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FINANCIAL REGULATION UNDER THE GLASS-STEAGALL ACT: DEBATE AND RESOLUTION

INTRODUCTION*

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I want to begin, ominously perhaps, with a disclaimer. Although I think that the student editors of the New York Law School Law Review have done an outstanding job in gathering such an eminent panel of speakers and commentators for this Symposium, I would not have chosen the subtitle they have given to it: *Debate and Resolution.* I'm sure that today we'll have plenty of debate, but I doubt whether we'll be able to agree on a resolution because of the many issues on which there is such deep disagreement. Indeed, what is unusual about the Glass-Steagall Act ("Act")[1] is not that there are so many disputes—that's true of many areas of the law—but that there is little or no consensus on any major issue, either as to what the statute means or to how, if at all, it should be amended.

Our problems begin with the structure of the Act itself. It is often said, even by the Supreme Court,[2] that Congress intended that the Act

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* Professor Dent's introduction commenced the day-long Symposium on Financial Regulation Under The Glass-Steagall Act, held in New York Law School's Froessel Library on April 4, 1986.

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1. The Glass-Steagall Act is the popular name for the Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

2. *See, e.g.*, Investment Co. Inst. v. Camp, 401 U.S. 617, 629 (1971) ("one of the objectives of the Glass-Steagall Act was to prohibit commercial banks . . . from going into the investment banking business").

separate commercial and investment banking as completely as possible. Perhaps some congressmen conceived it this way, but in the end the Act was not so broadly drafted; rather, Congress dealt in rather ad hoc fashion with specific abuses thought in 1933 to have caused or exacerbated the Depression. For example, it permitted banks to execute sales and purchases of securities on customer's orders[3]—that is to say, to act as brokers—and to underwrite distributions of municipal bonds.[4] These exceptions or, more pejoratively, loopholes, were intended. Others, however, may not have been intended, such as the ability of banks that are not members of the Federal Reserve System to have affiliates or subsidiaries that engage in investment banking.[5] In short, the Act as drafted did not completely separate commercial and investment banking.

Congress' ad hoc approach has resulted in difficult questions concerning the Act's meaning and wisdom, questions that are further complicated by profound changes in the financial markets during the last fifty years. For example, the sale of municipal bonds, once fairly small potatoes, has grown enormously. More important, new financial products have been devised. Congress could not have had any specific intent in 1933 about products that did not yet even exist, and the ad hoc nature of the Act makes it hard to determine how Congress would have treated these products if they had existed then. For example, banks now want to create and manage pooled IRA accounts. These pools resemble both pooled trust accounts, which are permitted to banks, and mutual funds, which are not. How should they be treated under Glass-Steagall?[6]

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3. Section 16 of the Glass-Steagall Act provides in part:

> The business of dealing in securities and stock by [a national bank] 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 [national bank] shall not underwrite any issue of securities or stock.

12 U.S.C. § 24, para. 7 (1982).

4. Section 16 of the Glass-Steagall Act additionally provides: "The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any state or political subdivision thereof." *Id.*

5. *See* Investment Co. Inst. v. Federal Deposit Ins. Corp., 606 F. Supp. 683, 686 (D.D.C. 1985) (state banks insured by FDIC that are not members of the Federal Reserve System can own affiliated subsidiaries engaged in securities business).

6. *Compare* Investment Co. Inst. v. Conover, 596 F. Supp. 1496 (D.D.C. 1984) ("*ICI 2*") *with* Investment Co. Inst. v. Conover, 593 F. Supp. 846 (N.D. Cal. 1984) ("*ICI 1*"). Decided only three months apart, the two cases produced conflicting opinions. On virtually identical facts, the court in *ICI 1* held that collectively invested common IRA trust funds are "securities" for purposes of the Glass-Steagall Act, 593 F. Supp. at 858, while the court in *ICI 2* held that they are not, 596 F. Supp. at 1501. Recently, the Court of Appeals for the District of Columbia affirmed *ICI 2*, Investment Co. Inst. v. Conover, 790

In some cases new products have been created to circumvent the Glass-Steagall Act's limitations. For example, a few years ago securities firms began offering interests in money market funds and permitting investors to write drafts on these accounts for as little as $250. Technically these are not demand deposits, which investment banks may not offer; but to the consumer, it looks just like a checking account. Both the banking and securities industries have chafed under the restrictions imposed by Glass-Steagall and have sought ways to sell securities, in the case of the banks, and to accept deposits, in the case of the securities industry.

Add to the foregoing that the sums of money involved are immense, and it is not surprising that the Glass-Steagall Act and related legislation have given rise to continual conflict in both the courts and in Congress. This conflict is complicated by the participation of not just two sides but many. Not only has the securities industry squared off against the banking industry, but there has also been activity by consumer groups, the real estate and insurance brokerage industries, and several subgroups of the banking industry, such as nonmembers of the Federal Reserve System, regional banks, and thrifts.

