Notes

THE DEMISE OF RULE 3b-9

I. Introduction

Following the stock market crash of 1929, Congress enacted significant legislation regulating the banking and securities industries. The Banking Act of 1933,[1] commonly known as Glass-Steagall,[2]

---

1. Pub. L. No. 73-66, ch. 89, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12, 15, and 39 U.S.C.).

2. The term "Glass-Steagall" is most often used to refer to §§ 16, 20, 21, and 32 of the Banking Act of 1933 which limit the securities activities of banks. Section 16, 12 U.S.C. § 24 (seventh) (1982), provides, in pertinent part:

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe . . . .

Section 16 expressly applies to national banks. However, the Federal Reserve Act, 12 U.S.C. § 335 (1982), makes all Federal Reserve System member banks subject to the same restrictions. Section 20, 12 U.S.C. § 377 (1982), provides, in pertinent part:

> After one year from June 16, 1933, no member bank shall be affiliated in any manner . . . with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stock, bonds, debentures, notes or other securities . . . .

A Federal Reserve System member bank "affiliate" is defined in 12 U.S.C. § 221a(b) (1982). Section 21, 12 U.S.C. § 378 (1982), provides, in pertinent part:

> (a) After the expiration of one year after June 16, 1933, it shall be unlawful—
>
> (1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever, in the business of receiving deposits . . . . *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, under-

separated commercial and investment banking activities. The Securities Exchange Act of 1934[3] (SEA) regulated the nation's securities markets. As originally passed, the definitional sections of the SEA expressly excluded banks.[4]

Effective January 1, 1986, the Securities and Exchange Commission[5] (SEC) adopted Rule 3b-9[6] which amended sections

---

writing, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title . . . .

Section 32, 12 U.S.C. § 78 (1982), provides:

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

3. 15 U.S.C. § 78a (1982). The SEA was enacted to provide for the regulation of securities exchanges and of the over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes. In addition, § 78b states that regulation is necessary to protect and make more effective the national banking system and Federal Reserve System.

4. *See id.* § 78c(a)(4). The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

See also id. § 78c(a)(5). The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank.

5. The Securities and Exchange Commission was established under § 4(a), 15 U.S.C. § 78(d) and is composed of five commissioners appointed by the President with the advice and consent of the Senate. Section 3(b), 15 U.S.C. § 78c(b) gives the Commission power by rules and regulations to define technical, trade, accounting, and other terms used in the SEA, consistent with the Act's provisions and purpose.

6. 17 C.F.R. § 240.3b-9(a) (1987). Definition of "bank" for purposes of sections 3(a)(4) and (5) of the Act.

(a)The term "bank" as used in the definition of "broker" and "dealer" in sections 3(a)(4) and (5) of the Act does not include a bank that:

(1) Publicly solicits brokerage business for which it receives transaction-related compensation unless the bank enters into a contractual or other arrangement with a broker-dealer registered under the Act pursuant to which the broker-dealer will offer brokerage services on or off the premises of the bank, provided that:

(i) Such broker-dealer is clearly identified as the person performing the

brokerage services;
(ii) Bank employees perform only clerical and ministerial functions in connection with brokerage transactions unless such employees are qualified as registered representatives pursuant to the requirements of the self-regulatory organizations;
(iii) Bank employees do not receive directly or indirectly, compensation for any brokerage activities unless such employees are qualified as registered representatives pursuant to the requirements of the self-regulatory organizations; and
(iv) Such services are provided by the broker-dealer on a basis in which all customers are fully disclosed.
(2) Directly or indirectly receives transaction-related compensation for providing brokerage services for trust, managing agency or other accounts to which the bank provides advice, provided, however, that this subsection shall not apply if the bank executes transactions through a registered broker-dealer and;
(i) Each account independently chooses the broker-dealer through which execution is effected;
(ii) The bank's personnel do not receive, directly or indirectly, transaction-related compensation or compensation based upon the number of accounts choosing to use the registered broker-dealer; and
(iii) The brokerage services are provided by the broker-dealer on a basis in which all customers are fully disclosed; or
(3) Deals in or underwrites securities.
(b) This rule shall not apply to any bank that engages in one or more of the following activities only:
(1) Effects transactions in exempted or municipal securities as defined in the Act or in commercial paper, bankers' acceptances or commercial bills;
(2) Effects no more than 1,000 transactions each year in securities other than exempted or municipal securities as defined in the Act or in commercial paper, bankers' acceptances or commercial bills;
(3) Effects transactions for the investment portfolio of affiliated companies;
(4) Effects transactions as part of a program for the investment of reinvestment of bank deposit funds into any no-load open-end investment company registered pursuant to the Investment Company Act of 1940 that attempts to maintain a constant net asset value per share or has an investment policy calling for investment of at least 80% of its assets in debt securities maturing in thirteen months or less;
(5) Effects transactions as part of any bonus, profit-sharing, pension, retirement, thrift, savings, incentive, stock purchase, stock ownership, stock appreciation, stock option, dividend reinvestment or similar plan for employees or shareholders of an issuer or its subsidiaries;
(6) Effects transactions pursuant to sections 3(b), 4(2), and 4(6) of the Securities Act of 1933 and the rules and regulations thereunder: or
(7) Is subject to section 15(e) of the Act.
(c) The Commission, upon written request, or upon its own motion, may exempt a bank, either unconditionally or on specific terms and conditions, where the Commission determines that the bank's activities are not within the intended meaning and purpose of this rule.
(d) For purposes of this section, the term "transaction-related compen-

3(a)(4)[7] and 3(a)(5)[8] of the SEA by making banks which solicit brokerage business or provide brokerage services to fiduciary accounts[9] for profit subject to all of the registration and reporting requirements of the SEA. In November 1986, the United States Court of Appeals for the District of Columbia reversed a lower court opinion and declared Rule 3b-9 unlawful "because [it] contravene[d] the intent of Congress unambiguously expressed in the language of the 1934 Act, and confirmed in the Act's legislative history."[10]

The purpose of this note is to trace the events that led to the SEC's adoption of Rule 3b-9 by first examining the statutory framework for reasons behind the SEA's definitional exclusion for banks and then reviewing pertinent administrative and judicial activities of the past fifty years. The note will next discuss Rule 3b-9 and why the SEC viewed this rule as a solution to perceived abuses. Finally, the note will examine the U.S. Court of Appeals' decision declaring Rule 3b-9 invalid.

II. STATUTORY FRAMEWORK

The involvement of national banks in the investment banking field is not a recent development. In 1891 when the United States Supreme Court first ruled that there was no statutory authority for national banks to engage in investment banking activities,[11] trust

---

sation" shall mean monetary profit to the bank in excess of cost recovery for providing brokerage execution services.

7. 15 U.S.C. § 78c(a)(4) (1982).

8. *Id.* § 78c(a)(5).

9. A fiduciary account is one in which title to property passes from the owner to the trustee who holds that property for the benefit of another. FINANCIAL HANDBOOK 6-1, 6-2 (4th ed. 1968).

10. American Bankers Ass'n v. SEC, 804 F.2d 739, 740 (D.C. Cir. 1986).

11. Logan County National Bank v. Townsend, 139 U.S. 67 (1891). In that case, Mr. Townsend sold Logan County bonds to Logan County National Bank with six months' accrued interest for 68 cents on the dollar with the understanding that, upon Townsend's demand, the bank would resell the bonds to him at the same price or less. The bank subsequently refused to resell the bonds. Townsend sued in state court for damages in the amount of $4,416 representing the difference between the price paid for the bonds and their par value plus the six months' accrued interest. Part of the bank's defense was that the bank had no authority, under its charter or the national banking act, to enter into the alleged agreement and therefore could not be held liable. The Court held that nothing in the national banking act would exempt the bank from honoring a contractual obligation, even though the bank had no authority to purchase the bonds from

companies and state chartered banks were offering a full range of financial services, including the distribution of corporate securities for their own accounts and for fiduciary accounts.[12] Six years later the Court prohibited national banks from purchasing corporate stocks.[13] As a result, national banks began to organize securities affiliates[14] under state corporation laws.[15] Use of affiliates enabled banks to conduct investment banking activities without regard to the Comptroller of the Currency's[16] regulations or the earlier court decisions. Absence of such restraints enabled banks to effectively compete with trust companies and state chartered banks.[17]

During World War I, the Board of Governors of the Federal

Townsend. The Court held that "the national banking act is an enabling act for associations organized under it, and a national bank cannot rightfully exercise any powers except those expressly granted by the act, or such incidental powers as are necessary to carry on the business for which it was established." *Id.* at 73.

