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### Cover Page Footnote

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# SHOULD THE SEC REGULATE BANKS AS BROKER-DEALERS?

*Linda B. Matarese**

## I. INTRODUCTION

Incursions by banks[1] into broker-dealer services traditionally re-

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1. The term "bank" is used herein synonymously with commercial bank. Commercial banks make loans and hold and maintain bank customer deposits. Additionally, commercial banks offer trust services and fiduciary funds. *See* 12 U.S.C. § 24 (1982). Commercial banks include both federally-chartered national banks and state-chartered banks. *See* C. GOLEMBE & D. HOLLAND, FEDERAL REGULATION OF BANKING 1983–1984, at 15–25 (1983). For a discussion of the federal-state "dual banking system" and bank regulation, see *infra* note 9.

The incursions of banks into the securities industry was prompted by the offering of money-market mutual funds by the securities-brokerage industry, which increased competition for money that traditionally would have been invested in bank savings and checking accounts. C. GOLEMBE & D. HOLLAND, *supra*, at 190–91. At the same time, bank lending has decreased as many businesses seeking financing found it advantageous to issue commercial paper rather than to borrow money from a bank. *See Court Rules for Bank on Commercial Paper*, N.Y. Times, Dec. 24, 1986, at D1, col. 3, D2, col. 1 (noting that large corporate borrowers deserted banks in late 1970s because they could obtain funds by issuing commercial paper at less cost than banks charged for short-term loans). Moreover, congressional expansion of the powers of federal thrift institutions (savings and loan associations and savings banks) allowed these institutions to compete with commercial banks for deposits and other traditional banking services. *See* C. GOLEMBE & D. HOLLAND, *supra*, at 184–85 (citing Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified in scattered sections of 11, 12, 15, 20, and 42 U.S.C.)). Additional competition for deposit and lending dollars has come from outside the banking and thrift industries, with the growth of nonbank banks. *See id.* at 194–96 (defining "nonbank bank" as institution that either accepts demand deposits or makes commercial loans, but does not do both). Nonbank banks enjoy a competitive advantage because they are exempt from the restrictions of banking laws. *See id.*

The increased competition led to solvency problems and numerous bank failures. *See id.* at 43–48 (noting sharp increase in bank failures from ten in 1981 to forty-two in 1982); *10 Pct. of Banks and 21 Pct. of S & L's Are Ailing, Federal Regulators Say*, Philadelphia Inquirer, Jan. 6, 1987, at D15, col. 4 (noting 1986 bank failures marked six-year surge of bank collapses—138 failures in 1986, compared with 120 in 1985, 79 in 1984, 48 in 1983, 42 in 1982, and 10 in 1981).

served for the securities-brokerage industry[2] have raised questions regarding the regulation of bank brokerage activities.[3] Initially, the Glass-Steagall Act[4] (Glass-Steagall) prohibited banks from dealing in

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2. The securities-brokerage industry consists of full-service broker-dealers, who provide investment advice to customers, and discount broker-dealers, who merely execute purchase and sell orders placed by a customer but do not provide investment advice or management services. *See* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 209 (1984).

3. The recent incursions of banks into the securities brokerage industry has been made possible by banking agency interpretations of the Glass-Steagall Act, 12 U.S.C. §§ 24, 78, 377–378 (1982 & Supp. IV 1986). Courts have shown great deference to these agency interpretations. *See, e.g.*, Clarke v. Securities Indus. Ass'n, 107 S. Ct. 750, 762 (interim ed. 1986) (Comptroller of Currency ruling; banks permitted to open discount brokerage offices across state lines); Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 212 (1984) (Federal Reserve ruling; bank holding company authorized to acquire nonbanking entity principally engaged in discount securities brokerage); Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 78 (1981) (Federal Reserve ruling; bank holding company permitted to act as investment adviser to closed-end investment company); Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 807 F.2d 1052, 1057–58 (D.C. Cir. 1986) (Federal Reserve ruling; distribution of commercial paper by bank permissible under Glass-Steagall); Investment Co. Inst. v. Conover, 790 F.2d 925, 927 (D.C. Cir. 1986) (Comptroller of Currency ruling; collective investment trusts for IRA trust assets not violative of Glass-Steagall), *cert. denied*, 107 S. Ct. 421 (interim ed. 1986); Investment Co. Inst. v. FDIC, 606 F. Supp. 683, 686 (D.D.C. 1985) (Federal Deposit Insurance Corporation regulation; state nonmember banks of Federal Reserve System permitted to own affiliates that underwrite securities), *aff'd*, 815 F. 2d 1540 (D.C. Cir.), *cert. denied*, 108 S. Ct. 143 (interim ed. 1987).

Commentators have long expressed concerns about the entrance of banks into the securities brokerage industry and proposed regulation of bank brokerage services. *See* S. JAFFE, BROKER-DEALERS AND SECURITIES MARKETS § 2.06 (1977) (comparing regulatory structure of banks with that of securities brokerage industry and concluding that banking agencies may not be appropriate to regulate bank securities activities); Plotkin, *What Meaning Does Glass-Steagall Have for Today's Financial World?*, 95 BANKING L.J. 404, 417–18 (1978) (advocating that securities laws be applied to banks engaging in securities brokerage activities).

Following the recent agency rulings and court decisions beginning in 1981, commentators have expressed renewed concern over regulation of bank brokerage services. *See, e.g.*, R. KARMEL, REGULATION BY PROSECUTION 311 (1982) (noting disparity of bank brokerage regulation by banking agencies compared with broker-dealer regulation by the SEC). Roberta Karmel, former SEC Commissioner, recommended that Congress require banking agencies to issue broker-dealer regulations commensurate with those issued by the SEC. *Id.* In the alternative, Karmel suggested that bank brokerage services could be regulated by the SEC. *Id.*; *see also* Note, *An Alternative to Throwing Stones: A Proposal for the Reform of Glass-Steagall*, 52 BROOKLYN L. REV. 281, 325 (1986) (advocating SEC regulation of bank brokerage services to ensure equality of regulation between banks and securities brokerage industry) [hereinafter Note, *A Proposal for the Reform of Glass-Steagall*]; Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 VA. L. REV. 1303, 1347–49 (1983) (expressing concern for investor protection and advocating that SEC regulate bank brokerage services) [hereinafter Note, *National Banks and the Brokerage Business*].

4. Glass-Steagall is the popular name for the Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.). Although the Banking Act of 1933 contained many provisions of importance to the banking industry, such as those creating the Federal Deposit Insurance Corporation, the term "Glass-Steagall" has come to represent those sections directed toward separating the securities-brokerage industry from commercial banking. Glass-Steagall consists of four sections of the Banking Act of 1933, specifically §§ 16, 20, 21, and 32, codified respectively at 12 U.S.C. §§ 24, 377, 378, 78 (1982 & Supp. IV 1986).

securities as broker-dealers,[5] and broker-dealers from acting as banks.[6] The Securities Exchange Act of 1934[7] (Exchange Act) granted jurisdiction to the Securities and Exchange Commission (SEC) over broker-dealers and the securities industry. Banks, exempted from SEC jurisdiction,[8] were regulated by banking agencies.[9]

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5. Section 16 of Glass-Steagall sets forth restrictions governing bank securities activities. *See* 12 U.S.C. § 24 para. Seventh (1982 & Supp. IV 1986). National banks and state-chartered banks that are members of the Federal Reserve System are prohibited from underwriting any security or stock. *Id.* As an accommodation service, banks may purchase and sell securities, without recourse, solely upon the order and for the account of their customers. *Id.* Subject to certain limitations, a bank may purchase for its own account certain investment securities defined by the Comptroller of the Currency. *Id.* In addition, banks may deal in, purchase for their own account, or underwrite obligations or bonds of the United States and general obligations of the states and their subdivisions. *Id.*

6. Section 21 of Glass-Steagall prohibits organizations engaged "in the business of issuing, underwriting, selling, or distributing" securities from accepting deposits. *See id.* § 378.

7. 15 U.S.C. §§ 78a–78kk (1982 & Supp. IV 1986). Congress enacted the Exchange Act to protect investors from abuses that existed in the securities markets during the period prior to the collapse of the stock market and banking system in 1929. *See* S. REP. NO. 792, 73d Cong., 2d Sess. 2–5 (1934), *reprinted in* 5 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 (1973); *see also* Loomis, *The Securities Exchange Act of 1934 and the Investment Advisors Act of 1940*, 28 GEO. WASH. L. REV. 214, 216–17 (1960). The Act created the Securities and Exchange Commission (SEC), which administers and enforces the Act. 15 U.S.C. § 78d (1982). In part, the Act regulates the securities markets and establishes registration and reporting requirements for broker-dealers who effect transactions on securities markets. *Id.* § 78*o* (1982 & Supp. 1986).

Section 15 of the Act requires all brokers and dealers to register with the SEC unless an exemption is available. *Id.* Broker-dealers are subject to SEC jurisdiction if they come within the definitions of "broker" or "dealer" in Exchange Act § 3(a)(4)–(5), which provides that

> [w]hen used in this chapter, unless the context otherwise requires—
>
> . . . .
>
> (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.
>
> (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, 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.

15 U.S.C. § 78c(a)(4)–(5) (1982). For a discussion of the consequences of broker-dealer registration, see S. JAFFE, *supra* note 3, § 2.02.

8. Banks are exempted from SEC regulation and from registration as brokers and dealers because the definitions of broker and dealer in the Exchange Act specifically exclude banks. *See* 15 U.S.C. § 78c(a)(4)–(5) (quoted *supra* note 7). According to further provisions of the Act, a bank is excluded from the definitions of "broker" and "dealer," "unless the context otherwise requires," if it is:

> (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, a substantial portion of the business of which consists of receiving deposits . . . and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this [title].

*Id.* § 78c(a)(6) (1982).

