adds stability to banking system); Note, *supra* note 98, at 726 (noting inconsistencies and exceptions in separation of commercial and investment banking and arguing that result is that statutory framework does not protect bank soundness).

102. *See* Note, *supra* note 98, at 726 (reasoning that activities allowed under exceptions to Glass-Steagall Act are as risky as underwriting corporate bonds).

103. *See* Note, *supra* note 98, at 726 (noting that banks may underwrite foreign securities); *see also supra* notes 23-97 and accompanying text (discussing decisions that have recognized exceptions to Glass-Steagall Act).

104. *See Modernization of the Glass-Steagall Act: Hearings Before the Senate Comm.*

These commentators conclude, therefore, that repealing the Glass-Steagall Act would not subject the banking system to increased risks.[105]

In addition to arguing that Congress should repeal the Glass-Steagall Act in light of the exceptions to the Act and the inapplicability of the Act to foreign securities, those in favor of the repeal of the Glass-Steagall Act believe that the Act's separation of commercial and investment banking was not essential to restore financial stability and protect bank depositors.[106] Commentators believe that Congress has continued the separation between commercial and investment banking found in the Glass-Steagall Act because of the fear that banking and securities conglomerates would dominate the business community and not because of the concern for the safety and soundness of banks.[107] Commentators argue that the FDIC's system of federally insured deposits serves to protect depositors and restore financial stability.[108] Representatives of the banking industry also argue that the Glass-Steagall Act serves only to protect the securities industry from competition and not to protect the stability of the banking system.[109]

Commentators argue that because the Glass-Steagall Act is no longer necessary to ensure bank stability and safety and because of the numerous exceptions to the Glass-Steagall Act, Congress should repeal the Glass-Steagall Act to reflect the changes that have occurred in the banking and securities industry since the passage of the Glass-Steagall Act.[110] Critics of the Glass-Steagall Act note that rather than the traditional form of

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on Banking, Housing, and Urban Affairs, 100th Cong., 1st Sess. 140 (1987) (statement of Thomas Johnson, President, Chemical Bank) (hereinafter 1987 Hearings) (noting that banks may underwrite and distribute corporate bonds abroad and reasoning that Congress should allow banks to underwrite and distribute corporate bonds in the United States).

105. *See id.* at 727-28 (arguing that repeal of Glass-Steagall Act to allow underwriting would not subject banks to uncontrollable risks).

106. *See* Longstreth, *supra* note 98, at 281-82 (reasoning that lack of public confidence caused unsoundness of banking system and Glass-Steagall Act was not essential to restore public confidence).

107. *See id.* at 283 (noting that Congress reaffirmed Glass-Steagall Act in passing Bank Holding Company Act of 1956 and subsequent amendments and reasoning that Congress reaffirmed Glass-Steagall Act to prevent banking and securities conglomerates from emerging); *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and S. 6778 Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 13 (1970) (testimony of Charles E. Walker, UnderSecretary of the Treasury) (stating that Congress did not need to enact legislation separating banking and securities industry to protect safety or solvency of banks).

108. Longstreth, *supra* note 98, at 282; *see* 12 U.S.C. § 1811 (1982) (creating Federal Deposit Insurance Corp. (FDIC) to insure bank deposits and regulate banks insured by FDIC); 12 U.S.C. § 1821 (1982) (establishing fund to insure bank deposits up to $100,000).

109. *See* 1987 Hearings, *supra* note 103, at 140 (suggesting that securities industry is not competitive because 10 securities firms control 60% of capital in securities industry and over one half of pretax profits in industry).