12. *See* 5 V. DILORENZO, W. SCHLICHTING & J. COOPER, BANKING LAW §§ 96.02[1], 96-5 (1987).

13. *See* California Bank v. Kennedy, 167 U.S. 362 (1897). Plaintiff in this action filed suit against the California Savings Bank seeking recovery of an alleged deposit. Suit was also filed against other defendants on the ground that, as shareholders of the bank, they were liable for the bank's debts. One such defendant was the California National Bank, which alleged that if any such stock had been issued, it was issued without proper authority from California National as a corporation and without legal authority. The Court said that statutes relating to powers of national banks prohibit banks from purchasing stock of another corporation, and any action to the contrary would be considered an *ultra vires* act. *Id.* at 367.

14. The term "affiliate" is

> sometimes used in a commercial or financial sense to describe an organization, usually a corporation, connected and controlled by a bank and whose activities cover a field of finance which cannot be entered by the bank under banking laws. In order for the relationship . . . to exist it is necessary that one body . . . have a financial interest in the other's business or a voice in its management.

2A C.J.S., *Affiliate* 511 (1972). Under the Investment Company Act of 1940, effective control is ownership of 25% or more of the voting stock. 15 U.S.C. § 80a-2 (1982).

15. *See* DILORENZO, SCHLICHTING & COOPER, *supra* note 12, at 96-6.

16. *See* 12 U.S.C. § 1. Under this statute, the Comptroller is charged with supervising the national banking system. The statute states in relevant part:

> There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of a national currency secured by United States bonds and, under the general supervision of the Board of Governors of the Federal Reserve System, of all federal reserve notes, the chief officer of which bureau shall be called the Comptroller of the Currency and shall perform his duties under the general directions of the Secretary of the Treasury. *Id.*

17. *See* DILORENZO, SCHLICHTING & COOPER, *supra* note 12, at 96-6.

Reserve System[18] (System) extended membership in the System to trust companies and state chartered banks without requiring those institutions to discontinue any powers granted them under state law.[19] Then, in 1927, Congress passed legislation approving specified underwriting activities of national banks subject to regulation by the Comptroller.[20]

The stock market crash of 1929 and the ensuing depression led Congress to reexamine regulation of the banking and securities industries.[21] The result was the passage, between 1933 and 1940, of the Banking Act of 1933 (Glass-Steagall) and six major statutes encompassing securities activities.[22] Only two of these statutes, Glass-Steagall and the SEA, are considered here.

The legislative history of Glass-Steagall indicates that one clear congressional objective was the separation of commercial and investment banking activities. Congress felt that public confidence in the banking system had been greatly diminished by bank failures due, in large part, to securities activities.[23] One concern was a

---

18. The Board of Governors of the Federal Reserve System, originally named the Federal Reserve Board, was created by 12 U.S.C. § 241 (1982) and empowered to exercise general supervision over federal reserve banks, by 248(j) and trust activities of national banks, by § 248(k).

19. *See* Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 BANKING L.J. 483, 491 (1971).

20. The McFadden Act, Pub. L. No. 69-639, 44 Stat. 1224 (1927) (codified in scattered sections of 12 U.S.C.) allowed national banks to underwrite investment securities directly and limited the amount of securities of any one issuer held by the bank to 25% of the bank's capital.

21. *See* DILORENZO, SCHLICHTING & COOPER, *supra* note 12, at 96-8.

22. The six securities acts include the Securities Act of 1933, 15 U.S.C. § 77a (1982); the Securities Exchange Act of 1934, 15 U.S.C. § 78a (1982); the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (1982); the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa (1982); the Investment Company Act of 1940, 15 U.S.C. § 80a-1 (1982); and the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 (1982).

23. *See* 75 CONG. REC. 9906 (1932). Senator Walcott, a member of the Senate Banking & Currency Committee, remarked:

> It is evident from what has been said that the underlying factor in the whole prepanic situation was excessive use of bank credit. . . . The excessive use of bank credit in making loans for the purpose of stock speculation, or, more generally stated, for the excessive carrying of securities with borrowed money, was generally admitted before the panic of 1929, and almost universally since that time, to have been one of the sources of major difficulty . . . . The net result of this competition between the State banking forces operating under loose laws and the national banking system operating under much more strict laws has been the disregard of a great many of the fundamentals

bank's imprudent investment of its own assets in speculative securities.[24] Another concern was the loss of public confidence in a bank if its securities affiliate suffered major losses.[25] The perceived danger was that the bank would make unsound loans to aid the affiliate or the companies in which it held investments.[26] Imprudent loans might also be made to customers with the hope that the loans would be used to purchase securities.[27] Yet another concern was the loss of impartiality by bankers who would be advising their clients to purchase something the banks were, in fact, selling.[28] This loss of impartiality was seen as a clear breach of fiduciary duty.[29]

The result of these concerns was an express desire by Congress to keep banks out of the securities business. The means was Glass-Steagall.[30] The major provisions are as follows: section 16 limits the securities activities of national banks to the purchase and sale of securities, without recourse, solely for customers' accounts; banks are precluded from investing for their own accounts and from acting

---

> of the banking business, taking chances with depositor's money, and the incorporation and rapid growth of the affiliate business, giving an outlet to that speculative type of business quite contrary to legitimate commercial banking. The net result is that to-day [sic] we have two billions and more of the money of innocent depositors locked up in closed banks. We have a complete collapse, in many cases, of these affiliate securities. We have banks that have closed their doors because they have over purchased, as correspondent banks of some of the larger ones, the very securities that the larger banks have forced upon them.

Id. See also 75 CONG. REC. 9911 (1932). Senator Bulkley stated:

> Did not professional pride become diverted from the pride of safe and honest banking service to that of profits, greed, expansion, power and domination? . . . Can any banker, imbued with the consciousness that his bond-sales department is, because of lack of securities for sale, losing money and at the same time losing its morale, be a fair and impartial judge as to the necessity and soundness for a new security issue which he knows he can readily distribute through channels which have been expensive to develop but which presently stand ready to absorb the proposed security issue and yield a handsome profit on the transaction?

Id.

24. *See Camp*, 401 U.S. at 630.
25. *Id.* at 630-31.
26. *Id.* at 630-32.
27. *Id.* at 632.
28. *Id.* at 633-34.
29. *Id.*
30. *See* Goodwin, *Fifty-Two Years After the Glass-Steagall Act: Do Commercial Bank Securities Activities Merit a Second Look?*, 4 DET. C.L. REV. 933, 937-38 (1984).

as underwriters; section 21 prohibits banks from issuing, underwriting, selling, or distributing stocks, bonds, notes, debentures, or other securities; sections 20 and 32 prohibit affiliations and interlocking management, respectively, between member banks and entities engaged in investment banking activities.[31] Although Glass-Steagall was originally enacted on June 16, 1933, Congress delayed its effective date for one year to give banks time to dispose of their securities operations.[32] The Comptroller of the Currency was charged with the administration of the national banking laws, subject to the general supervision of the Board of Governors of the Federal Reserve System.[33]

While Glass-Steagall was seen as an expression of the legislative policy of complete separation of commercial and investment banking, Congress recognized that additional legislation might be required and thus turned its attention to the nation's securities markets.[34] The SEA was the result. Its purpose was to regulate the securities industry, ensure the maintenance of fair and honest markets, and to make the national banking and Federal Reserve Systems more effective.[35]

The legislative history of the SEA reflects concern that inclusion of banks within the purview of the statute would subject them to duplicate regulation by two arms of government with potentially conflicting views.[36] The term "broker" was originally defined as "any person engaged in the business of buying and selling securities for the account of others."[37] Since section 16 of Glass-Steagall granted banks express authority to effect securities transactions for customers' accounts,[38] banks would clearly fall within the definition of broker under the SEA. Similarly, the term "dealer" was defined as "any person engaged in the business of buying and selling

---

31. *See supra* note 2 and accompanying text (statutory language of pertinent provisions of the Glass-Steagall Act).