9. A bank must obtain a corporate charter before it can function. *See* P. WELCH & G. WELCH, ECONOMICS 216–17 (1982). Under the dual banking system in the United States, both

Recently, securities brokerage activities by banks have expanded dramatically.[10] A 1982 reinterpretation of Glass-Steagall by the Comptroller of the Currency (Comptroller) led to a sudden increase of banks entering the discount securities-brokerage industry.[11] When in 1985 the SEC adopted rule 3b-9[12] to regulate banks as broker-dealers under the Exchange Act, a jurisdictional controversy arose over the SEC's authority to regulate banks.

In *American Bankers Association v. SEC*,[13] an association repre-

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federal and state governments have the right to charter banks. If a bank incorporates under a state bank charter, a state banking agency has supervisory authority; if under a federal charter as a national bank, the Comptroller of the Currency has regulatory authority. *Id.* In addition, both federal and state-chartered banks may be regulated by the Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System (Federal Reserve). *Id.* The Federal Reserve regulates national banks, those state-chartered banks that elect to become members in the Federal Reserve (state member banks), and all bank holding companies. *Id.* The FDIC insures deposits in all national banks and state member banks. *Id.* Other state-chartered banks may join the FDIC and thus become subject to federal regulation. *Id.; see also* 1 W. SCHLICHTING, T. RICE, & J. COOPER, BANKING LAW § 2.03 (1986) (discussing regulatory interaction of state and federal banking agencies); C. GOLEMBE & D. HOLLAND, *supra* note 1, at 1–29 (discussing history of dual banking system and relevant regulatory agencies.

10. Before 1977, bank securities activities were minimal. Only one bank advertised itself as a retail broker. *See* SECURITIES AND EXCHANGE COMMISSION, INITIAL REPORT ON BANKS SECURITIES ACTIVITIES 88–89 (1977) [hereinafter SEC INITIAL REPORT], *reprinted in* SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 95TH CONG., 1ST SESS., REPORTS ON BANK SECURITIES ACTIVITIES OF THE SECURITIES AND EXCHANGE COMMISSION 97–98 (Comm. Print 1977) [hereinafter SENATE COMM. PRINT]. However, bank securities activities have expanded exponentially since then. By 1983, an estimated one thousand banks were engaged in securities brokerage activities. *See* 50 Fed. Reg. 28,385, 28,386 (1985) (codified at 17 C.F.R. 240.3b-9) [hereinafter SEC Final Rule]. By 1984, the number had increased to 1,200. *See* [Current Report] Fed. Banking L. Serv. (Pratt) (Apr. 20, 1984) 4 (statement by FDIC Chairman William Isaac).

11. As the federal chartering authority for national banks, the Comptroller has led the expansion in bank brokerage powers through numerous reinterpretations of § 16 of Glass-Steagall. *See* Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank, [1982–1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284 (Comptr. Currency Aug. 26, 1982) (authorizing national banks to offer discount securities-brokerage services through subsidiaries to nonbanking customers), *aff'd in part and rev'd in part on other grounds sub nom.* Securities Indus. Ass'n v. Comptroller of the Currency, 577 F. Supp. 252, 255 (D.D.C. 1983) (upholding Comptroller's interpretation of § 16 of Glass-Steagall), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986).

The other two federal banking agencies, the Federal Reserve and the FDIC, also have reinterpreted §§ 16 and 21 of Glass-Steagall to allow banks to offer discount securities-brokerage services to nonbanking customers. *See* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 209 (1984) (upholding Federal Reserve authorization of bank holding company to acquire the discount securities brokerage of Charles Schwab & Co.); FDIC Gen. Counsel's Op. No. 6, 48 Fed. Reg. 22989 (1983) (authorizing state banks that are insured by, but not members of, Federal Reserve to offer discount brokerage services), *reprinted in* 4 Fed. Banking L. Rep. (CCH) ¶ 47,998E (May 23, 1983).

12. SEC Final Rule, *supra* note 10. Rule 3b-9 required banks that engage in securities brokerage for profit to register as broker-dealers under the Exchange Act. *Id.* at 28,386.

13. 804 F.2d 739 (D.C. Cir. 1986).

senting the banking industry[14] successfully challenged the authority of the SEC to issue rule 3b-9. Reversing a lower court ruling, the United States Court of Appeals for the District of Columbia Circuit held that the SEC had no jurisdiction under the Exchange Act to regulate banks as broker-dealers.[15] Because the rule conflicted with the intent of Congress clearly set forth in the language of the Exchange Act and its legislative history, the court declared the SEC's promulgation of the rule unlawful.[16] Furthermore, the court held that responsibility for regulating bank brokerage services rests with the appropriate banking agencies, and can only be changed by congressional action.[17]

This article examines the court's holding, its implications, and SEC legislative initiatives in response to the decision. Part II of this article reviews the relationship of banks and the securities industry, scrutinizes the statutory authority for the SEC to regulate banks as broker-dealers, and discusses judicial decisions that consider SEC authority to alter the definition of "bank" in the Exchange Act. Part III examines the *American Bankers* decisions. Part IV analyzes the appellate court decision and its implications, argues that upholding the SEC regulation would have been an equally-rational alternative, and presents recommendations for congressional action. Part IV also suggests that the *American Bankers* decision will result in minimal regulation of bank brokerage activities by the banking agencies, thereby leaving numerous investors without the type of protections provided by SEC regulation of registered broker-dealers. The author proposes solutions to this jurisdictional controversy that would maintain separate regulatory jurisdiction by banking agencies over banks while providing for comprehensive investor protection. Finally, Part V considers legislation proposed by the SEC to enact rule 3b-9 in response to the *American Bankers* decision and by the Senate Committee on Banking, Housing and Urban Affairs to partially repeal Glass-Steagall and, at the same time, to authorize the SEC to regulate banks as broker-dealers.

## II. BACKGROUND

### A. *Banks and the Securities Industry*

The separation of banking and the securities-brokerage industry

14. *See* Brief for Plaintiff-Appellant at 7, *American Bankers Ass'n* (No. 85-6055) (noting that American Bankers Association includes national banks, member banks of Federal Reserve, and state-chartered banks not members of Federal Reserve but insured by FDIC).

15. *American Bankers Ass'n*, 804 F.2d at 743 (reversing district court decision that had upheld rule 3b-9).

16. *Id.* at 740.

17. *Id.* at 755 (warning SEC that it cannot on its own authority extend its jurisdiction over banks regulated by federal and state banking agencies).

has been a predominant regulatory principle since the nineteenth century.[18] Historically, banks accepted deposits from the public and made loans,[19] while securities broker-dealers bought and sold securities to the public for profit.[20] Bank brokerage activities were at first limited to non-profit accommodation services to bank customers, whereby banks would place orders for securities at customer request.[21] Ostensibly prohibited from dealing in securities with persons who were not banking customers, banks circumvented these restrictions by organizing separate bank subsidiaries or affiliates that bought and sold securities to the public.[22]

Bank brokerage activities flourished through these affiliates until the stock market crash of 1929 and the collapse of the banking system.[23] Subsequent congressional hearings determined that bank securi-

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18. *See* Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 BANKING L.J. 483, 485–87 (1971) (discussing basis of American banking system; banking and securities brokerage were two distinct functions and should be performed in separate institutions).

For a discussion of the history of separation of commercial and investment banking, see generally Pitt, Miles, & Dabney, *The Evolving Financial Services Industry; Statutory and Regulatory Framework and Current Issues in the Banking/Securities Arena*, in SECURITIES ACTIVITIES OF BANKS 15–29 (1983). The United States banking system inherited the eighteenth-century English view that deposits and investment in securities should remain separated. *Id.* at 15. However, the state-federal dual bank-chartering system in the United States, which evolved in the nineteenth century, did not lend itself to this separation. *Id.*

19. *See supra* note 1 (discussing banking functions).

20. *See supra* note 2 (discussing functions of securities brokerage industry).

21. *See* Note, *National Banks and the Brokerage Business*, *supra* note 3, at 1303–35 (1983) (prior to 1933, banks regularly bought and sold securities on behalf of bank customers); *see also* Block v. Pennsylvania Exchange Bank, 253 N.Y. 227, 232–33, 170 N.E. 900, 901–02 (1930) (upholding bank practice of purchasing securities for banking customers that have sufficiently large deposit accounts); Le Marchant v. Moore, 150 N.Y. 209, 215, 44 N.E. 770, 772 (1896) (concluding that it was common practice for bank customers to purchase securities through banks).

22. *See* 5 V. DI LORENZO, W. SCHLICHTING & J. COOPER, BANKING LAW § 96.02[1] (1986) [hereinafter BANKING LAW] (discussing organization of securities affiliates). Securities affiliates were organized by national banks because the National Bank Act denied such banks any securities-brokerage powers. *Id.* In contrast, state-chartered banks had expansive securities-brokerage and underwriting powers. *Id.* The formation of securities affiliates by national banks enabled them to compete with the securities-brokerage industry and with state-chartered banks. *Id.* *See generally* Perkins, *supra* note 18, at 487–90 (affiliates, subsidiaries of banks exempt from underwriting prohibitions, were created by giving bank's stockholders shares in affiliate, investing bank funds in affiliate, or granting ownership to holding company that also controlled bank).

23. *See* 5 BANKING LAW, *supra* note 22, § 96.02[1] (securities affiliates conducted extensive securities activities during World War I). Banks were a predominant force in the securities industry after Congress permitted banks to conduct "certain underwriting activities" by passing the McFadden Act in 1927. *Id.* (citing McFadden Act, ch. 191, 44 Stat. 1224 (1927) (codified in scattered sections of ch. 3 of 12 U.S.C.)); *see also* Perkins, *supra* note 18, at 486–97 (tracing development of securities affiliates). The downfall of the bank securities-affiliate system came with the failure of the Bank of the United States in December 1930. *Id.* at 496–97; *see also* Note, *An Adjustment in the National Banking Laws*, 22 GEO. L.J. 85, 85 (1933) (remarking that high point of bank insolvencies came in 1931, when 2,300 banks failed in one year). In all, 5,000 banks failed

ties-brokerage activities had been a major cause of the crisis.[24] As a result, Congress enacted Glass-Steagall[25] to separate banks from the securities-brokerage industry.[26] Under the Act, banks were initially prohibited from engaging in all broker-dealer activities,[27] but were later permitted to provide limited brokerage-accommodation services to

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between 1929–1933 and an additional 1,200 were absorbed by more solvent banks. J. COCHRAN, MONEY, BANKING, AND THE ECONOMY 63–65 (1979). *See generally* Note, *Bank Holding Companies Attempt to Enter a Forbidden Market*—Investment Company Institute v. Board of Governors of the Federal Reserve System, 1980 WIS. L. REV. 976, 979–80 (detailing commercial-bank securities activities prior to collapse of banking system).