Although I'm sure that we can't reach any consensus about what changes should be made in this field, I think we can agree that more change is inevitable. Litigation continues. For example, the Supreme Court has recently granted certiorari to decide whether an office of a national bank offering only discount brokerage services constitutes a "branch" for purposes of the McFadden Act.[7] Changes in the industry will continue as lawyers and businessmen devise new products and new ways to challenge the restrictions of the Act.

Perhaps the biggest question mark in the equation is what Congress should and will do. Despite rapid and often wrenching change in

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F.2d 925 (D.C. Cir. 1986), *cert. denied sub nom.* Investment Co. Inst. v. Clarke, 55 U.S.L.W. 3316 (U.S. Nov. 4, 1986) (No. 86-152), and the Court of Appeals for the Ninth Circuit reversed *ICI 1*, Investment Co. Inst. v. Clarke, 793 F.2d 220 (9th Cir. 1986), *cert. denied*, 55 U.S.L.W. 3316 (U.S. Nov. 4, 1986) (No. 86-153). *See also* Investment Co. Inst. v. Clarke, 630 F. Supp. 593 (D. Conn. 1986), *aff'd*, 789 F.2d 175 (2d Cir. 1986) (per curiam), *cert. denied*, 55 U.S.L.W. 3316 (U.S. Nov. 4, 1986) (No. 86-154), in which the District Court for the District of Connecticut agreed with the decision in *ICI 2*, holding that the operation of a collective investment trust for IRA assets does not run afoul of the Glass-Steagall Act. *Id.* at 597.

7. Securities Indus. Ass'n v. Comptroller, 577 F. Supp. 252 (D.D.C. 1983), *aff'd mem.*, 758 F.2d 739 (D.C. Cir. 1985), *cert. granted sub nom.* Clarke v. Securities Indus. Ass'n, 106 S. Ct. 1259 (1986). Section 8 of the McFadden Act permits national banks to transact general business in branches under certain circumstances. 12 U.S.C. § 81 (1982). The issue that the Supreme Court faces in *Clarke* is whether a bank may operate a brokerage subsidiary at non-branch offices. 577 F. Supp. at 257-58. The District Court for the District of Columbia, in reversing the Comptroller, found that the branching restrictions of the McFadden Act apply to brokerage activities. *Id.* at 259.

the financial industries, Congress has remained pretty much on the sidelines, unable or unwilling to act, content to let the courts, the government agencies, the states, and the parties themselves work things out as best they can. But Congress still receives floods of legislative proposals, proposing everything from total deregulation of banking to the removal of existing exceptions, or closing of loopholes, in the Act.[8] Perhaps as conditions become more unwieldy, Congress will finally be pressed into action. Many hope that Congress will act, but others, either believing that the status quo isn't so bad or that any legislative change would probably be for the worse, hope that Congress will leave things alone.

If Congress does act, what should it do? Debate rages over whether separation of investment and commercial banking is wise and, if so, how much separation. Some believe that involvement in investment banking would threaten the safety of the banks by exposing them to financial risks inherent in investment banking, to operating risks from entering unfamiliar fields, and to inevitable conflicts of interest from acting as lender and underwriter for the same companies, and as bank and broker for the same consumers.[9] Others argue that the separation of commercial and investment banking is artificial and inefficient; that it limits competition to the detriment of consumers; and that, by barring banks from potentially lucrative activities, it even defeats its own purpose of making banks safer. They see bank failures as creating no dangers considerably different from the dangers of failure in other industries, and believe that the market can handle dangers of concentration and conflicts of interest.[10] In between are those who would remove some of the current restrictions, but only with the institution of various safeguards.

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8. For example, a banking reform bill that was passed through the Senate in September, 1984, contained one provision that would have permitted commercial banks to "underwrite, deal in, sell, and distribute, as principal or agent or both, commercial paper issued by any entity." S. 2851, 98th Cong., 2d Sess. § 104(e)(3), 130 CONG. REC. 11,106, 11,165 (daily ed. Sept. 13, 1984) (proposed amendment to 12 U.S.C. § 1843(c) (1982)). This provision would have expanded the role of commercial banks in the field of investment. *See* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 137 (1984) (holding that commercial paper was a "security" for purposes of the Glass-Steagall Act and was therefore subject to the Act's restrictions). The bill eventually died in the House because of differences over the deregulation of the banking industry.

9. *See* Securities Industries Association, *Bank Securities Activities: Memorandum for Study and Discussion*, 14 SAN DIEGO L. REV. 751 (1977) (arguing that provisions of the Glass-Steagall Act should be tightened to restrict bank securities activities).

10. *See* Clark & Saunders, *Glass-Steagall Revised: The Impact on Banks, Capital Markets, and the Small Investor*, 97 BANKING L.J. 811 (1980) (arguing for revisions of the Glass-Steagall Act to break down the barrier between commercial and investment banking).

Although I doubt that we can resolve the issues we confront here today, I'm confident that our speakers will shed light on these problems and move us at least a step or two toward some answers.