32. *Id.*

33. *See* 12 U.S.C. § 1; *supra* note 16.

34. *American Bankers*, 804 F.2d at 745.

35. 15 U.S.C. § 78b (1982). *See supra* note 3 and accompanying text.

36. *See generally Stock Exchange Practices: Hearings before the Senate Committee on Banking and Currency, Part 15*, 73d Cong., 1st Sess. 7221, 7221-22 (1934) [hereinafter *Hearings*] (statement of W. Potter, chairman of the Board of Guaranty Trust Company).

37. *See id.*

38. *See supra* note 2 (statutory language of § 16 of the Glass-Steagall Act).

securities for his own account."[39] The definition of dealer would thus have encompassed a bank's activities as a trustee. Both definitional sections in final form expressly excluded banks.[40] This exclusion was viewed as a purposeful decision on the part of Congress that banks not be subject to SEC jurisdiction because they were already subject to the authority of state and federal regulators.[41]

Additional evidence of congressional intent not to subject banks to the securities laws may be found in the Banking Act of 1935[42] which, in part, clarified permitted activities under section 16 of Glass-Steagall.[43] The amendment gave national banks express permission to buy and sell stocks for customers' accounts without recourse.[44] The amendment was recommended by the Comptroller of the Currency on the ground that, as originally enacted, section 16 did not clearly permit banks to broker stock and such a result was arguably contrary to congressional intent.[45]

III. INTERPRETATION AND CONTROVERSY

In the post-depression decades, the Comptroller tended to be ultra-conservative in interpreting Glass-Steagall. As a result, bank activities were narrowly confined.[46] As regulatory interpretations relaxed, banks began to engage in more securities-related activities and consequently litigation followed. A review of the relevant case law will serve to illustrate the gradual liberalization by the Comptroller as to permissible bank activities.

Investment Company Institute v. Camp[47] was a challenge to a national bank's attempt to operate a mutual fund.[48] Until 1962, the

---

39. *See Hearings, supra* note 36, at 7222.

40. 15 U.S.C. § 78c(a)(4)-(5) (1982). *See supra* note 4 and accompanying text.

41. *American Bankers*, 804 F.2d at 746 & n.17.

42. Pub. L. No. 305, 49 Stat. 709, 12 U.S.C. § 24 (1935).

43. *See* Kress, *The Banking Act of 1935*, 34 MICH L. REV. 155, 177-78 (1935).

44. *Id.*

45. *Id.*

46. *See* Letter from James E. Smith, Comptroller of the Currency, to G. Duane Vieth (June 10, 1974), *reprinted in* [1973-78] Fed. Banking L. Rep. (CCH) ¶ 96,272, at 81,357 (June 20, 1974) [hereinafter *Letter*].

47. 401 U.S. 617 (1971).

48. A mutual fund is an open-end investment company. The Investment Company Act of 1940 defines an investment company as an "issuer" of "any security" which "is or holds itself out as being engaged primarily . . . in the business of investing . . . in securities." 15 U.S.C. §§ 80a-2(a)(21), -3(a)(1). An open-end company "offer[s] for sale or has outstanding any redeemable security of which it is the issuer." *Id.* § 80a-5(a)(1); *Camp*, 401 U.S. at 625 n.11.

Board of Governors of the Federal Reserve System which had regulatory authority over trust activities of national banks,[49] consistently permitted the collective investment of trust assets only for fiduciary accounts and expressly prohibited operation of a common trust fund as a means of attracting public investments.[50] Shortly after Congress transferred jurisdiction to the Comptroller, new regulations were promulgated which allowed banks to collectively invest managing agency accounts as well.[51] In 1965, First National City Bank of New York received approval from the Comptroller for a plan whereby a bank customer could appoint the bank as its agent to purchase interests in a registered investment company underwritten by the bank.[52]

The Investment Company Institute, a trade association, brought suit alleging violations of sections 16 and 21 of Glass-Steagall. These sections prohibit a bank from effecting securities transactions for its own account and from issuing, underwriting, and distributing securities.[53] The Investment Company Institute argued that a bank's purchase of stock for its own investment fund was a purchase for the bank's own account[54] and that creation and operation of an investment fund offered to bank customers involved the issuance, underwriting, and distribution of securities.[55]

The Supreme Court agreed, holding that while the banking laws would permit a bank to pool trust assets, act as managing agent for individual customers, or purchase stock for a customer's account, the combination created an investment fund in which the potential conflicts and abuses that Congress intended to eliminate by passage of Glass-Steagall were inherent.[56] In reaching this conclusion, the Court said that a statutory interpretation by the regulatory agency charged with enforcement of that statute must be given great weight as long as the interpretation is reasonable and comes from the administrative official directly, as an expert, and not from the later arguments of counsel.[57] In a case which involves

---

49. *See Camp*, 401 U.S. at 621.
50. *Id.*
51. *Id.* at 621-22.
52. *Id.*
53. *See* 12 U.S.C. §§ 24 (seventh), 378. *See also supra* note 2 and accompanying text.
54. *See Camp*, 401 U.S. at 623-24.
55. *Id.* at 624.
56. *Id.* at 624-25.
57. *Id.* at 626-28.

a request for a grant of new authority, the Comptroller's ruling must follow his satisfaction that the activity involved will not violate congressional intent.[58] The Court traced the legislative history of Glass-Steagall and found one undisputed objective to be the separation of commercial and investment banking due to inherent conflicts of interest.[59] Accordingly, the Comptroller's interpretation was not deemed to be reasonable and was overruled.[60]

Two years later, the United States District Court for the District of Columbia upheld the Comptroller's approval of applications submitted by two national banks to establish or purchase discount brokerage subsidiaries. In *Securities Industry Association v. Comptroller of the Currency*,[61] a trade association representing securities brokers and dealers[62] challenged the Comptroller's decision as violating sections 16 and 21 of Glass-Steagall.[63] The first application, filed by Union Planter's National Bank in June 1982, sought approval for the acquisition of an existing discount brokerage business.[64] The next month, an application was filed by Security Pacific National Bank for approval of a plan to establish a new operating subsidiary to provide discount brokerage services. Both applications were subsequently approved by the Comptroller.[65]

In holding that Glass-Steagall does not prohibit national banks from owning and operating discount brokerage subsidiaries, the district court deferred to the Comptroller's decision as reasonable.[66] While agreeing that section 16 does contain language limiting bank brokerage activity to accommodation services for customers, without recourse, the court found nothing in the language that would require the services to be provided without charge or the brokerage cus-

---

58. *Id.* at 628.

59. *Id.* at 629-34.

60. *Id.* at 639.

61. 577 F. Supp. 252 (D.D.C. 1983), *aff'd*, 758 F.2d 739 (D.C. Cir. 1985), *rev'd on other grounds*, 107 S. Ct. 750 (1987).

62. The Securities Industry Association is a national trade association representing more than 500 securities brokers, dealers, and underwriters. *Id.* at 253.