24. Senator Carter Glass (D-Va.) maintained that bank securities activities were one of the chief causes of the Great Depression. *See* 75 CONG. REC. 9887 (1932) (statement of Sen. Glass). Congress enacted Glass-Steagall in part because it thought that the connection between banking and the securities industry led to the rash of bank failures. *See, e.g.*, S. REP. NO. 77, 73d Cong., 1st Sess. 6, 10 (1933). Many believe that the diversion of bank depositors' funds into the speculative markets of Wall Street was one of the major causes of the financial crisis. *E.g.*, 77 CONG. REC. 3907 (1933) (Statement of Sen. Koppleman); *see also* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 137, 144 (1984) (explaining that Glass-Steagall responded to widely-expressed opinion that involvement in the securities industry through security affiliates caused banks to fail); Pitt & Williams, *The Glass-Steagall Act: Key Issues for the Financial Services Industry*, 11 SEC. REG. L.J. 234, 235–27 (1983) (noting belief of Congress that bank securities-brokerage activities caused 1929 financial crisis and Great Depression).

However, S. REP. NO. 305, 100th Cong., 2d Sess. (1988), issued in connection with S. 1886, 100th Cong., 134 CONG. REC. S3521 (1988) (discussed *infra* notes 219–30), concluded that bank securities activities "were not a substantial cause" of the 1929 crash. S. REP. NO. 305, *supra*, at 8–9.

25. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

26. *See Hearings Pursuant to S. Res. No. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3rd Sess., pt. I, at 1001 (1931) (during hearings on bank securities activities, Senator Glass became convinced that separation of banking and securities industry was essential to integrity of banking system); *see also* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 137, 147–48 (1984) (quoting Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61–62, 70 (1981) (citing 77 CONG. REC. 3,837 (1933) (statement of Rep. Steagall)) (Congress enacted Glass-Steagall to separate as completely as possible banking from securities industries); Note, *An Adjustment in the National Banking Laws*, *supra* note 23, at 86–87 (noting congressional intent supporting Glass-Steagall was to separate banking and securities industries by preventing bank speculation using depositor funds). Ultimately, President Franklin D. Roosevelt recommended passage of Glass-Steagall because it separated banks from the securities industry. 76 CONG. REC. 1940 (1933) (message of President Roosevelt), *cited in* Port of N.Y. Authority v. Baker, Watts & Co., 392 F.2d 497, 498 (D.C. Cir. 1968).

27. *See* Banking Act of 1933, ch. 89, § 16, 48 Stat. 162, 184–85 (codified as amended at 12 U.S.C. § 24) (forbidding sale of corporate securities including sales made as accommodation services to bank customers). The Comptroller also interpreted § 16 of Glass-Steagall to prohibit banks from engaging in any bank brokerage services, even as an accommodation service to bank customers. *See* 1933 COMPTR. CURRENCY ANN. REP. 11, *cited in* Kress, *The Banking Act of 1935*, 34 MICH. L. REV. 155, 177 n.103 (1935) (commenting that Federal Reserve had instructed member banks that Glass-Steagall prohibitions on purchase and sale of securities by banks included services provided to bank customers); *see also* Investment Co. Inst. v. Comptroller of the Currency, 401 U.S. 617, 623 n.10 (1971) (stating that § 16 of Glass-Steagall originally granted banks no authority to make securities purchases for accounts of existing bank customers).

existing bank customers.[28] Moreover, the Act also prohibited broker-dealers from receiving deposits and thus acting as banks.[29]

### B. SEC Authority to Regulate Banks as Broker-Dealers

Following the passage of Glass-Steagall, Congress enacted the Exchange Act[30] to regulate broker-dealers. Under the Exchange Act, the SEC subjected broker-dealers to comprehensive regulation of securities sales and marketing practices.[31] Banks, regulated by the Comptroller, Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), and state banking

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28. The Federal Reserve and the Comptroller, dissatisfied with the Glass-Steagall § 16 prohibition on securities accommodation services to bank customers, issued their own reinterpretations of § 16 to permit non-profit securities-accommodation services to existing bank customers. *See* Kress, *supra* note 27, at 177–78 nn.102–03.

The 1935 amendments to § 16 of Glass-Steagall codified this interpretation. *See* Banking Act of 1935, ch. 614, § 308, 49 Stat. 684, 709; *see also Banking Act of 1935: Hearings on S. 1715 and H.R. 7617 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 74th Cong., 1st Sess. 153 (1935) (statement of J.F.T. O'Connor, Comptroller of the Currency) (approving of accommodation services but warning that amendment to § 16 of Glass-Steagall did not authorize banks to conduct general securities brokerage to nonbanking customers) [hereinafter *Hearings*]; S. REP. NO. 1007, 74th Cong., 1st Sess. 17 (1935); H.R. REP. NO. 742, 74th Cong., 1st Sess. 18 (1935); 1 Bull. Comptr. Currency ¶ 36 (Oct. 26, 1936) (limiting banks to non-profit securities-accommodation services for bank customers), *cited in* American Bankers Ass'n v. SEC, 804 F.2d 739, 740–41 (D.C. Cir. 1986).

29. *See supra* note 6 (noting that § 21 of Glass-Steagall prohibited securities brokerages or investment banks from accepting deposits).

30. 15 U.S.C. §§ 78a–78kk (1982 & Supp. IV 1986); *see also supra* note 7 and accompanying text (discussing registration of broker-dealers under Exchange Act).

In addition to Glass-Steagall and the Exchange Act, other legislation responding to the 1929 financial crisis included the Securities Act of 1933, ch. 38, tit. I, 48 Stat. 74 (codified at 15 U.S.C. §§ 77a–77aa) (regulating issuance of corporate securities), and the Public Utility Holding Company Act of 1935, ch. 687, tit. I, 49 Stat. 803 (codified in scattered sections of 15 U.S.C.) (regulating use of holding-company structure by public utilities to prevent abusive pyramiding of parent and subsidiary companies that had encouraged issuance of large amounts of worthless securities during 1920s).

31. For a discussion of regulatory obligations of broker-dealers, see S. JAFFE, *supra* note 3, §§ 1.06, 2.02. A broker-dealer is required to register with the SEC by completing a form that discloses the history and past associations of all principals and employees. *Id.* § 2.02 (discussing 15 U.S.C. § 78*o*(b) (1982)). Subject to SEC bookkeeping rules, a broker-dealer must file a balance sheet and income statement and must satisfy net-worth and capital requirements of between $2,500 and $50,000. *Id.* (citing 17 C.F.R. 240.15c3-1 (1987)).

Furthermore, the principals of an SEC-registered broker-dealer must pass examinations to determine their qualifications in the securities industry and all broker-dealers are subject to bonding requirements. *Id.* SEC-registered broker-dealers are regulated by the stock exchanges, the National Association of Securities Dealers (NASD), the National Market Advisory Board, and the Municipal Securities Rule Making Board, as well as state agencies acting under state securities laws. *Id.* § 1.06. In addition, the Securities Investor Protection Corporation (SIPC) oversees financial responsibility of broker-dealers and insures customer accounts in the event of broker-dealer financial difficulty. *See id.* § 14.02. For a comprehensive discussion of SIPC protection of investor funds, see also E. GUTTMAN, MODERN SECURITIES TRANSFERS app. 81–195 (Supp. 1985).

agencies, were exempt from SEC jurisdiction.[32] Congressional intent supporting such an exemption for banks, however, was unclear.[33]

1. The Bank Exemption: Ascertaining Congressional Intent

As originally proposed, the Exchange Act did not contain an exemption for banks from the definitions of "broker" and "dealer."[34] During congressional hearings prior to the Act's passage, witnesses supported the proposed bank exemption because of the limitations on bank brokerage powers already existing under Glass-Steagall. One commentator argued for the bank exemption because bank brokerage activities were minimal under Glass-Steagall, limited to non-profit banking-customer accommodation services and, thus, SEC jurisdiction was unnecessary.[35] Another commentator supported the exemption on the grounds that banks were already regulated by banking agencies and should not be subjected to the jurisdiction of two agencies.[36] With bank brokerage activities remaining minimal for over forty years following passage of Glass-Steagall and the Exchange Act, Congress did not seriously reexamine the bank exemption until 1975.[37]

2. Congress Reexamines the Bank Exemption

In amending the Exchange Act in 1975, Congress recognized that reinterpretations of the scope of Glass-Steagall by banking agencies

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32. *See supra* notes 8–9 and accompanying text (discussing bank exemption and banking-agency regulation).

33. *See infra* notes 35–36 and accompanying text (describing conflicting testimony supporting bank exemption).

34. *See* American Bankers Ass'n v. SEC, 804 F.2d 739, 746 (D.C. Cir. 1986).