110. *See* Longstreth, *supra* note 98, at 287 (noting that traditional business of banks has changed and that this change has weakened banks); 1987 Hearings, *supra* note 103, at 141 (reasoning that banking system should reflect current technology and reality of international competition and antiquated regulations harm consumers).

borrowing through the short-term commercial loan, corporate borrowers now obtain a securitized loan by issuing commercial paper.[111] Furthermore, critics of the Glass-Steagall Act note that depositors whose deposits funded the commercial loans now invest in money market funds and commercial paper.[112] Commentators believe, therefore, that the Glass-Steagall Act prevents banks from remaining competitive as the business of lending evolves.[113] Accordingly, commentators argue that Congress should repeal the Glass-Steagall Act to ensure that commercial banks remain competitive and viable.[114]

B. *The Case for Retaining the Glass-Steagall Act*

Those opposing the repeal of the Glass-Steagall Act offer several arguments that reject the contentions of those supporting the repeal.[115] Those opposing the repeal do not believe that the existence of judicially and administratively created exceptions to the Glass-Steagall Act necessarily leads to the conclusion that Congress should repeal the Act.[116] Supporters of the Act argue, instead, that Congress should legislatively eliminate the judicial and administrative exceptions.[117] Those opposed to the repeal of the Glass-Steagall Act also reject the idea that the Act was unnecessary to restore financial stability and protect bank depositors.[118] Although

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111. *See* Longstreth, *supra* note 98, at 287 (noting that commercial paper now equals one half of amount of commercial loans by banks); 1987 Hearings, *supra* note 104, at 141 (noting that issuing commercial paper is most efficient way for large firms to obtain short-term funding).

112. Longstreth, *supra* note 98, at 287; *see* 1987 Hearings, *supra* note 104, at 141 (noting that mutual funds represent increasingly attractive way for consumers to invest savings).

113. *See* Longstreth, *supra* note 98, at 288 (noting that by preventing banks from evolving, Glass-Steagall Act impairs banks' soundness); *see also supra* notes 111-12 and accompanying text (noting changes that have occurred in banking industry).

114. Longstreth, *supra* note 98, at 288; *see* 1987 Hearings, *supra* note 104, at 141 (reasoning that Congress should repeal Glass-Steagall Act to ensure healthier earnings for banking system based in United States, not abroad); *see also supra* notes 99-113 and accompanying text (discussing reasoning of commentators that support repeal of Glass-Steagall Act).

115. *See infra* notes 116-32 and accompanying text (discussing reasoning of opponents of repeal of Glass-Steagall Act and opponents' arguments rejecting reasoning of proponents of repeal).

116. *See* Note, *Federal Regulation of Bank Securities Activities: Will Congress Allow Glass-Steagall to be Shattered?*, 12 J. CONTEMP. L. 99, 133 (arguing that judicial and administrative interpretations of Glass-Steagall Act that have allowed banks to engage in securities activities are impairing soundness of banking system).

117. *See* O'Brien, *Financial Deregulation: The Securities Industry Perspective*, 31 N.Y.L. SCH. L. REV. 271, 278 (1986) (arguing that piecemeal dismantling of Glass-Steagall Act has weakened securities industry); Note, *supra* note 116, at 135 (arguing that Congress should reaffirm barriers of Glass-Steagall Act); *supra* notes 23-97 and accompanying text (discussing court decisions upholding federal regulators' interpretations of Glass-Steagall Act that allow banks to engage in securities activities).

118. *See infra* notes 119-21 and accompanying text (reasoning that Glass-Steagall Act was essential to restore financial stability and public confidence in banking system and to protect bank depositors).

federal banking regulators may prevent some of the inherent risks encountered by banks engaging in securities activities, the nature of the securities industry prevents the elimination of all risks.[119] These commentators argue that the separation between commercial and investment banking has reduced the risks inherent when commercial banks become involved in securities activities.[120] Those opposed to repeal reason, therefore, that Congress should not repeal the Glass-Steagall Act because of the increased risks that occur when commercial banks enter the securities industry.[121] Opponents argue, further, that the changes in financial technology do not justify removing the barriers between commercial and investment banking.[122] Opponents believe, instead, that the growth in technology allows banks to abuse the combination of credit allocation by banks and capital raising by securities firms.[123] Thus, opponents argue that Congress should not repeal the Glass-Steagall Act because the abuses of the 1920's and 1930's could occur today if Congress permits banks to engage in securities activities.[124]