63. *Id. See also* 12 U.S.C. §§ 24 (seventh), 378; *supra* note 2 and accompanying text.

64. Discount brokers execute purchase-and-sale orders for customers. Because such firms do not provide investment advice, they can afford to charge lower commissions than full service brokers. *See Securities Indus. Ass'n*, 577 F. Supp. at 253.

65. *Id.*

66. *Id.* at 254.

tomers to have a preexisting relationship with the bank.[67] Instead, the court construed the section 16 limitation as one that simply distinguished accommodation services from the bank's ability to buy and sell securities for its own account.[68]

In reaching its decision, the court looked to the legislative history of Glass-Steagall and found no support for the petitioner's view that Congress' intent to separate commercial and investment banking included a limitation on brokerage activity by banks.[69] In fact, the court found reinforcement for its interpretation of legislative intent in section 20 which prohibits a bank's affiliation with any institution whose principal business involves the issuance, underwriting, or public distribution of securities.[70] The prohibition in that section was deemed to be aimed at investment bankers who purchase securities for their own accounts from issuers for resale to the general public, not at brokers who simply act as agents for a customer's account.[71]

In mid-1984, the Supreme Court overturned a court of appeals decision which accepted an interpretation by the Federal Reserve Board (Board) that commercial paper was not a security under Glass-Steagall. In *Securities Industry Association v. Board of Governors of the Federal Reserve System (Bankers Trust)*,[72] the Securities Industry Association (SIA) challenged as unlawful under sections 16 and 21 of Glass-Steagall[73] the Board's ruling permitting Bankers Trust Company, a state-chartered commercial bank member of the Federal Reserve System, to act as marketing agent for commercial paper issued by its corporate customers.[74]

In reaching its decision, the Board acknowledged congressional intent to separate commercial and investment banking activities, but expressed concern that a broad interpretation could prevent banks from engaging in traditional bank activities.[75] Accordingly,

---

67. *Id.* at 255.
68. *Id.*
69. *Id.*
70. *Id.* at 256.
71. *Id.*
72. 468 U.S. 137 (1984) [hereinafter *Bankers Trust*].
73. *See* 12 U.S.C. §§ 24 (seventh), 378. *See supra* note 2 and accompanying text.
74. Commercial paper is generally defined as short-term, unsecured promissory notes issued by corporations to finance short-term credit needs. The paper is usually sold at a discount and, at the time of issuance, has maturity of less than nine months. *See Bankers Trust*, 468 U.S. at 140 n.1.
75. *Bankers Trust*, 468 U.S. at 141.

the Board adopted a "functional analysis" test whereby any financial instrument that evidenced a transaction that in the Board's view was more like traditional commercial banking activity than investment banking would be deemed not to be a security under Glass-Steagall.[76] The Board applied this test to commercial paper and concluded that such paper was similar to a commercial bank loan and, therefore, not a security.[77]

In reviewing the Board's decision, the Court discussed the standard of review required and, consistent with prior policy, acknowledged the need to grant deference to an interpretation by the agency charged with enforcement of the statute in question, unless the interpretation appeared to be inconsistent with congressional intent.[78] However, as in *Camp*, the Court noted that deference is not granted to the opinions of appellate counsel regarding the rationale behind earlier administrative action.[79] Since the only position expressed by the Board at the administrative level was that commercial paper was not a security within the meaning of Glass-Steagall, the later insistence by counsel that Bankers Trust's activities did not involve any of the dangers Glass-Steagall was intended to eliminate, was afforded less weight.[80]

In analyzing Glass-Steagall, the Court reiterated congressional concerns that the separation of commercial and investment banking was necessary to avoid the potential risks inherent in securities activities and, more importantly, the conflicts of interest that arise when a bank acts as fiduciary, managing agent, and investment banker.[81] Section 16 limits the securities activities of commercial banks, prohibits a bank from purchasing securities other than investment securities for its own account, and from underwriting or issuing securities.[82] Section 21 prohibits investment bankers from entering the commercial banking business.[83] Therefore, the Court reasoned that Bankers Trust could not legally underwrite commercial paper if it were deemed to be a "security" as defined in Glass-Steagall.[84]

---

76. *Id.*
77. *Id.*
78. *Id.* at 142.
79. *Id.* at 142-44.
80. *Id.* at 144.
81. *Id.* at 144-48.
82. 12 U.S.C. § 24 (seventh). *See supra* note 2 (text of statute).
83. *See* 12 U.S.C. §§ 24 (seventh), 378. *See supra* note 2 (text of statute).
84. *Bankers Trust*, 468 U.S. at 140.

In deciding that commercial paper was, in fact, a security, the Court relied on congressional intent.[85] Petitioner's functional analysis test was deemed unreasonable because it focused exclusively on the financial instrument involved and ignored the bank's role in the transaction.[86] The intent of Congress in passing Glass-Steagall was to regulate bank activities, not the underlying securities. As a policy matter, the Court expressed concern that a conclusion that commercial paper was not covered by Glass-Steagall would, in effect, give the Board authority to regulate the sale of commercial paper as part of its general supervisory powers. Such authority would, in effect, reduce part of Glass-Steagall's broad statutory prohibitions to a system of administrative regulation.[87] Since there was no evidence in the legislative history to suggest an intent by Congress to give the Board rulemaking authority over prohibited activities, the functional analysis approach was viewed as unreasonable, and the sale of commercial paper was deemed to be a violation of sections 16 and 21.[88]

In a companion case to the *Bankers Trust* decision, the Court unanimously upheld the Board's authority to allow a bank holding company to acquire a nonbanking affiliate engaged principally in the retail securities business. *Securities Industry Association v. Board of Governors of the Federal Reserve System (BankAmerica Corp.)*,[89] involved the Board's approval of an application by BankAmerica Corporation, a bank holding company, to acquire all of the voting stock of the Charles Schwab Corporation which owned a retail discount brokerage business.[90]

The Board's decision was based largely on provisions of the Bank Holding Company Act[91] which permits a bank holding company to engage in nonbank activities determined by the Board to be closely related to banking.[92] However, part of the SIA's challenge

---

85. *Id.* at 150-52.
86. *Id.* at 154.
87. *Id.* at 153.
88. *Id.* at 154.
89. 468 U.S. 207 (1984) [hereinafter *BankAmerica*].
90. *Id.* at 208-09.
91. 12 U.S.C. § 1843(c)(8) (1982). The Act is administered by the Board of Governors of the Federal Reserve System.
92. Section 4 of the Bank Holding Company Act, as originally enacted, provided, in pertinent part:

(a) Except as otherwise provided in this Act, no bank holding company

was to section 20 of Glass-Steagall which prohibits a bank holding company from owning any entity engaged primarily in the retail securities business.[93] The Board found no such prohibition under Glass-Steagall; it reasoned that even though the acquisition would make Schwab an affiliate of BankAmerica Corporation's banking subsidiary and, therefore, subject to Glass-Steagall, Schwab's activities were not prohibited to member bank affiliates under that Act.[94]

The United States Supreme Court agreed. The Court interpreted section 20 to prohibit bank affiliations with underwriters functioning as principals in securities transactions, not affiliations with brokers whose activities are in an agency capacity.[95] In reviewing the legislative history, the Court reiterated Congress' concern over underwriting activities by bank affiliates as risky and potentially unsound.[96] Because Schwab's profitability was dependent solely upon volume of shares traded rather than upon transactions in any particular security, the service provided was viewed as consistent with the accommodation services permitted by section 16.[97] Because the Board's interpretation was reasonable in light of congressional intent and consistent with prior Board rulings, the Court deferred to the Board's judgment and upheld the decision.[93]

IV. THE SEC BANK STUDY

Although not actively involved in litigation, the SEC was pursuing legislative changes to deal with its perception that banks were

---

shall—

(1) after the date of enactment of this Act acquire direct or indirect ownership or control of any voting shares of any company which is not a bank

. . . .