35. *See Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 86 (1934) (statement of Thomas G. Corcoran, Counsel to the Reconstruction Finance Corporation) (explaining that limitations on bank securities activities in Glass-Steagall provided basis for excluding banks from definitions of "broker" and "dealer") [hereinafter *Hearings on Stock Exchange Regulation*], *reprinted in* 8 J. ELLENBERGER & E. MAHAR, *supra* note 7. Corcoran supported the bank exemption because, under Glass-Steagall, banks could no longer act as broker-dealers and were limited to minimal accommodation services that did not need to be regulated. *Hearings on Stock Exchange Regulation, supra*, at 86; *see also Stock Exchange Practices: Hearings Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess., pt. 15, at 6470 (1934) (statement of Thomas G. Corcoran, Counsel to the Reconstruction Finance Corporation) (agreeing that Glass-Steagall permitted banks only to buy securities for their own account and to provide accommodation services to bank customers) [hereinafter *Hearings on Stock Exchange Practices*], *reprinted in* 6 J. ELLENBERGER & E. MAHAR, *supra* note 7.

36. *See Hearings on Stock Exchange Regulation, supra* note 35, at 7222–24 (statement of William Potter, Chairman of the Board, Guaranty Trust Co. of New York) (arguing for bank exemption because banks were regulated by Comptroller, Federal Reserve, and other banking agencies), *reprinted in* 6 J. ELLENBERGER & E. MAHAR, *supra* note 7.

37. *See* Act of June 4, 1975, Pub. L. No. 94-29, § 11(a)(3), 89 Stat. 97, 112 (directing SEC to reexamine bank exemption).

had caused a gradual increase in bank broker-dealer activities.[38] Thus, it directed the SEC to study the effect of increased bank brokerage activities on the bank exemption and to recommend legislation.[39] In its reports to Congress two years later, the SEC concluded that bank brokerage activities remained minimal and that the bank exemption should, at this time, remain unchanged,[40] but warned that changes in bank broker-dealer activities might affect the agency's conclusion.[41]

3. Rule 3b-9 and SEC Authority to Issue the Rule Under the "Context Clause"

The dramatic increase after 1977 in bank brokerage activities,[42]

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38. *See* H.R. REP. NO. 123, 94th Cong., 1st Sess. 93 (1975) (stating that although Glass-Steagall was thought to have "effectively removed banks from the securities business," banks recently have begun to engage in many securities-related activities). In 1975, Congress questioned the bank exemption because recent banking-agency interpretations of Glass-Steagall were beginning to expand bank securities activities. *Id.* For example, in a 1957 decision, the Comptroller permitted banks to receive profit from brokerage accommodation services for bank customers. 1957 Dig. Op. Comptr. Currency ¶ 220A, *quoted in* Letter from James Smith, Comptroller of the Currency, to Duane Vieth (June 10, 1974) [hereinafter Letter], [1973–1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272, at 81,357–58. Later, in 1974, the Comptroller permitted banks to offer and advertise computer-assisted stock purchasing services. Letter, *supra,* ¶ 96,272, at 81,353.

39. 15 U.S.C. § 78k-1(d)(3)(B) (1982) (authorizing SEC to recommend appropriate legislation if it concluded that banks should be subjected to SEC broker-dealer regulation).

40. *See* SEC INITIAL REPORT, *supra* note 10, at 69 (noting that in 1977 only one bank offered securities-brokerage services to nonbanking customers), *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 79. All other banks offered accommodation services as an "informal service . . . marketed to bank customers . . . rarely mentioned in bank literature, and viewed . . . uniformly unprofitable to the bank." SEC INITIAL REPORT, *supra* note 10, at 69, *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 79; *see also* SEC INITIAL REPORT, *supra* note 10, at 33 (recommending that Congress direct banking agencies to issue regulations that would protect investors if bank broker-dealer activities were to increase), *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 43; SECURITIES AND EXCHANGE COMMISSION, FINAL REPORT ON BANKS SECURITIES ACTIVITIES 43 (1977) [hereinafter SEC FINAL REPORT], *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 343. The Bank Study distinguished areas of bank broker services that lacked regulation. SEC INITIAL REPORT, *supra* note 10, at 69, *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 79.

41. *See* SEC FINAL REPORT, *supra* note 10, at 43, *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 343. The SEC submitted its initial report on January 3, 1977, second report on February 3, 1977, and a final report on June 30, 1977. *See generally* Plotkin, *Confirmation and Recordkeeping Requirements,* in LEGAL PROBLEMS OF BANK REGULATION 1299–1300 (1978) (summarizing results of 1977 SEC reports on bank securities activities). The "[r]eport concluded that it was not necessary to remove the exclusion for banks but that certain bank securities should be more intensely and uniformly regulated by bank regulatory agencies." *Id.* at 1299. The SEC "recommended (1) adoption of uniform recordkeeping requirements and uniform confirmation standards for bank securities activities; (2) development of detailed examination procedures and examiner training in bank securities activities; (3) establishment of competency requirements for bank securities personnel; (4) consultation with SEC concerning bank securities activities; and (5) adoption of a statutory requirement mandating federal bank agencies to act for the protection of investors." *Id.*

42. *See supra* notes 10–11 and accompanying text (discussing banking-agency interpretations that expanded bank brokerage powers and resultant actual increase in bank brokerage activi-

which were conducted outside comprehensive SEC regulation, raised substantial concerns about investor protection.[43] Banks first expanded accommodation services offered to bank customers through dividend reinvestment plans and automatic investment services.[44] In addition, banks entered "networking" arrangements with SEC-registered broker-dealers.[45] After 1982, a conflict arose between the securities industry and banks, as banks began executing bank customer and non-customer buy or sell orders, without investment advice, through discount brokerage services.[46]

In response, the SEC determined that it had the authority to reinterpret Exchange Act definitions[47] and noted that the Exchange Act charges the SEC with investor protection and safeguarding the national banking system.[48] The SEC contended that the Act's definitions of

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ties since 1977).

43. *See* 48 Fed. Reg. 51,930 (1983) (to be codified at 17 C.F.R. § 240.3b-9) (proposed Nov. 15, 1983) (proposing to regulate bank brokerage services to assure investor protection, complete and effective regulation of securities markets, and maintenance of fair and orderly markets) [hereinafter SEC Original Proposal].

44. *See* Norton, *Up Against "The Wall": Glass-Steagall and the Dilemma of Deregulated ("Reregulated") Banking Environment*, 42 BUS. LAW. 327, 353 (1987). In a dividend reinvestment plan, a bank purchases shares of common stock for its bank customers and credits the stock dividends directly to the customers' bank accounts. *Id.* at 355. Automatic investment services authorize a bank to deduct a fixed amount monthly from the checking account of its bank customers. *Id.* at 356. The amount is invested in common stock of the top twenty-five corporations on Standard and Poor's Industrial Index. *Id.*

45. In a "networking" arrangement, the broker-dealer leases space from a bank and pays the bank a percentage for orders by bank customers that have been directed to the broker-dealer by the bank. SEC Original Proposal, *supra* note 43, at 51,390 n.3 (describing INVEST networking arrangement).

46. Norton, *supra* note 44, at 359–63; *see also* SEC Final Rule, *supra* note 10, at 28,386–87 (noting approval of Comptroller in 1982 to creation of broker-dealer subsidiaries of national banks). In 1983, the Federal Reserve amended Regulation Y to permit bank holding companies to engage in discount brokerage. 12 C.F.R. § 225 (1987). *See generally* Norton, *supra* note 44 (discussing ongoing court battles between securities industry and banks). Currently, bank holding companies offer investment advice and information in a manner akin to a full-service securities brokerage. *See* Norton, *supra* note 44, at 363–64 (noting Federal Reserve approval of National Westminster Bank PLC (NatWest) to provide investment advice).

47. *See* SEC Final Rule, *supra* note 10, at 28,395 (amending Exchange-Act definitions of "broker" and "dealer" pursuant to authority in Exchange Act §§ 2, 3, 15, 23(a), 15 U.S.C. §§ 78b, 78c, 78*o*, 78w(a) (1982)).

Section 23(a)(1) of the Exchange Act grants the SEC "power to make such rules and regulations as may be necessary to implement the provisions" of the Act. 15 U.S.C. § 78w(a)(1). In addition, § 3(b) provides that the SEC "shall have power by rules and regulations to define technical, trade, accounting, and other terms" used in the Act. 15 U.S.C. § 78c(b). For a description of other Exchange-Act provisions, see *supra* note 7 (§ 15) & *infra* note 48 (§ 2).

48. *See* Brief for Defendant-Appellee at 27, American Bankers Ass'n v. SEC, 804 F.2d 739 (D.C. Cir. 1986) (No. 85-6055) (arguing that § 2 of Exchange Act confirms that Congress did not intend to exempt banks from "broker" and "dealer" registration in order to permit them to carry out brokerage activities outside newly-established regulatory structure for broker-dealer business). Section 2 of the Exchange Act charges the SEC "to impose requirements necessary to

"broker," "dealer," and "bank" were not plain and unambiguous, but were conditioned by the words "unless the context otherwise requires," which precede the definitions in the Act.[49] Therefore, the SEC concluded that the "context clause" gave it authority to change the definitions not only to unify them within the text of the Act, but also to correspond with changes in the factual and regulatory circumstances in which the definitions were originally employed.[50]

The SEC asserted that the factual context had changed significantly since the time of the Act's adoption in 1934.[51] According to the SEC, the original context exempted banks from SEC jurisdiction because Congress believed that Glass-Steagall authorized only minimal, banking-customer accommodation services.[52] However, banking agency interpretations and court decisions changed this context by permitting banks to offer the same brokerage services provided by SEC registered broker-dealers.[53] Thus, in 1985, believing that the changed factual context merited a change in the regulatory context, the SEC promulgated rule 3b-9.[54]

Rule 3b-9, as originally proposed, would have required all banks that solicit brokerage business and receive profits from brokerage services to register with the SEC as broker-dealers.[55] Banks that engaged

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make [securities] regulation . . . complete and effective . . . to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets." 15 U.S.C. § 78(b) (1982).

49. *See* SEC Final Rule, *supra* note 10, at 28,392 (citing context clause as statutory authority to alter definitions); *see also* Securities Act Release No. 5491 (SEC Apr. 30, 1974) (Exchange Act definitions may be "modified, altered or even inapplicable [sic] if the context otherwise requires"), *quoted in* SEC Original Proposal, *supra* note 43, at 51,932.