In addition to rejecting the arguments of those in favor of repealing the Glass-Steagall Act, those opposed to repeal offer additional arguments to support preservation of the Glass-Steagall Act.[125] Opponents of repeal argue that the securities industry is already competitive and the entry by banks will not increase competitiveness because the securities firms have competed on price for several years.[126] Additionally, commentators opposed to repeal reason that the acquisitions of firms in the securities industry by companies such as Sears, Prudential, and Equitable indicate that the ease of entry into the securities industry has prevented securities

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119. *See* O'Brien, *supra* note 117, at 276 (reasoning that because of risky nature of securities markets, banking regulators likely cannot prevent all risks that arise when commercial banks enter investment banking).

120. *See* Note, *supra* note 116, at 133 (noting that history of period following enactment of Glass-Steagall Act has shown that separating commercial banks from investment banking has eliminated dangers and risks in banking that Congress intended Glass-Steagall Act to eliminate).

121. *See* O'Brien, *supra* note 117, at 276 (arguing that securities abuses of 1920's could occur today if Congress removes barriers between commercial banks and securities industry); *see also supra* note 3 (discussing legislative history of Glass-Steagall Act and noting that Congress believed that risks occur when commercial banks engage in investment banking).

122. O'Brien, *supra* note 117, at 276.

123. *Id.*

124. *See id.* (arguing that abuses of the 1920's could occur today if Congress allows banks to engage in underwriting securities); Note, *supra* note 116, at 134 (reasoning that Congress intended Glass-Steagall Act to ensure banking soundness in future as well as correct abuses of 1920's and 1930's and that repeal of Glass-Steagall Act could endanger banking system today).

125. *See infra* notes 126-32 and accompanying text (discussing arguments of opponents of repeal of Glass-Steagall Act).

126. O'Brien, *supra* note 117, at 276. The Securities and Exchange Commission deregulated commission rates of securities firms in 1975 and, therefore, increased competition in the securities industry. SEC Release No. 11,203 [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) § 80,067 (Jan. 23, 1975).

firms from eliminating competitiveness in the securities industry.[127] Opponents of repeal also argue that the viability of securities firms should be a policy concern when considering whether to allow banks to have securities affiliates.[128] The opponents of repeal argue that large banks could take the lead in the securities industry as the banks did in the 1920's with similar devastating results.[129] Those opposed to repeal also argue that because of current weaknesses in the banking system, Congress would be unwise to allow banks to increase risks by entering the securities industry.[130] Finally, opponents argue that banks have been given special advantages involving credit and federal insurance because of the banks' role as trustees of depositors' funds.[131] Because of the special role of banks and the banks credit advantages, opponents of repeal, therefore, contend that Congress should not allow the banks to enter the securities industry.[132]

C. *Congressional Response*

Because of the debate over whether Congress should repeal the Glass-Steagall Act, Congress passed the Competitive Equality in Banking Act of 1987 (1987 Act) to give Congress an opportunity to review banking and financial laws and to make decisions on the need for financial restructuring legislation.[133] The 1987 Act placed a moratorium on certain securities, insurance, and real estate activities by banks until March 1, 1988.[134] The 1987 Act also required state-chartered, nonmember banks to adhere to sections 20 and 32 of the Glass-Steagall Act until March 1, 1988.[135] The 1987 Act also stated that Congress intended to complete its review of the banking system and make any decisions on restructuring the system before the moratorium expired.[136]

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127. *See* O'Brien, *supra* note 117, at 276 (discussing competitiveness of securities industry).

128. Note, *supra* note 116, at 133.

129. *Id.*

130. *See* O'Brien, *supra* note 117, at 274 (discussing weaknesses of banking system and noting that banks today are in weakest condition since 1930's).