(c) The prohibitions in this section shall not apply—

. . . .

(6) to shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board after due notice and hearing, and on the basis of the record made at such hearing, by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto

. . . .

93. 12 U.S.C. § 377. *See supra* note 2 and accompanying text.
94. *BankAmerica*, 468 U.S. at 212.
95. *Id.* at 218.
96. *Id.* at 213.
97. *Id.*
98. *Id.* at 214-15.

encroaching on the territory of broker-dealer firms under its jurisdiction. In 1975, Congress authorized the SEC to study the market and to determine whether the definitional exclusion for banks contained in the SEA should be withdrawn.[99] The SEC was instructed to ignore Glass-Steagall questions such as whether banks should be conducting securities activities at all.[100]

The SEC produced a study consisting of three reports which set forth: (1) facts and figures regarding brokerage-type services being offered by banks; (2) the existing regulatory framework for banks and brokers on a comparative basis; and (3) an examination of corporate financing and trust department trading desk activities of banks.[101] Part one of the study revealed that banks were not very active in providing brokerage-type services.[102] The dominant activity engaged in by banks was administration of dividend reinvestment plans, a business virtually untouched by broker-dealers.[103] Bank involvement in the administration of employee stock purchase plans and automatic investment services[104] was minimal, while traditional accommodation services, effecting trades for existing customers without recourse, remained the predominant activity.[105]

---

99. *See* Spencer, *Regulation of Bank Securities Activities: The Effects of the SEC Bank Study*, 95 BANKING L.J. 616 (1978).

100. *Id.* at 617 n.2. *See also American Bankers*, 804 F.2d at 747. Congress limited the scope of the study because an investigation dealing with the scope of bank activities under Glass-Steagall had already been planned by the Senate Committee on Banking, Housing, and Urban Affairs. *Id.*

101. The study was submitted to Congress on "Reports on Bank Securities Activities of the Securities and Exchange Commission" pursuant to § 11A(c) of the SEA, Pub. L. No. 94-29. Spencer, *supra* note 99, at 616 n.1 and 617.

102. *See* Spencer, *supra* note 99, at 618-21.

103. *See* Norton, *Up Against "The Wall":* Glass-Steagall *and a Deregulated Banking Environment*, 42 BUS. LAW. 327, 355 (1987). Dividend reinvestment plans allow shareholders of a participating corporation to direct that dividends be paid directly to their banks. *See also* Spencer, *supra* note 99, at 618. As of September 30, 1976, 68 banks administered these plans for 727 companies with over 1.8 million participants who purchased over $130 million worth of stock during the third quarter of 1976. For the same period, only 2 broker-dealers were administering such plans. *Id.*

104. Employee stock purchase plans provide a way for participating employees of a company to invest in the company's stock through payroll deduction. *See* Spencer, *supra* note 99, at 617 n.4. Automatic investment services allow bank customers the opportunity to invest in the common stock of the top 25 companies on Standard and Poor's Industrial Index. The customer makes the selection. The bank then deducts the funds necessary from the customer's account and purchases the stock in the open market. *See* Norton, *supra* note 103, at 356.

105. As of September 30, 1976, only 59 banks offered 105 employee stock

Parts two and three of the study disclosed bank involvement in more usual and customary brokerage services.[106] Trust department trading desks were found to operate much like retail brokers by matching their client's accounts with third parties interested in buying or selling a particular security.[107] The volume of trades executed and the sophistication of the market required bank trust departments to upgrade their personnel and facilities.[108] In addition, bank involvement in investment banking activities such as private placements, mergers, and acquisitions was found to be in direct competition with the activities of registered broker-dealers.[109] The SEC felt that these bank activities, in particular, would compel inclusion of banks within the SEA definition of "broker" if not for the exemption provided.[110] The SEC study raised significant questions on potential abuses by bank traders, including the distribution of unregistered securities, violations of credit requirements, and insider trading due to a lack of awareness of the security laws.[111]

Consistent with the congressional mandate, the SEC's analysis of the data compiled focused exclusively on the adequacy of existing bank regulations.[112] The SEC concluded that, although some areas of current regulation appeared adequate, changes in the regulatory structure were needed to ensure adequate investor protection.[113] Protection of customers' funds and securities against loss by theft or insolvency appeared satisfactory, but the SEC felt that trading activities, in particular, had been ignored by bank regulators.[114] The study revealed that record-keeping, competency of personnel, delivery of confirmations, disclosure, and bank examination procedures needed better regulation.[115]

---

purchase plans with 165,403 participants and $120.6 million in assets. Banks offering automatic investment services declined from 20 in 1974 to 18 in 1976. At the same time, over 4000 banks offered "accommodation" services. *See* Spencer, *supra* note 99, at 618-19. It is interesting to note that the term "accommodation" never actually appears in Glass-Steagall or in the legislative history—only in Comptroller opinions. *See, e.g.*, *Letter*, *supra* note 46, at 81,357-58.

106. *See* Spencer, *supra* note 99, at 617-18.
107. *Id.* at 619.
108. *Id.* at 619-21.
109. *Id.* at 621-22.
110. *Id.*
111. *Id.* at 622-23.
112. *Id.* at 624.
113. *Id.* at 624, 631-32.
114. *Id.* at 624.
115. *Id.* at 623-26.

The SEC did not recommend elimination of the exclusion for banks from the SEA definitions of "broker" and "dealer" because it feared that imposition of full broker-dealer regulation would result in duplicative and unduly burdensome requirements.[116] Instead, the SEC recognized a need for continued interaction between the securities and federal banking agencies so that each agency would have responsibility for regulating areas within its own area of expertise.[117] This interaction would eliminate regulatory duplication.[118] Copies of the study were sent to the federal bank agencies, which responded favorably by revising bank policies and procedures, reinforcing the statutory framework implemented by Congress in the 1930s.[119] Banks remained excluded from the SEA definitions of "broker" and "dealer" and direct SEC jurisdiction, but the federal banking agencies took a more active role in securities regulation with the SEC's guidance and advice.[120]

V. RULE 3b-9

On July 12, 1985, the SEC adopted Rule 3b-9 which requires banks engaging in a general securities business to register as broker-dealers and to be subject to all of the regulatory requirements of the SEA.[121] In the adopting release, the SEC expressed its belief that the Rule was necessary to ensure adequate investor protection in light of the recent expansion of the securities activities of banks.[122]

As evidence of this expansionist activity, the SEC reiterated many of the statements it made in the SEC bank study conducted ten years earlier.[123] Specific areas perceived as not subject to ad-

---

116. *Id.* at 626.

117. *Id.*

118. *Id.* at 626-29.

119. *Id.*

120. The Comptroller revised the *Handbook for National Trust Examiners* to require examiners to make specific inquiries on securities-related activities such as record keeping and implemented training programs for examiners on the securities laws and markets. The sessions were led by SEC staff members. Under SEC proposals, banking agencies would remain primarily responsible for enacting and enforcing rules and regulations governing banks' securities activities and for conducting examinations with the expectation that the SEC would be consulted as an expert on a regular basis and be kept informed of potential securities law violations. *See* Spencer, *supra* note 99, at 626-31.

121. 17 C.F.R. § 240.3b-9 (1985). *See supra* note 6 and accompanying text.

122. *Applicability of Broker-Dealer Registration to Banks*, 50 Fed. Reg. 28,385 (1985) [hereinafter *SEC Release*].