50. SEC Final Rule, *supra* note 10, at 28,392.

51. *Id.*

52. *Id.* at 28,392–93.

53. *Id.* at 28,393.

54. Rule 3b-9, 17 C.F.R. 240.3b-9 (1987).

Rule 3b-9 was originally proposed in 1983. *See* SEC Original Proposal, *supra* note 43 (soliciting comments on proposed rule). After the comment period, the rule was adopted in 1985 to become effective January 1, 1986. SEC Final Rule, *supra* note 10 (adopting rule as proposed with new exemptions from SEC registration as suggested by banks).

55. SEC Original Proposal, *supra* note 43. Rule 3b-9 provides that the term "bank," as used in the exemption from the definition of "broker and "dealer" in the Exchange Act, does not include a bank that (i) publicly solicits brokerage business for transaction-related compensation; or (ii) receives transaction-related compensation for providing brokerage services for trust, managing agency, or other accounts to which the bank provides advice; or (iii) deals in or underwrites securities other than exempted or municipal securities. Rule 3b-9, *supra* note 54, § 240.3b-9(a). For the Exchange Act definitions of "broker" and "dealer," see *supra* note 7.

"Transaction-related compensation" is defined in the rule as "monetary profit to the bank in excess of cost recovery for providing brokerage execution services." Rule 3b-9, *supra* note 54, § 240.3b-9(d). Although the rule does not define "public solicitation," it does provide guidelines. Principally, a bank that sends to its customers sales literature promoting the availability of its brokerage services is subject to the rule, *see id.* § 240.3b-9(a)(1)(i) to -9(a)(1)(iv), and thus sub-

in non-profit banking-customer securities-accommodation services, however, were not to be affected.[56] In response to adverse comments from banks, the SEC added exemptions from SEC broker-dealer registration to cover banks that conducted only limited brokerage activities.[57]

### *C. Courts Examine SEC and Bank Agency Authority to Alter Definitions*

#### 1. "Plain Meaning" v. Congressional Intent

In order for the SEC to claim jurisdiction over banks that engage in brokerage activities for profit, it first had to revise the existing Exchange-Act definition of "bank."[58] Evaluation of the authority of the SEC and other agencies to change an existing statutory definition rests on several theories of definitional interpretation.[59]

One theory of definitional interpretation was followed in *FAIC Securities, Inc. v. United States*,[60] where the District of Columbia Circuit struck down agency rulemaking authority to redefine an existing term in the Federal Deposit Insurance Act.[61] The court held that the literal

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ject to SEC regulation. *See also supra* note 7 and accompanying text (discussing regulatory obligations of SEC-registered broker-dealers).

56. *See* American Bankers Ass'n v. SEC, 804 F.2d 739, 742 (D.C. Cir. 1986) (recognizing that rule 3b-9 did not apply to bank accommodation services permitted by Comptroller's original 1936 ruling). For a discussion of accommodation services permitted under Glass-Steagall, see *supra* notes 27–29 and accompanying text.

57. Under the version of Rule 3b-9 ultimately adopted, a bank does not have to register if it contracts with an SEC-registered broker-dealer to provide brokerage services on or off the bank's premises, provided that the broker-dealer is clearly identified, the bank performs only clerical functions, the bank employees receive no transaction-related compensation, and the broker-dealer performs clearing services for the bank on a fully disclosed basis. Rule 3b-9, *supra* note 54, § 240.3b-9(a).

In addition, rule 3b-9 provides seven exemptions. A bank does not have to register if it is subject to § 15(e) of the Exchange Act or if it effects no more than 1000 transactions per year; effects transactions only in commercial paper, banker's acceptances, or commercial bills; effects transactions for affiliated companies; effects transactions for the investment of bank deposit-account funds; effects transactions as part of employee or shareholder plans; effects transactions in reliance on §§ 3(b), 4(2), and 4(6) of the Securities Act of 1933. *Id.* § 240.3b-9(b)(1) to -9(b)(7).

For an explanation of bank reaction to proposal of rule 3b-9, see *infra* notes 90–93 and accompanying text.

58. *American Bankers Ass'n*, 804 F.2d at 743 (D.C. Cir. 1986). The bank exemption is discussed *supra* notes 7–8 and accompanying text (pre-rule) & *supra* notes 55–57 and accompanying text (under rule 3b-9).

59. *See infra* notes 60–88 and accompanying text (comparing agency authority to reinterpret a statute's definitions based on either statute's plain language or congressional intent supporting it with context-clause analysis or agency rulemaking authority).

60. 768 F.2d 352 (D.C. Cir. 1985).

61. *Id.* at 362. The appellate court affirmed a lower court decision striking down regulations issued by the FDIC and the Federal Home Loan Bank Board. *Id.* at 354. The proposed regulations changed the existing federal insurance coverage of $1,000,000 per depositor, per financial

meaning or "plain language" of the definitions in a congressional act precludes consideration of legislative history supporting the agency's proposed definition or agency rulemaking authority.[62] In the court's reasoning, the intent of Congress is best illustrated in the plain language of a statute; legislative history is only a "second-best indication."[63]

Another theory was espoused in *SEC v. Variable Annuity Life Insurance Co.*,[64] where the Supreme Court upheld agency authority by rejecting a literal reading of the statute in favor of interpreting the definition so as to effect congressional intent and the "plain purpose" of the act.[65] Similarly, in *Baurer v. Planning Group, Inc.*,[66] the Court of Appeals for the District of Columbia Circuit held that the "broad remedial purposes of the securities laws" mandated a flexible definitional construction.[67] Moreover, the *Baurer* court rejected a literal definitional approach when the protection of investors was at issue.[68]

2. Context Clause

In addition to balancing plain meaning with congressional intent and plain purpose, courts reviewing SEC authority to alter definitions under the Exchange Act must decide what, if any, additional interpretational powers the context clause confers on the SEC.[69] One interpretation of the context clause was exemplified in *Ruefenacht v.*

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institution, by adding the qualification that funds deposited through a deposit broker were limited to $1,000,000 per broker, per financial institution. *Id.*

62. *Id.* at 361.

63. *Id.* at 362.

64. 359 U.S. 65 (1959).

65. *Id.* at 69–73 (by implication) (holding that new form of annuity contract, "variable annuity," and life insurance company that issued such contracts were not exempt from securities laws even though annuity contracts were within literal language of exclusions).

The concurring opinion in *Variable Annuity* argued that a new "form of investment arrangement" offered by an industry that Congress had exempted from the securities laws should be examined to test whether it is consistent with congressional intent. *Id.* at 75–76 (Brennan, J., concurring). Furthermore, Justice Brennan argued, the "purposes" of the federal securities laws must serve as the "guide to interpreting the scope of an exemption from their coverage." *Id.* at 80 (Brennan, J., concurring). The reasoning of the concurring opinion in *Variable Annuity* was later adopted by the Supreme Court majority in SEC v. United Benefit Life Ins. Co., 387 U.S. 202, 210–12 (1967).

66. 669 F.2d 770 (D.C. Cir. 1981).

67. *Id.* at 772 (holding that short-term notes, excluded from definition of "security" in Exchange Act, are nevertheless subject to regulation under federal securities laws) (discussing 15 U.S.C. § 78c(a)(10)). The court reasoned that the surrounding circumstances—public marketing of the notes to investors—required federal regulation. *Id.* at 775–78.

68. *Id.* at 776.

69. *See supra* notes 49–50 and accompanying text (explaining SEC's use of context clause in issuing rule 3b-9).

*O'Halloran*,[70] in which the Third Circuit held that the clause permits the SEC to alter a definition only to assure its uniformity within the text of the Exchange Act.[71] The court in *Ruefenacht* pointed to the ambiguous legislative history supporting the context clause in reasoning that the clause conferred minimal ability upon agencies to alter legislative definitions.[72]

In contrast, other courts have held that the context clause permits interpretation of a definition in order to conform the term's meaning with factual, historical, or regulatory changes.[73] In fact, in *Marine Bank v. Weaver*,[74] the Supreme Court determined that the context clause authorized the SEC to interpret an Exchange-Act definition to conform with the regulatory context supporting the definition.[75]

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70. 737 F.2d 320 (3d Cir. 1984), *aff'd sub nom.* Gould v. Ruefenacht, 471 U.S. 701 (1985).

71. 737 F.2d at 331. The court held that sale of all or part of a business effected by the transfer of stock bearing traditional incidents of stock ownership is the sale of a "security" under the Securities Act of 1933 and the Exchange Act. *Id.* at 321.

72. *Id.* at 330–31. The court reviewed the legislative history of the context clause, and noted that the Senate bill and the original version of the House bill later enacted as the Securities Act of 1933 contained the prefatory expression, "When used in this Act the following terms shall, unless the text otherwise indicates, include the following respective meanings." *Id.* at 330 (emphasis omitted) (quoting H.R. 5480, 73d Cong., 1st Sess. 39 (1933); S. 875, 73d Cong., 1st Sess. 1 (1933)). A later House version of the bill substituted without comment the wording, "unless the context otherwise requires." *Id.* (quoting H.R. 5480, *supra*). Since Congress did not differentiate between the two versions, the court assumed that "context" and "text" were synonymous. *Id.* at 331. The court noted that definitions contained in the Exchange Act were to be used throughout the Act unless its text makes the definitions inapplicable to any particular section. *Id.*

73. *See* C.N.S. Enters. v. G & G Enters., 508 F.2d 1354, 1357–62 (citing Sanders v. John Nuveen & Co., 463 F.2d 1075, 1078 (7th Cir.) (applying congressional-intent-revealed-in-context approach as against literal-text reading of Exchange-Act definition), *cert. denied*, 409 U.S. 1009 (1972)), *cert. denied*, 423 U.S. 825 (1975). In *C.N.S. Enterprises*, Seventh Circuit examined the legislative history of the context clause. 508 F.2d at 1358. Since Congress purposefully substituted "context" for "text" in the Exchange Act, the Court held that the context clause requires examination of the underlying factual circumstances of a transaction as it applies to Exchange-Act definitions. *Id.*; *see also* Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) (prior decisions aid in defining the term security; "form should be disregarded for substance and the emphasis should be on economic reality"); SEC v. Howey Co., 328 U.S. 293, 298–99 (1945) (judicial interpretation used to define a term, especially if interpretation is consistent with statutory intent); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350–51 (1943) ("courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy"); Bellah v. First Nat'l Bank, 495 F.2d 1109, 1113–14 (5th Cir. 1974) (factual context of a commercial loan transaction must be examined since not all notes are securities; some are beyond the scope of the Act).