131. *Id.* at 276; *see* 133 CONG. REC. S16,663 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire) (noting that Federal Reserve's discount to banks provides low cost funds to borrowing bank and that bank's securities affiliates' use of low cost funds would disadvantage securities firms not affiliated with bank).

132. O'Brien, *supra* note 117, at 276; *see supra* note 131 and accompanying text (noting that banks can borrow money at a discount from Federal Reserve and, therefore, banks' securities affiliates can obtain money at lower cost than securities firms not affiliated with banks).

133. Competitive Equality in Banking Act of 1987, Pub. L. No. 100-86 § 203, 101 Stat. 552, 584 (to be codified in scattered sections of 12 U.S.C.) (hereinafter 1987 Act).

134. *Id.* § 201, 101 Stat. at 581-83.

135. *Id.* § 103, 101 Stat. at 566; *see supra* notes 89-97 and accompanying text (discussing *Investment Co. Inst. v. Federal Deposit Ins. Corp.* and the D.C. Circuit's holding that §§ 20 and 32 of Glass-Steagall Act do not apply to state-chartered, nonmember banks).

136. 1987 Act, *supra* note 133, § 203. The 1987 Act also stated that Congress did not intend to extend the moratorium regardless of whether or not Congress passed subsequent banking legislation. *Id.*

After committee hearings on whether Congress should repeal the Glass-Steagall Act and restructure the banking system,[137] Senator Proxmire introduced Senate Bill Number 1886 (S. 1886).[138] The Senate passed S. 1886 on March 30, 1988.[139] If passed by the House of Representatives, S. 1886 would repeal sections 20 and 32 of the Glass-Steagall Act.[140] S. 1886 also contains several other provisions that affect the relationship between the banking and securities industries.[141] The repeal of sections 20 and 32 of the Glass-Steagall Act would permit banks to affiliate with securities firms and, under certain circumstances, would allow banks and securities firms to have common officers and directors.[142] S. 1886 requires that firms that intend to engage in banking and securities activities affiliate through a holding company structure.[143] S. 1886 also prohibits a bank from lending money to the bank's securities affiliates, to mutual funds that the bank advises, to a company for the purpose of repaying securities underwritten by the bank's securities affiliate, or to investors for the purpose of purchasing securities underwritten by the bank's securities affiliate.[144] In addition to permitting banks to affiliate with securities firms, S. 1886 permits banks to underwrite municipal revenue bonds.[145] S. 1886 also allows banks that have no securities affiliates to issue mutual fund shares

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137. 1987 Hearings, *supra* note 104; *New Securities Powers for Bank Holding Companies: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. (1987); *Status of United States Financial System: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. (1987).

138. *See* 133 CONG. REC. S16,659-668 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire) (introducing S. 1886 and discussing major provisions of bill); *infra* notes 140-48 and accompanying text (noting major provisions of S. 1886 that affect separation between commercial and investment banking); *infra* note 140 and accompanying text (noting that Senate passed S. 1886 on March 30, 1988). An amendment to S. 1886 passed by the Senate renamed the bill the Proxmire Financial Modernization Act of 1988. 134 CONG. REC. S3424 (daily ed. March 30, 1988).

139. 134 CONG. REC. S3437 (daily ed. March 30, 1988).

140. S. 1886, 100th Cong., 1st Sess. § 101, 134 CONG. REC. S3360 (daily ed. March 30, 1988).

141. *See* 133 CONG. REC. S16,659-668 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire) (introducing S. 1886 and discussing major provisions of bill); *infra* notes 142-48 and accompanying text (noting major provisions of S. 1886 that affect banking and securities industries).

142. *See* 133 CONG. REC. S16,652 (daily ed. Nov. 20, 1987) (statement of Senator Proxmire) (stating that because of repeal of §§ 20 and 32 of Glass-Steagall Act, banks could affiliate with securities firms); *supra* note 15 and accompanying text (noting provisions of §§ 20 and 32 of Glass-Steagall Act).