123. *Id.* at 28,387-88.

equate regulation were qualifications of personnel conducting securities transactions, knowledge of the federal securities laws, restrictions on advertising, and examinations for compliance with regulations, the same concerns expressed in the 1975 study.[124] In 1975 the SEC had concluded that regulatory action was not required due to the relatively low volume of activity, but it had retained the right to alter that opinion if market conditions changed substantially.[125]

In support of its position, the SEC cited the Board of Governors' approval of BankAmerica Corporation's application to acquire Charles Schwab[126] and approval of the applications of Union Planters and Security Pacific to create and operate discount brokerage subsidiaries.[127] In reviewing these activities, the SEC noted that bank employees take orders and forward them to executing brokers in exchange for part of the commission paid by the customer; banks solicit brokerage customers through active and aggressive advertising campaigns; and that the services actually provided exceed accommodation services to existing customers to the point that they are functionally indistinguishable from services provided by broker-dealers.[128] Accordingly, the SEC concluded that fairness required that all institutions providing brokerage services should be comparably regulated so that investors would receive the same protection regardless of the institution with which they chose to do business.[129]

As enacted, the SEA definitions of "broker" and "dealer," found in sections 3(a)(4) and 3(a)(5), expressly excluded banks.[130]

---

124. *See* Spencer, *supra* note 99, at 623-26.

125. *See SEC Release*, *supra* note 122, at 28,386.

126. *See BankAmerica*, 468 U.S. at 209.

127. *See* Securities Indus. Ass'n v. Comptroller of the Currency, 577 F. Supp. 252 (D.D.C. 1983), *aff'd*, 758 F.2d 739 (D.C. Cir. 1985), *rev'd on other grounds*, 107 S. Ct. 750 (1987).

128. *BankAmerica*, 468 U.S. at 216-18.

129. *SEC Release*, *supra* note 122, at 28,386-87. The SEC noted that:

> Orders are taken and forwarded by bank employees to clearing brokers for execution in exchange for part of the commission paid by the customer. Members of the public are solicited through extensive and aggressive advertising campaigns to become "brokerage" customers of the bank. Rather than merely providing accommodation services to existing customers, the services now promoted by banks, particularly those for which banks receive transaction-related compensation, are functionally indistinguishable from those offered by registered broker-dealers.

130. 15 U.S.C. § 78c(1)(4)-(5) (1982). *See supra* note 4.

A bank was originally defined in section 3(a)(6) to be, in pertinent part, a banking institution organized under the laws of the United States or a member bank of the Federal Reserve System.[131] The effect of Rule 3b-9 is to alter the definition of "bank" as used in sections 3(a)(4) and 3(a)(5) so that banks which engage in specified activities lose their exemption and become subject to the registration and reporting requirements of the SEA. Specifically, the definition no longer includes banks which: (1) publicly solicit brokerage business for profit; (2) receive a profit for brokerage services provided to accounts for which the bank also provides investment advice; or (3) underwrite securities.[132] Exceptions are granted to banks which provide services only through a registered broker-dealer; deal only in exempt, municipal, or certain money market securities; or handle less than 1000 transactions per year.[133]

The SEC draws its authority to promulgate Rule 3b-9 from two sources. Section 3(b) of the SEA grants the Commission the power to define technical, trade, accounting, and other terms used in the Act by rules and regulations.[134] In addition, the definitional section of the SEA begins with the phrase, "unless the context otherwise requires."[135] The SEC has interpreted the context clause to mean the environment in existence at the time the statutory provision in question was enacted.[136] In the SEC's view, this context permitted national and state member banks to provide accommodation services for customers' accounts at cost.[137] Since the volume and nature of services provided by banks have changed substantially since 1933, the SEC concluded that the context required a redefining of certain terms used in the SEA.[138]

---

131. The term "bank" means

> (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any state or of the United States . . . and which is supervised and examined by State and Federal authority having supervision over banks.

15 U.S.C. § 78c(a)(6) (1982).

132. *Compare* 17 C.F.R. § 240.3b-9 *with* 15 U.S.C. § 78c(1)(4)-(5). *See supra* notes 4 & 6 (text of statutes).

133. 17 C.F.R. § 240.3b-9. *See supra* note 6 and accompanying text.

134. 15 U.S.C. § 78(b). *See supra* note 5 and accompanying text.

135. 15 U.S.C. § 78(c)(A).

136. *SEC Release, supra* note 122, at 28,392-93.

137. *Id.* at 28,393.

138. *Id.*

The American Bankers Association recently challenged the validity of Rule 3b-9 when it filed suit in federal district court seeking an injunction prohibiting the SEC from enforcing the Rule against its members.[139] On cross-motions for summary judgment, the district court ruled for the defendant and dismissed the complaint.[140] The United States Court of Appeals for the District of Columbia reversed, declaring Rule 3b-9 unlawful because it contravened congressional intent.[141]

In analyzing congressional intent, the appellate court said that the definitions of "broker," "dealer," and "bank" in the SEA reflected a purposeful decision that SEC jurisdiction would not extend to banks already subject to extensive regulation.[142] The definition of "bank" in particular applies only to institutions subject to the authority of either the Comptroller (national banks), the Board of Governors of the System (member banks) or some other state or federal authority.[143] The court found evidence in the legislative history of the SEA that the decision to preclude SEC regulation of banks was made to avoid duplicative regulation.[144] The purpose of the SEA was to create a scheme of governmental regulation for brokers and dealers comparable to that which Glass-Steagall set in place for banks.[145] No support was found for the SEC's contention that Congress would not have exempted banks (as it did) had it known at the time that the Comptroller and the courts would later use the exemption to allow banks to engage in discount brokerage activities.[146] Since Congress did not expressly delegate authority to the SEC to change the statute to accommodate changes in bank activities, the SEC was deemed to have exceeded its authority by passage of Rule 3b-9.[147]

The court stated that the context clause should be interpreted to apply to frequently occurring statutory terms only when a literal application in a given context would produce an absurd or obviously

---

139. American Bankers Ass'n v. SEC, 804 F.2d 739, 740 (D.C. Cir. 1986).
140. *Id.*
141. *American Bankers*, 804 F.2d at 755-56.
142. *Id.* at 744.
143. *Id.*
144. *Id.* at 744-45.
145. *Id.* at 745.
146. *Id.* at 748-49.
147. *Id.* at 747.

incongruous result.[148] Despite the well-accepted view that the courts should grant great deference to interpretations by agencies charged with administration and enforcement of a statute, the court felt that according wide deference in the present case could ultimately alter doctrines of plain meaning and congressional intent and would be too broad a sanction of administrative independence.[149]

The court of appeals did not address the potential need for or benefits of Rule 3b-9. The opinion focused upon the statutory framework in which Congress purposefully allocated regulatory responsibilities over the financial markets among different federal agencies and the fact that the SEC, as one such agency, had no authority to change that congressional intent by extending its own jurisdiction.[150]

VI. COMMENTARY

In the fifty years since Glass-Steagall and the SEA were enacted, there is no doubt that both the volume and nature of bank involvement in securities-related activities has increased,[151] with the greatest expansion occurring during the past ten years. The statutory framework set in place in the early thirties was the result of Congress' view that the stock market crash and bank failures during that period were largely due to the commingling of commercial and investment banking.[152] Glass-Steagall was a reflection of congressional intent to restore public confidence by keeping banks in the banking business and providing a safe place for people to keep their money.[153]

---

148. *Id.* at 753.

149. *Id.* at 754.

150. *Id.* at 755.

151. *Id.* at 740 (discussing the comptroller's broadening interpretation of Glass-Steagall in the last 50 years leading to a dramatic surge of banks into the discount brokerage business).

152. *See supra* note 23 and accompanying text.

153. *See* Goodwin, *supra* note 30, at 936 n.20. During the Congressional hearings, Representative Glass, co-sponsor of the Act, commented:

> [T]he purpose of this legislation is to protect the people of the United States in the right to have banks in which their deposits will be safe. They have a right to expect of Congress the establishment and maintenance of a system of banks in the United States where citizens may place their hard earnings with reasonable expectation of being able to get them out again upon demand.

Id.