74. 455 U.S. 551 (1982).

75. *Id.* at 556. Stating that the test to determine whether an instrument is a security is "[w]hat character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect," the Court found certificates of deposit purchased from a federally-regulated bank not to be securities as defined in the Exchange Act. *Id.* at 555 (citing SEC v. United Benefit Life Ins. Co., 387 U.S. 202, 211 (1967) & quoting SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352–53 (1943)).

3. *Chevron* Analysis

In addition to analyzing agency definitional interpretation based upon either of the two previous theories, courts may evaluate an agency's rulemaking authority according to the Supreme Court's test in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[76] Under *Chevron*, if Congress has not directly addressed "the precise question at issue"[77] and if an agency decision represents a reasonable accommodation of conflicting policies committed to such agency's care by the statute, a court should not disturb the promulgated rule unless it appears from the act or its legislative history that the rule was not one that Congress would have sanctioned.[78] Furthermore, agency regulations are controlling unless they are "arbitrary, capricious, or manifestly contrary" to the enabling statute.[79] Finally, agency regulations are entitled to deference where the regulatory scheme is technical and complex, where the agency considered the matter in a detailed and reasoned manner, and where the regulation involves a reconciliation of conflicting policies.[80]

The conflict regarding agency authority to interpret an existing definition was more recently addressed by the Supreme Court in *Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*[81] The Court, in striking down a banking-agency regulation, relied on the plain language of a statutory definition[82] and cited *Chevron* to support its holding that agencies and courts cannot alter the meaning of a statute "if [the language of] the statute is clear and unambiguous."[83] Since statutory language is the clearly expressed intent of Congress, the Court held "traditional deference" to agency interpretation to be unnecessary.[84]

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76. 467 U.S. 837 (1984).

77. *Id.* at 843. *Chevron* involved an Environmental Protection Agency regulation. *See id.* at 840.

78. *Id.* at 865.

79. *Id.* at 844.

80. *Id.* at 865.

81. 106 S. Ct. 681 (interim ed. 1986).

82. *Id.* at 689. *Dimension Financial* involved the jurisdiction of the Federal Reserve over "nonbank banks" under § 2(c) of the Bank Holding Company Act of 1956, 12 U.S.C. § 1841(c) (1982) (defining "bank" as any "institution that (1) accepts deposits that depositor has legal right to withdraw on demand and (2) engages in business of making commercial loans"). An institution that performs one of these functions, but not the other, claims to be a "nonbank bank" and therefore to be exempt from Federal-Reserve regulation. *See Dimension Fin.*, 106 S. Ct. at 683 (noting that, in 1984, the Federal Reserve issued regulations amending definition of "bank" to bring nonbank banks under its jurisdiction).

83. *Id.* at 686. The Court held that the Federal Reserve did not act within its statutory authority in redefining "banks" to include "nonbank banks." *Id.* at 685–89.

84. *Id.* at 686.

In contrast, in *FDIC v. Philadelphia Gear Corp.*,[85] the Court disregarded the literal reading of a definition[86] and upheld the agency's definitional interpretation even though the plain language or literal reading of the act at issue did not support that interpretation.[87] Instead, the Court based its deference upon the plain purpose of the act.[88]

## III. THE DEMISE OF RULE 3B-9: *AMERICAN BANKERS ASSOCIATION V. SEC*[89]

### *A. The District Court Upholds SEC Authority to Promulgate Rule 3b-9*

Following adoption of rule 3b-9, the American Bankers Association (Association) brought an action in the United States District Court for the District of Columbia challenging the SEC's authority to promulgate the rule.[90] The Association contended that the SEC exceeded its statutory rulemaking power when it revised the Exchange Act's[91] definitions of "broker" and "dealer" to include banks that deal in securities for profit.[92] Moreover, the Association argued that compliance with rule 3b-9 would be costly and would subject banks to capital requirements inconsistent with those required by bank regulators.[93]

In an unpublished decision, the district court granted the SEC's motion for summary judgment.[94] The court maintained that the context

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85. 106A S. Ct. 1931 (interim ed. 1986).

86. *Id.* at 1934–35. *Philadelphia Gear* involved an FDIC reinterpretation of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811–1832 (1982). The regulation at issue provided that a letter of credit backed by a contingent promissory note is not covered by FDIC deposit insurance. *See Philadelphia Gear*, 106A S. Ct. at 1934–39.

87. 106A S. Ct. at 1934–39; *see also id.* at 1939 (Marshall, J., dissenting) (remarking that majority "read qualifications into the statute that do not appear there").

88. *Id.* at 1935–37. The Court based its holding on congressional purpose in creating federal deposit insurance "to protect the assets and hard earnings that businesses and individuals entrust to banks." *Id.* at 1935.

89. 804 F.2d 739 (D.C. Cir. 1986).

90. *See id.* Rule 3b-9 met with hostility from the banking community from its inception. Following the proposal of the rule in 1983, the SEC received 272 comment letters, which included over 200 unfavorable letters from banks. *See* SEC Final Rule, *supra* note 10, at 28,387. The banks found the rule unnecessary, citing the lack of bank brokerage abuses and the burdens that would result from duplicative regulation; the securities industry, however, supported the rule. *Id.*

91. 15 U.S.C. §§ 78a–78kk (1982 & Supp. IV 1986).

92. Plaintiff's Brief in Opposition to Defendants' Cross-Motion for Summary Judgment at 1–3, American Bankers Ass'n v. SEC, No. 85-2482 (D.D.C. Oct. 30, 1985) (LEXIS, Genfed library, Dist file), *rev'd*, 804 F.2d 739 (D.C. Cir. 1986).

93. *Id.* at 25–26.

94. *American Bankers Ass'n*, No. 85-2482, slip op. at 1. The court's rationale is more fully outlined in Official Record of Proceedings at 63–65, *American Bankers Ass'n* (No. 85-2482). The district court upheld the authority of the SEC to promulgate rule 3b-9, finding that the rule contravened neither the Exchange Act itself nor the Act's legislative history. *Id.*

clause rendered the meaning of the definitions uncertain.[95] Thus, since the Exchange Act was imprecise and congressional intent unclear, the court stated that under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[96] it must defer to the SEC's reasonable interpretation of the Exchange Act.[97] The court further held that the SEC had broad rulemaking authority to redefine "technical, trade, accounting, and other terms . . . whether or not already defined"[98] and noted that SEC jurisdiction over banks was nowhere expressly prohibited.[99] Therefore, the district court decided that the SEC could redefine the Exchange Act definition of "bank" to correspond to changing market or regulatory conditions.[100] On appeal, however, the decision was reversed.

### *B. The Court of Appeals Reverses*

The Court of Appeals for the District of Columbia Circuit reversed the district court's dismissal of the Association's complaint and held that the SEC had no authority under the Exchange Act to regulate banks as broker-dealers.[101] Furthermore, the court held that the SEC cannot on its own authority encroach upon the regulatory jurisdiction of the banking agencies.[102]

First, the court prefaced its decision by discussing Glass-Steagall[103] restrictions on bank brokerage powers and the recent expansion of such powers by the Comptroller, which had prompted the SEC to propose rule 3b-9.[104] Rule 3b-9, the court observed, divided bank regulation among banking agencies and the SEC according to different "financial functions" as opposed to dividing regulation according to bank-chartering agencies.[105] According to the court, regulation by financial

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95. *Id.* at 61–62. The court did not find the definitions of "bank," "broker," or "dealer" in the statute to be unclear in and of themselves; however, the court held that all the definitions were unclear because they were qualified by the "weasel [sic] language in the statute, 'unless the context or [sic] otherwise requires.'" *Id.* at 61; *see also supra* notes 64–65 and accompanying text (discussing agency authority according to SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959), to alter Exchange-Act definitions to conform with purpose of act).

96. 467 U.S. 837 (1984).

97. Official Record of Proceedings, *supra* note 94, at 63.

98. *Id.* at 64; *see also supra* note 47 and accompanying text (discussing SEC rulemaking authority under § 3(b) of Exchange Act).

99. Official Record of Proceedings, *supra* note 94, at 64.

100. *Id.* at 65–66 (noting that banks currently advertise brokerage services to public rather than "merely providing accommodation services to existing customers").

101. *American Bankers Ass'n*, 804 F.2d at 743.

102. *Id.* at 755 (noting that only Congress can grant SEC regulatory jurisdiction over bank brokerage activities).

103. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

104. *American Bankers Ass'n*, 804 F.2d at 740–42.

105. *Id.* at 742–43. The court, however, noted that regulation of banks according to finan-

function was not the approach taken by the 1934 Congress in the Exchange Act and therefore could not provide the basis for the rule.[106]

Second, in examining the Exchange-Act definitions of "broker," "dealer," and "bank," the court pointed out that a "crucial problem" with the SEC's new definition of "bank" was that it directly conflicted with the existing Exchange-Act definition of "bank."[107] Although the court recognized that congressional intent for including the bank exemption was "ambiguous,"[108] it adopted the Association's rationale that the plain language of the existing bank exemption represented congressional intent that the SEC should not have duplicate jurisdiction over banks.[109] The court rejected the SEC's contention that Congress had originally adopted the Exchange-Act bank exemption under the premise that Glass-Steagall prohibited banks from engaging in most brokerage activities;[110] in fact, the court implied in dictum that Glass-Steagall never prohibited banks from acting as broker-dealers.[111]

Third, the court decided that the 1975 amendments to the Exchange Act evidenced continuing congressional intent to maintain the jurisdictional separation of banks from SEC regulation.[112] Stating that Congress was aware of the same concerns that had prompted the SEC to promulgate the rule, the court noted that Congress could have amended the definitions of "broker," "dealer," and "bank" to authorize the SEC to regulate banks as broker-dealers in 1975 had the rationale for excepting banks from SEC jurisdiction no longer been valid.[113] Nonetheless, the court observed, Congress specifically chose not to alter the definitions.