143. *See* S. 1886 100th Cong., 1st Sess. § 102, 134 CONG REC. S3360 (daily ed. March 30, 1988) (requiring that banks affiliate with securities firms only through bank holding company structure).

144. *See id.* (amending § 4(c) of Bank Holding Company Act to regulate the funding of securities affiliates by prohibiting loans between bank and affiliated securities firm); *supra* note 24 (discussing § 4 of the Bank Holding Company Act).

145. *See* S. 1886, 100th Cong., 1st Sess. § 108, 134 CONG. REC. S3363 (daily ed. March 30, 1988) (authorizing commercial banks to underwrite municipal revenue bonds).

and sponsor unit investment trusts.[146] S. 1886, however, prohibits mergers between bank holding companies whose assets exceeded thirty billion dollars and securities firms with assets in excess of fifteen billion dollars.[147] The limitation on mergers prohibits mergers between the fifteen largest banks and the fifteen largest securities firms.[148]

IV. Should Congress Repeal the Glass-Steagall Act?

The provisions of S. 1886 provide a mechanism to eliminate the Glass-Steagall Act's separation of commercial and investment banking.[149] Sponsors of S. 1886 correctly recognize that the separation between commercial banking and the securities industry is no longer necessary to protect the stability of the banking system and bank depositors.[150] By repealing sections 32 and 20 of the Glass-Steagall Act, S. 1886 allows banks to affiliate with securities firms, but retains the prohibition against banks' directly dealing in or underwriting securities.[151] S. 1886 thus protects the safety of a bank by requiring a separate capitalization of a securities affiliate.[152] The prohibition in S. 1886 against loans from a bank to a securities affiliate will protect the federal deposit insurance program and ensure the safety of bank deposits.[153] The provision in S. 1886 prohibiting a loan from a bank to the bank's securities affiliate also alleviates Congress' fear that a bank would loan money to a financially weak securities affiliate to maintain public confidence.[154]

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146. *Id.*

147. *See id.* § 102, 134 CONG. REC. S3360 (daily ed. March 30, 1988) (regulating concentration of resources between banks and securities firms).

148. 133 CONG. REC. S16,663 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire); *see supra* note 107 and accompanying text (noting that Congress reaffirmed Glass-Steagall Act because Congress feared that conglomerates of banking and securities firms would dominate business community).

149. *See supra* notes 140-48 and accompanying text (discussing provisions of S. 1886). S. 1886 also addresses the concerns of those opposed to the repeal of the Glass-Steagall Act. *See supra* notes 116-32 and accompanying text (discussing reasoning of those opposed to repeal of Glass-Steagall Act); *infra* notes 150-68 and accompanying text (analyzing provisions of S. 1886).

150. *See supra* note 108 and accompanying text (noting that creation of FDIC rather than enactment of Glass-Steagall Act protected bank depositors and ensured stability of banking system).

151. *See supra* notes 11-14 and accompanying text (noting that §§ 5 and 16 of Glass-Steagall Act prohibit banks from underwriting or dealing in securities). S. 1886 would repeal only sections 20 and 32 of the Glass-Steagall Act. S. 1886, 100th Cong., 1st Sess. § 101 (1987).

152. *See* S. 1886, 100th Cong., 1st Sess. § 102, 134 CONG. REC. S3360 (daily ed. March 30, 1988) (requiring that bank holding company capitalize securities affiliate separately from bank holding company's banking subsidiary).

153. *See supra* note 144 and accompanying text (noting that S. 1886 prohibits loans from bank to bank's securities affiliate); *see also supra* note 3 and accompanying text (discussing legislative history of Glass-Steagall Act and noting that Congress feared that banks would make unsound loans to securities affiliates).