Consistent with this view, Glass-Steagall[154] allowed a bank to purchase and sell securities solely as a service to customers and prohibited the bank from investing on its own behalf.[155] Glass-Steagall also prevented a bank from being affiliated with any entity engaged in the securities business, kept investment bankers out of commercial banking and prohibited interlocking management between securities firms and banks.[156] Administration of these provisions was delegated to the Comptroller of the Currency under supervision of the Board of Governors of the Federal Reserve System.[157]

The SEA was enacted to regulate the nation's securities markets through a comprehensive system of registration and reporting requirements administered by the SEC.[158] Banks were purposefully excluded from the provisions of the SEA and thus SEC jurisdiction, because Congress felt there was no need to subject banks to duplicative and potentially conflicting regulation.[159]

The judicial challenges that began with *Camp* in 1971 came principally from the Investment Company Institute and the SIA, trade associations interested in protecting their members by curtailing the securities activities of banks. The decisions invariably reflect the view that courts will grant deference to statutory interpretations by the administrative agency charged with enforcement if reasonable and not in contravention of congressional intent.[160] Judicial analysis of congressional intent in passage of Glass-Steagall focused on two main points—the desire to separate commercial and investment banking due to potential conflicts of interest and the desire to avoid duplicative regulation.[161]

The court's decision in *American Bankers* is entirely consistent with prior judicial action as to the permissible scope of agency action. Glass-Steagall was enacted to limit the securities activities of banks, subject to administration and interpretation by the Comp-

---

154. "Glass-Steagall" refers to §§ 16, 20, 21, and 32 of the Banking Act of 1933 which limit the securities activities of banks. *See supra* note 2 and accompanying text.

155. 12 U.S.C. § 24 (seventh). *See supra* note 2 (text of statute).

156. 12 U.S.C. § 377. *See supra* note 2 (text of statute).

157. 12 U.S.C. § 1. *See supra* note 16 and accompanying text.

158. *See supra* note 3 and accompanying text.

159. *See supra* note 36 and accompanying text.

160. *See Camp*, 401 U.S. at 621-22; *supra* note 57 and accompanying text.

161. *See Camp*, 401 U.S. at 623-24.

troller of the Currency.[162] The SEA created a comparable regulatory environment for the securities industry, controlled by the SEC.[163] The authority of both administrative agencies was statutory and neither had the ability to alter that authority by the promulgation of regulations.[164] In its definitions of "broker" and "dealer" in the SEA, Congress deliberately excluded banks from SEC jurisdiction.[165] The *American Bankers* court refused to allow the SEC to alter the balance of power by unilateral administrative action.

The arguments propounded by the SEC in *American Bankers* reflect its view that regulatory action was required due to increased securities activities by banks, particularly the banks' entry into the discount brokerage business.[166] The SEA was designed for investor protection.[167] The SEC expressed concern that banks were now offering a traditional brokerage service in direct competition with SEC-registered broker-dealers, without being subject to the same standards of knowledge, disclosure or review as broker-dealers under SEC purview.[168]

The court in *American Bankers* agreed that dramatic changes have occurred in the nature of financial institutions and in market practices during the past fifty years and specifically stated that Congress should undertake a comprehensive review of Glass-Steagall and the securities acts.[169] However, the court, in accord with prior policy, refused to accord deference to an administrative agency interpretation in contravention of congressional intent.[170] In promulgating Rule 3b-9, the SEC effectively altered the statutory definitions of "broker" and "dealer" contained in the SEA, making banks subject to all of the requirements of that Act and to SEC jurisdiction.[171] Since a primary congressional objective was the avoidance of duplicative regulation, the SEC's action was deemed unreasonable and, consequently, overturned.[172]

---

162. *See American Bankers*, 804 F.2d at 740.
163. *Id.* at 740-42.
164. *Id.* at 755.
165. *Id.* at 743-44.
166. *See* Spencer, *supra* note 99, at 626.
167. *See* 12 U.S.C. § 1.
168. *Id.* at 626-29.
169. *See American Bankers*, 804 F.2d at 751.
170. *Id.* at 740.
171. *See supra* note 6.
172. *See American Bankers*, 804 F.2d at 740, 743.

Rule 3b-9 was based on the premise that a bank's ability to offer traditional brokerage services without being subject to the SEA's registration and reporting requirements contravenes the SEA's goal of investor protection.[173] There is validity to the SEC's argument that an investor who chooses a bank to execute his securities transactions may not be receiving the same degree of customer protection as an investor who effects the same transaction through a registered broker-dealer.[174] Rule 3b-9 was an administrative attempt to ensure that all such transactions were comparably regulated.

However, the problem with the SEC's argument is that it supports its position by citing a bank's ability to offer discount brokerage services to customers, an activity permitted by Glass-Steagall. By definition, discount brokerage services are not traditional brokerage services.[175] A broker-dealer who offers discount brokerage services offers execution only; no investment advice is given. The customer makes his own investment decisions; the broker-dealer merely executes the requested trades as an accommodation. A bank which provides this accommodation service for its customers is doing exactly what section 16 of Glass-Steagall permits—purchasing and selling securities upon the order and for the account of customers.[176]

The SEC bases its context clause argument on the view that the nature and volume of services provided by banks have changed substantially in the years since Glass-Steagall and the SEA were enacted.[177] However, since accommodation services were expressly permitted, the real reason for Rule 3b-9 would appear to be the fact that more banks are engaging in more discount brokerage transactions. Support for this view may be found in the Rule itself which provides an exemption from registration for banks which execute less than 1000 transactions per year.[178] However, in effecting the separation of commercial and investment banking, Congress specified certain activities in which banks could engage, permitting activities that did not present a conflict of interest or potential

173. *See SEC Release, supra* note 122, at 28,387.
174. *See supra* note 129 and accompanying text.
175. *See supra* note 64 and accompanying text.
176. *See supra* note 2 and accompanying text.
177. *See SEC Release, supra* note 122.
178. 17 C.F.R. § 240.3b-9(b)(2) (1985).

breach of fiduciary duty.[179] No limitation was placed on the number of banks that could offer such services or the number of transactions a particular bank could execute. In fact, the approval of BankAmerica Corporation's application to acquire Charles Schwab was upheld because Schwab's profitability was dependent solely on the volume of shares traded.[180]

The legislative histories of Glass-Steagall and the SEA reflect the intent of Congress to prohibit banks from engaging in the type of securities activities which led to the stock market crash of 1929.[181] As part of this separation, Congress designed a statutory framework which subjected banks to regulation by the Comptroller and exempted them from duplicate regulation by the SEC.[182] It seems inconceivable that Congress intended to allow either agency the ability to alter that balance by administrative action.[183] It is submitted that if Rule 3b-9 had been upheld, the judiciary would have granted the SEC the power to regulate securities activities of banks not previously under their control solely because of the SEC's perception that the volume of such activity had increased.

On April 29, 1987, the SEC approved a legislative package for submission to Congress.[184] The proposal was based on Rule

---

179. *See Comp*, 401 U.S. at 634.

180. *BankAmerica*, 468 U.S. at 220-21.

181. 15 U.S.C. § 78(b). *See also Bankers Trust*, 468 U.S. at 137 (holding commercial paper to be a security); Conover v. Dean Witter Reynolds, 794 F.2d 520, 525-26 (9th Cir. 1986) (1933 and 1934 securities acts are to be read cumulatively to further their broad remedial purpose); *supra* notes 77-88 and accompanying text.

182. 12 U.S.C. § 24 (seventh). *See supra* note 2 (text of statute). *See also* Independent Banker's Ass'n of Am. v. Heimann, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980) (recognizing the comptroller's ability to accomplish regulatory supervision over unsafe and unsound banking practices by way of cease-and-desist proceedings under 12 U.S.C. § 1818 (1982)).

183. *See American Bankers*, 804 F.2d at 750.