Fourth, the court examined case law relevant to SEC authority to

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cial function was recommended by a special task force established to reevaluate bank regulation. *Id.* at 742–43 & 743 n.8 (citing BLUE PRINT FOR REFORM: REPORT OF THE TASK GROUP ON REGULATION OF FINANCIAL SERVICES 39–41 (1984)).

106. *Id.*

107. *Id.* at 744 (noting that Exchange-Act definition of "bank" contains no language excluding banks that engage in securities brokerage for profit); *see also supra* notes 7–8 and accompanying text (discussing Exchange-Act definitions of "broker," "dealer," and "bank").

108. *Id.* at 749.

109. *Id.* at 746. The argument of the American Bankers Association was based on the 1934 congressional hearing testimony of William Potter, Chairman of the Board, Guaranty Trust Company of New York, discussed *supra* note 36 and accompanying text.

110. *American Bankers Ass'n,* 804 F.2d at 747–48.

111. *Id.* at 748 (dictum) ("An argument certainly could be made that a bank could do just that . . . .") (citing Securities Indus. Ass'n v. Comptroller of the Currency, 577 F. Supp. 252 (D.D.C. 1983) (upholding Comptroller's 1982 interpretation of Glass-Steagall allowing bank subsidiaries to offer discount brokerage services to members of general public), *aff'd per curiam,* 758 F.2d 739 (D.C. Cir. 1985), *cert. denied,* 474 U.S. 1054 (1986)).

112. *Id.* at 750.

113. *Id.*

redefine Exchange-Act definitions.[114] The court declined to apply *SEC v. Variable Annuity Life Insurance Co.*,[115] which had been cited by the district court in support of its holding that reviewing courts may interpret Exchange Act definitions to reflect congressional intent and need not be bound by the literal language of the definitions.[116] Instead, the appellate court used a *Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*[117] analysis[118] requiring adherence to the literal language of the act itself.[119] Noting that agency rulemaking will be upheld under a *Dimension Financial Corp.* analysis when it is limited to carrying out the will of Congress as expressed in the plain language of the statute, the court concluded that the plain language of the definition of "bank" precluded the SEC from issuing a regulation altering an existing definition.[120]

Fifth, the court rejected the district court's statements that the meaning of the Act's definitions was blurred by the context clause preceding them and that courts were required under *Chevron* to accept reasonable agency interpretations of the definitions.[121] Instead, the court stated that the context clause has minimal effect on Exchange Act definitions and allows the SEC to modify a definition only when necessary to unify its meaning throughout the Exchange Act.[122] Nor did the appellate court accept the SEC's context-clause argument based on the Supreme Court's holding in *Marine Bank v. Weaver*[123] that a court could consider changes in factual circumstances surrounding Exchange-Act definitions.[124]

In its conclusion, the court maintained that the primary consideration must be the unambiguous statutory language chosen by Congress.[125] Moreover, the court noted that neither the context clause of the Exchange Act nor agency rulemaking authority allows an agency to

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114. *Id.* at 750–53.

115. 359 U.S. 65 (1959).

116. *Id.* at 67–68, *cited in* Official Record of Proceedings, *supra* note 94; *see also supra* notes 64–65 and accompanying text (discussing *Variable Annuity* Court's rejection of plain language of act in favor of purpose).

117. 106 S. Ct. 681, 687 (interim ed. 1986).

118. *See supra* notes 81–84 and accompanying text.

119. *American Bankers Ass'n*, 804 F.2d at 752–53.

120. *Id.* at 752.

121. *Id.* at 753 (discussing Chevron); *see also* notes 94–97 and accompanying text (discussing *Chevron* analysis employed by district court in *American Bankers*).

122. *American Bankers Ass'n*, 804 F.2d at 753.

123. 455 U.S. 551 (1982).

124. *See supra* notes 73–75 and accompanying text (discussing context-clause analysis that permitted interpretations of Exchange-Act definitions to conform with factual or out-of-act changes).

125. *American Bankers Ass'n*, 804 F.2d at 755. Indeed, the court's reliance on the plain meaning of the definitions is reinforced throughout its opinion. *See id.* at 740, 744, 749, 754.

alter a statutory definition if the result will be jurisdictional conflict between agencies.[126]

## IV. ANALYSIS

Although the court of appeals in *American Bankers Association v. SEC*[127] could have declared rule 3b-9[128] invalid because it contravened the plain language of the Exchange-Act[129] bank exemption,[130] the court instead found it necessary to support its holding by engaging in an extensive analysis of the legislative history of the Exchange-Act bank exemption and its relation to Glass-Steagall.[131] Ironically, the Court's analysis shows that the legislative history, was, at best, ambiguous.[132]

In ascertaining the legislative history of the Exchange Act, the court arbitrarily disregarded the testimony of Thomas G. Corcoran, one of the Exchange-Act's draftsmen, who argued for the exemption on the premise that Glass-Steagall had already prohibited banks from engaging in brokerage activities.[133] In fact, the court failed to recognize that Corcoran's testimony was also supported by the legislative history of Glass-Steagall, which clearly indicated the intent to exclude banks from the securities industry and thus to prohibit them from acting as broker-dealers.[134] Furthermore, the court ignored the plain language of

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126. *Id.* at 755. In its conclusion, the court recommended that Congress should reevaluate Glass-Steagall and that if Congress determines that banks "should be allowed to engage in brokerage business like any other broker," the SEC should regulate banks as it does all other broker-dealers. *Id.*

127. 804 F.2d 739 (D.C. Cir. 1986).

128. SEC Final Rule, *supra* note 10.

129. 15 U.S.C. §§ 78a–78kk (1982 & Supp. IV 1986).

130. *American Bankers Ass'n,* 804 F.2d at 744–50.

131. *Id.*

132. *See id.* at 749.

133. *Id.* at 748. The court merely assumed that "Corcoran was incorrect in telling the 1934 Congress that the Glass-Steagall Act precluded banks from acting like other brokers." *Id.* In contrast, the Supreme Court itself has noted (albeit in a different context) that remarks made by Corcoran, as "a spokesman for drafters" of the Exchange Act, deserved "significant" attention. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 & n.24 (1976). In fact, Corcoran, an eminent securities law attorney, was also a draftsman of the Securities Act of 1933. *See* Landis, *The Legislative History of the Securities Act of 1933,* 28 GEO. WASH. L. REV. 29, 33–34 (1959).

134. *See supra* notes 25–27 and accompanying text (Glass-Steagall was enacted to separate banks from securities industry).

In fact, Glass-Steagall continued the tradition of separating banking and securities industries, prevalent in the United States since colonial times. *See Review of Approach Toward Banking and Bank Holding Company Legislation: Hearings Before the Subcomm. on Commerce, Consumer & Monetary Affairs of the House Comm. on Government Operations,* 99th Cong., 2d Sess. A-1 to -13 (1986) (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System) (tracing history of banking and securities industry from 1776 to 1970) [hereinafter *Hearings*]. Prior to Glass-Steagall, congressional intent supporting separation of banking and securities industries was embodied in the National Bank Act of 1864, ch. 106, 13 Stat. 99 (codified as amended in scattered sections of 12 U.S.C.). Congress later reinforced Glass-Steagall's separation

Glass-Steagall itself, which prohibited all bank brokerage services until amended in 1935.[135] In addition, the court incorrectly discredited a 1934 interpretation of the Comptroller, effective for more than forty years, which limited bank brokerage activities to non-profit accommodation services for existing bank customers.[136]

To support its position that the bank exemption prohibited dual regulation by the SEC, the court relied upon nothing more than a discussion of "implications" in one Senate report on the Exchange-Act and upon the unsupported testimony of one participant in the Exchange-Act hearings.[137] Indeed, the court was forced to conclude that the legislative history of the Exchange-Act bank exemption was ambiguous—thus directly contradicting its initial rationale that the legislative history of the bank exemption clearly "confirm[s]" the intent of Congress.[138]

The court also incorrectly pointed to 1975 Exchange Act amendments as supporting continuing congressional intent to exempt banks from SEC jurisdiction.[139] The court failed to recognize that Congress, in passing the amendments, had actually authorized the incursion by the SEC into bank brokerage regulation: Congress had requested the SEC to propose bank-exemption legislation and also had given the SEC jurisdiction over banks that deal in municipal securities.[140] Most signifi-

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of banking and securities industries in the Bank Holding Company Act of 1956, ch. 240, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841–1850), and again in the Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760 (codified as amended at 12 U.S.C. §§ 1841–1850 (1982)). *See Hearings, supra,* at A-4, -6 to -7.

135. Banking Act of 1933, ch. 89, § 16, 48 Stat. 162, 184–85 (codified as amended in scattered sections of 12 U.S.C.). Glass-Steagall's original prohibition on all securities activities is discussed *supra* notes 25–27 and accompanying text.