154. *See supra* note 144 and accompanying text (noting that S. 1886 prohibits loans

In addition to recognizing that the Glass-Steagall Act does not serve to protect the safety of the banking system and of depositors' funds, sponsors of S. 1886 also correctly recognize that the Glass-Steagall Act's separation of commercial and investment banking is unnecessary in view of the exceptions to the Act.[155] Because banks can underwrite the bonds of United States corporations abroad, banks should be able to underwrite these bonds in the United States.[156] A bank would incur no greater risk from underwriting activities in the United States than from underwriting activities abroad.[157]

While S. 1886 does not increase the risk of bank depositors, S. 1886 does ensure that banks will not have a competitive edge in competing with securities firms.[158] Because S. 1886 prohibits banks from making loans to securities affiliates, banks cannot use funds borrowed from the Federal Reserve System at a discount to loan money to securities affiliates at a discount and, therefore, give the affiliate an advantage over securities firms not affiliated with a bank.[159] Furthermore, S. 1886 eliminates the anti-competitive effects of the Glass-Steagall Act.[160] The increased competition between banks and securities firms in the area of municipal bonds will be especially beneficial to consumers.[161] By allowing banks to underwrite municipal bonds, S. 1886 will cause competition to reduce under-

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from banks to securities affiliates); *see also supra* note 3 and accompanying text (discussing legislative history of Glass-Steagall Act and noting that Congress feared that bank may make unsound loans to financially unsound securities affiliate to maintain public confidence in bank).

155. *See supra* notes 101-05 and accompanying text (reasoning that because of the numerous exceptions to Glass-Steagall Act, Congress should repeal Glass-Steagall Act); *see also supra* notes 23-97 and accompanying text (discussing court decisions upholding administratively created exceptions to Glass-Steagall Act).

156. *See supra* note 103 and accompanying text (noting that banks may underwrite in foreign countries bonds issued by United States corporations).

157. *See* Longstreth, *supra* note 98, at 285 (stating that underwriting bonds in United States is no riskier than underwriting bonds abroad or than other activities permitted by exceptions to Glass-Steagall Act).

158. *See supra* notes 131-32 and accompanying text (arguing that Congress should not repeal Glass-Steagall Act because of special credit advantages of banks); *infra* note 159 and accompanying text (noting that banks cannot use funds borrowed at discount to loan funds to securities affiliates).

159. *See supra* note 144 and accompanying text (noting that S. 1886 prohibits banks from making loans to banks' own securities affiliates); 133 CONG. REC. S16,663 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire) (reasoning that Federal Reserve's discount to banks provides low cost funds to borrowing banks and that securities affiliate's use of funds borrowed at a discount would disadvantage securities firms not affiliated with banks).

160. *See supra* note 109 and accompanying text (reasoning that Glass-Steagall Act has insulated securities industry from competition); *infra* note 161 and accompanying text (reasoning that increased competition will benefit consumers).

161. *See* 133 CONG. REC. S16,661 (daily ed. Nov. 20, 1987) (statement of Sen. Proxmire) (noting that during first six months of 1987, 10 largest securities firms underwrote 67% of municipal bonds issued); *infra* notes 162-63 and accompanying text (noting that allowing banks to underwrite municipal bonds will benefit consumers).

writing fees.[162] Consumers will benefit from these reductions because consumers ultimately service the municipal debt represented by the bonds.[163] Additionally, S. 1886's prohibition against mergers between the fifteen largest securities firms and the fifteen largest banks will prevent the establishment of banking and securities conglomerates.[164] S. 1886, therefore, encourages competition without risking monopolization.[165]

In addition to ensuring bank safety and promoting competition in the securities industry, S. 1886's repeal of sections 20 and 32 of the Glass-Steagall Act allows banks to remain viable in light of changing technology in the financial community.[166] Because borrowers increasingly raise capital through securitized debt rather than commercial loans, banks have lost much of the banks' traditional business.[167] By allowing banks to participate in the market for securitized debt through subsidiary affiliates, banks should become more sound rather than less sound.[168]

V. Conclusion

Congress enacted the Glass-Steagall Act to protect bank depositors and stabilize the banking system.[169] Courts interpreting the Glass-Steagall Act have noted that the major concern of Congress was to prevent hazards that occur when banks underwrite and deal in securities or affiliate with investment banks and securities firms.[170] S. 1886 does not repeal the

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162. 133 CONG. REC. S16,661 (daily ed. Nov. 20, 1987) (Statement of Sen. Proxmire).