184. *See SEC to Ask Congress to Require Banks to Register Securities Affiliates*, 19 Sec. Reg. & L. Rep. (BNA) No. 18, at 626 (May 1, 1987). The proposed bill is reprinted in 19 Fed. Sec. L. Rep. (CCH) ¶ 84,124 (May 13, 1987) [hereinafter SEC Bill]. As submitted to Congress, the Bill stated:

BILL

To amend the Securities Exchange Act of 1934 to ensure that all participants in the nation's securities markets are equally regulated, to promote fair competition among those providing essentially identical services, and to ensure adequate protection for all investors.

Be it enacted by the Senate and the House of Representatives of the United States of America in Congress assembled,

SECTION 1. TITLE

This Act may be cited as the Bank Broker-Dealer Act of 1987.

TITLE I—DEFINITIONS OF BROKER AND DEALER

SECTION 101. DEFINITION OF BROKER

Section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(4)) is amended to read:

(4)(a) the term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank except as provided in paragraph (b) of this subsection.

(b) The term "broker" includes any bank that: (1) publicly solicits brokerage business; (2) receives transaction-related compensation for brokerage services provided to trust, managing agency or other advised accounts; or (3) underwrites securities on an agency basis; provided that a bank will not be a broker if it restricts its activities to transactions in exempted securities.

SECTION 102. DEFINITION OF DEALER.

Section 3(a)(5) of the Securities Exchange Act of 1935 (15 U.S.C. § 78c(a)(5)) is amended to read:

(5)(a) The term "dealer" means any person engaged in the business of purchasing and selling securities for his own account, through a broker or otherwise, but does not include a bank, except as provided in paragraph (b) of this subsection, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

(b) The term "dealer" includes any bank that: (1) publicly solicits securities transactions to be effected on a principal basis, whether in a riskless principal capacity or otherwise; (2) receives transaction-related compensation for effecting transactions in securities on a principal basis for trust, managing agency or other advised accounts; or (3) deals in or underwrites securities; provided that a bank will not be a dealer if it restricts its activities to transactions in exempted securities.

SECTION 103. POWER TO EXEMPT FROM THE DEFINITIONS OF BROKER AND DEALER

Section 3 of the Securities Exchange Act is amended by inserting after section 3(d) the following new section:

(e) The Commission, by rule or order, upon its own motion or upon application, may conditionally or unconditionally exempt banks from the definitions of "broker" or "dealer," if the Commission finds that such exemption is consistent with the public interest, the protection of investors or the purposes of the Act.

SECTION 104. REQUIREMENTS THAT BANKS FALLING WITHIN THE DEFINITIONS OF BROKER OR DEALER PLACE THEIR SECURITIES ACTIVITIES IN A SEPARATE CORPORATE ENTITY

Section 15(a) of the Securities Exchange Act is amended to read:

Sec. 15(a)(1) It shall be unlawful for any broker or dealer that is either a person other than a natural person or a natural person not associated with a broker or dealer that is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exhange [sic]) to make use of the mails or any means or intrumentality [sic] of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with

3b-9[185] and was drafted in direct response to the court of appeals decision in *American Bankers*.[186] The SEC is requesting amendments to the present SEA definitions of "broker" and "dealer" that would alter the blanket exception for banks.[187] Specifically, banks that "(1) publicly solicit brokerage business; (2) receive transaction related compensation for providing brokerage services to advised accounts; or (3) deal in or underwrite securities would no longer be exempt."[188]

The proposal differs from Rule 3b-9 in several important respects. The Rule contains seven exemptions for various types of transactions.[189] The proposal exempts only banks that deal in exempted securities.[190] However, the proposal does add a new section, 3(e), to the SEA which would afford the SEC discretionary authority to exempt banks if within the public interest.[191] Under Rule 3b-9,

---

subsection (b) of this section.

(2) It shall be unlawful for any bank to act as a broker or dealer, except on an exclusively intrastate basis or in transactions in exempted securities, municipal securities, or commercial paper, bankers' acceptances, or commercial bills; provided, however, that this section shall not preclude a bank subsidiary or bank holding company affiliate, which is separate from the bank and is registered in accordance with subsection (b) of this section, from engaging in securities activities to any extent otherwise permissible by law.

(3) The Commission, by rule or order, as it deems consistent with the public interest and the protection of investors, may conditionally or unconditionally exempt from paragraphs (1) and (2) of this subsection any broker or dealer or class of broker[s] or dealer[s] specified in such rule or order.

TITLE II—SAVINGS PROVISIONS AND EFFECTIVE DATES

SECTION 201. JURISDICTION OF FEDERAL BANKING REGULATORS

Nothing in this Act affects the statutory provisions of the Glass-Steagall Act of 1933, 12 U.S.C. §§ 24, 377, 378, 78 or the jurisdiction of the Office of the Comptroller of the Currency or the Board of Governors of the Federal Reserve System to enforce the Glass-Steagall Act's provisions.

SECTION 202. GENERAL EFFECTIVE DATES

This Act shall take effect 180 days after the date of enactment of this Act.

185. *See* 19 Sec. Reg. & L. Rep. (BNA) No. 18, at 626 (May 1, 1987).
186. 19 Fed. Sec. L. Rep. (CCH) ¶ 84,124, at 88,667 (May 13, 1987).
187. *Id.*
188. *Id.* at 88,666.
189. 17 C.F.R. § 240.3b-9(b)(1) to (7). *See supra* note 6.
190. SEC Bill, *supra* note 184, §§ 101, 102.
191. *Id.* § 103.

banks had the option of either registering as broker-dealers themselves or establishing and registering securities affiliates.[192] The proposed amendments require banks that fall within the new definitions to establish separate entities registered as broker-dealers with the SEC.[193]

In drafting this proposal, the SEC expressly stated that the amendments were necessary because of the increased involvement of banks in securities activities.[194] The amendments are designed to achieve regulation by function instead of by industry classification. Under this approach, any entity engaged in the securities business will be subject to the same rules and regulations Congress initially imposed on broker-dealers alone.

VII. CONCLUSION

During the period from 1933 to 1940 Congress enacted substantial legislation regulating the nation's banks and securities markets. Glass-Steagall limited the securities activities of banks and the SEA regulated securities firms and markets. Included within the statutory framework was a system of administrative supervision which divided interpretive and enforcement authority among different federal agencies. The Comptroller of the Currency was primarily responsible for supervising banks while broker-dealers fell under SEC purview. This separation was reflective of a congressional objective to avoid duplicative regulation while keeping the commercial and investment banking businesses distinct.

When the SEA was enacted, banks were excluded from the definitions of "broker" and "dealer" so that any securities activities engaged in by banks remained subject to the jurisdiction of the Comptroller alone. In 1985, the SEC passed Rule 3b-9 which altered those definitions by removing the statutory exclusion for banks, thus subjecting banks' brokerage activities to SEC jurisdiction. While agreeing that administrative agencies do have considerable authority to interpret statutory provisions, courts have consistently refused to grant deference to that authority if the administrative interpretation is seen as unreasonable or in contravention of congressional intent.

---

192. *See* 19 Sec. Reg. & L. Rep. (BNA) No. 18, at 626 (May 1, 1987).
193. SEC Bill, *supra* note 184, at § 104.
194. *See* 19 Fed. Sec. L. Rep. (CCH) ¶ 84,124, at 88,667 (May 13, 1987).

The invalidation of Rule 3b-9 was not because of any failure to recognize the significant changes that have occurred in the banking industry or the need for functional regulation to provide consistent protection to the investing public. The court in *American Bankers* adopted the view that the statutory framework was a reflection of Congress' intent to keep the regulation of banking and brokerage institutions separate. Therefore, any change that would have the effect of altering that framework by submitting banks to a system of duplicate regulation would necessarily require legislative, not administrative, action.[195]

Sandra M. Krauss

195. *See American Bankers*, 804 F.2d at 755.