163. *Id.*

164. *Id.* Some commentators believe that fear of the establishment of banking and securities conglomerates led Congress to reaffirm the Glass-Steagall Act. *See supra* note 107 and accompanying text (noting that Congress reaffirmed Glass-Steagall Act out of fear that banking and securities conglomerates would dominate American business).

165. *See supra* notes 158-64 and accompanying text (reasoning that S. 1886 promotes competition in securities industry without promoting creation of banking and securities monopolies).

166. *See supra* notes 110-14 and accompanying text (reasoning that repeal of Glass-Steagall Act will allow banks to remain competitive in face of changing technology in banking and securities industries).

167. *See supra* note 111 and accompanying text (noting that commercial paper has replaced short-term commercial lending).

168. *See supra* note 113-14 and accompanying text (noting that by allowing banks to remain competitive and produce healthier earnings for banks, repeal of Glass-Steagall Act will ensure safety and stability of banking system).

169. *See supra* note 2 and accompanying text (noting that Congress intended Glass-Steagall Act to protect safety of bank customers' deposits and to add stability to banking system); *supra* notes 3 & 5 and accompanying text (discussing legislative history of Glass-Steagall Act and noting that Congress believed that separating commercial banking from investment banking would protect depositors and stabilize banking system).

170. *See* Investment Co. Inst. v. Camp, 401 U.S. 617, 630 (1971) (stating that Congress intended to prevent hazards that arise when commercial banks engage in securities activities); Securities Indus. Ass'n. v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 219-20 (1984) (Schwab) (noting that Congress believed that involvement of banks in underwriting lead to bank failures); *supra* notes 23-41 and accompanying text (discussing Supreme Court's decision in *Schwab*).

prohibition against banks' underwriting and dealing in securities.[171] S. 1886, however, does allow banks to affiliate with investment banks and securities firms.[172] Because S. 1886 requires that commercial banks affiliate with investment banks and securities firms through a carefully regulated holding company structure, S. 1886 protects the stability of the banking system.[173] Because S. 1886 removes the separation between commercial and investment banks without jeopardizing the safety of the banking system, the House of Representatives should follow the lead of the Senate and enact S. 1886 and repeal sections 20 and 32 of the Glass-Steagall Act.[174]

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171. *See supra* note 151 and accompanying text (noting that S. 1886 does not repeal §§ 5 and 16 of Glass-Steagall Act and, therefore, does not allow banks to underwrite or deal in securities); *see also supra* notes 11-14 and accompanying text (noting provisions of §§ 5 and 16).

172. *See supra* note 142 and accompanying text (discussing provisions of S. 1886 and noting that repeal of §§ 20 and 32 of Glass-Steagall Act by S. 1886 allows banks to affiliate with securities firms).

173. *See supra* note 143 and accompanying text (discussing provisions of S. 1886 and noting that S. 1886 requires banks to affiliate with securities firms through holding company structure); *supra* note 144 and accompanying text (noting that S. 1886 prohibits loans from bank to securities affiliate).

174. *See supra* notes 106-09 & 155-57 and accompanying text (noting that commentators reason that separation between commercial and investment banking is no longer essential to stabilize banking system); *supra* notes 150-57 and accompanying text (reasoning that S. 1886 protects safety of bank depositors and stability of banking system); *supra* notes 158-68 and accompanying text (reasoning that S. 1886 promotes competition in securities industry and allows banks to remain viable in financial industry).