136. *American Bankers Ass'n,* 804 F.2d at 742–43. In his 1933 Annual Report, the Comptroller advocated to Congress that it amend Glass-Steagall to restore at least limited bank brokerage accommodation services to existing bank customers. *See Hearings, supra* note 28, at 153, *discussed in* Kress, *supra* note 27, at 177–78. In 1935, Congress amended the Act to permit banks to offer limited accommodation services. Banking Act of 1935, ch. 614, § 308, 49 Stat. 684, 709 (amending § 16 of Glass-Steagall), *cited in American Bankers Ass'n,* 804 F.2d at 740 n.2. Although Congress had the opportunity in 1935 to approve additional bank broker-dealer activities, it chose not to do so. *See* Kress, *supra* note 27, at 177–78. In fact, one year later the Comptroller ruled that the amendments to § 16 did not authorize general bank brokerage business. 1 Bull. Comptr. Currency ¶¶ 10, 35–36 (Oct. 26, 1936), *cited in American Bankers Ass'n,* 804 F.2d at 740–41.

137. *See American Bankers Ass'n,* 804 F.2d at 745 (noting that "[t]he necessary implication of the Senate Report was that any bank already subject to administrative oversight need not be subjected" to SEC jurisdiction).

138. *See id.* at 740 (stating that congressional intent to exempt banks from Exchange Act was "confirmed in the Act's legislative history"). *But cf. id.* at 749 (concluding that review of bank-exemption legislative history reveals "some ambiguities").

139. *See id.* at 749–50 (noting that 1975 Amendments did not grant SEC jurisdiction over bank brokerage activities).

140. *See* S. JAFFE, *supra* note 3, § 2.06 (emphasizing that 1975 amendments to Exchange

cantly, the court failed to recognize that the SEC always had jurisdiction over banks through Exchange-Act antifraud provisions[141] and reporting requirements.[142]

In basing its plain meaning analysis on *Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*,[143] the *American Bankers* court overlooked the unsettled question of that case's continuing validity, raised by the Supreme Court's decision in *FDIC v. Philadelphia Gear Corp.*[144] In *Philadelphia Gear*, the Court upheld an agency interpretation even though the interpretation was not supported by the plain meaning of the statute.[145] The application of a *Philadelphia Gear* analysis would have supported SEC jurisdiction to issue rule 3b-9 because the legislative history of Glass-Steagall and the Exchange Act, if examined in a 1934 historical context, would support SEC jurisdiction.[146] Furthermore, *Dimension Financial* is not consistent with *American Bankers* because the statute construed in the former case did not contain a public-benefit provision,[147] while the Exchange Act, construed in the latter, included a mandate to protect investors and "the national banking system."[148] In addition, the court's plain-language interpretation in *American Bankers* is in conflict with *Baurer v. Planning Group, Inc.*,[149] where a different panel of the District of Columbia Circuit disregarded a plain-meaning interpretation of an Exchange-Act definition for an interpretation favoring greater investor protection.[150]

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Act authorized initial SEC incursion into bank regulation by subjecting banks that deal in municipal securities to SEC jurisdiction); Greenberg, *Banks and the Federal Securities Laws: Some Recent Developments*, CORPORATE PRAC. COMMENTATOR 46, 58–68 (1977–1978) (noting that regulation of bank municipal-securities activities is "shared" between SEC and banking agencies). A municipal security is a security issued by a state, state agency, or political subdivision. *See* H. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 1.04 (1986–1987).

141. *See* Exchange Act § 10b, 15 U.S.C. § 78j(b); Rule 10b-5, 17 C.F.R. § 240.10b-5; *see also* Evans, *Regulation of Bank Securities Activities*, 91 BANKING L.J. 611, 615–16 (1974) (recognizing SEC jurisdiction over banks through antifraud provisions of Exchange Act).

142. *See* Exchange Act §§ 12–14, 15 U.S.C. §§ 78*l*–78n; *see also* Greenberg, *supra* note 140, at 48 (noting SEC jurisdiction over banks).

143. 106 S. Ct. 681 (interim ed. 1986).

144. 106 S. Ct. 1931, 1939 (interim ed. 1986) (Marshall, J., dissenting) (asserting that majority opinion conflicted with Court's earlier opinion in *Dimension Financial*).

145. *Id.* at 1934–35.

146. *See supra* notes 24–27 and accompanying text (analyzing Glass-Steagall within 1934 context).

147. Dimension Fin. Corp. v. Board of Governors of the Fed. Reserve Sys., 744 F.2d 1403, 1408 (10th Cir. 1984) (noting that under Bank Holding Company Act, Federal Reserve "does not have the broad scope to work in as do many other agencies" whose enabling statutes contain a "public good" or "public benefit" provision), *aff'd*, 106 S. Ct. 684 (interim ed. 1986).

148. Exchange Act § 2, 15 U.S.C § 78b (quoted *supra* note 48).

149. 669 F.2d 770 (D.C. Cir. 1981).

150. *See supra* notes 64–68 and accompanying text (giving effect to purpose of statute as opposed to language of statute).

In its analysis of the context clause, the court in *American Bankers* improperly dismissed as mere dicta[151] the Supreme Court's context-clause analysis in *Marine Bank v. Weaver*.[152] Instead, the *American Bankers* court favored the context-clause analysis used by the Third Circuit in *Ruefenacht v. O'Halloran*,[153] which gave the clause minimal effect by restricting it to "in act" textual changes.[154] The *American Bankers* court, however, overlooked a previous case in which a different panel of the Third Circuit had held that the context clause may authorize interpretation of an Exchange-Act definition to conform with an out-of-act commercial context.[155] Even the *American Bankers* court concluded that, on another occasion, the context clause might provide justification for interpreting an Exchange-Act definition in light of changing market conditions, so long as that interpretation would not allow an agency to alter its own jurisdiction.[156]

The court in *American Bankers* should have applied the district court's *Chevron* analysis[157] and deferred to the SEC's reasonable interpretation of the act, once the court found that the legislative history of the Exchange Act was ambiguous and that Congress had not directly addressed the precise question before the court.[158] Moreover, a *Chevron* analysis would have brought the *American Bankers* decision into harmony with other decisions that expanded banking-agency power to reinterpret permissible bank brokerage activities under Glass-Steagall beyond either the plain language or legislative intent of the Act.[159] Some courts have employed a *Chevron* analysis in granting great deference to the banking agency charged with interpreting the statute.[160] In *Ameri-*

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151. *American Bankers Ass'n*, 804 F.2d at 753 & n.23.

152. 455 U.S. 551 (1982). In *Marine Bank*, the Supreme Court considered out-of-Act factors, as required by the context clause, such as banking regulation and FDIC insurance and held that the certificate of deposit at issue was not a security. *Id.* at 557–59.

153. 737 F.2d 320 (3d Cir. 1984), *aff'd sub nom.* Gould v. Ruefenacht, 471 U.S. 701 (1985).

154. *American Bankers Ass'n*, 804 F.2d at 754.

155. *See* Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973), *cited in Ruefenacht*, 737 F.2d at 339 (Hunter, J., concurring) (*Lino* court accorded "context clause" broader meaning than did the *Ruefenacht* majority).

In fact, a most-noted commentator on securities regulation has supported the application of the context clause as referring not only to the context of the statute itself but also to the surrounding factual circumstances. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 244–46 (1988). Moreover, Professor Loss argued that the legislative history supports giving effect to factual circumstances because Congress purposefully substituted "context" for "text." *Id.* at 246.

156. *American Bankers Ass'n*, 804 F.2d at 754.

157. *See supra* notes 76–80 and accompanying text (discussing *Chevron* analysis).

158. *Chevron*, 467 U.S. at 843–45.

159. *See supra* note 3 (citing cases in which courts deferred to banking agency's reinterpretation of Glass-Steagall expanding bank brokerage powers).

160. *See* Investment Co. Inst. v. Conover, 790 F.2d 925, 935 (D.C. Cir.) (stating that court can lawfully overturn agency interpretation only if congressional policy is sufficiently clear, and

*can Bankers*, however, the court of appeals adopted the plain meaning rule of interpretation and denied any deference to the SEC.[161] Ostensibly, the decision in *American Bankers* prohibits the use of a *Chevron* analysis when deference to the agency would create conflict with another agency's jurisdiction.[162] After *American Bankers*, then, only Congress can extend the SEC's jurisdiction over banks as broker-dealers.[163]

### *A. Implications of the District of Columbia Circuit Decision*

In preserving the jurisdiction of the banking agencies, the court overlooked the importance of protecting investors who purchase or sell securities through a bank.[164] Instead of comprehensive SEC regulation,[165] such investors can only rely on the less-than-rigorous regulation accompanying bank brokerage activities.[166] Unlike employees of SEC-regulated broker-dealers, bank employees who sell securities are not required to pass any test examining their knowledge of the securities industry.[167] Employers of SEC-regulated broker-dealers must adequately supervise employees to prevent violations of the securities laws;[168] bank brokerage employers have no such duty.[169] In addition, banks have no comparable rules governing abuses in sales practices.[170] The few restrictions on bank broker-dealer advertising practices[171] are substantially less stringent than those placed on SEC-registered broker-deal-

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agency's interpretation inconsistent with that policy), *cert. denied*, 107 S. Ct. 421 (interim ed. 1986).

161. *American Bankers Ass'n*, 804 F.2d at 740, 744, 749, 754.

162. *Id.* at 754–55. *But see supra* notes 140–42 and accompanying text (noting SEC jurisdiction over banks in certain areas).

163. *American Bankers Ass'n*, 804 F.2d at 755 (dictum) (urging Congress to reexamine Glass-Steagall and the Exchange Act).

164. *See* SEC Final Rule, *supra* note 10, at 28,385, 28,387 (noting that rule 3b-9 necessary to assure investor protection); *cf. supra* note 40 (discussing SEC 1977 bank study recommendation that Congress require federal banking agencies to act for protection of investors). At the present time, banking agencies are only required to safeguard bank deposits and ensure bank stability. R. KARMEL, *supra* note 3, at 306.

165. *See* SEC Final Rule, *supra* note 10, at 28,388 (goals of federal securities laws include providing comprehensive and coordinated regulation, preventing unfair market practices, and assuring fair competition); *see also* Note, *National Banks and the Brokerage Business*, *supra* note 3, at 1347 n.243.

166. *See supra* note 31 (discussing SEC broker-dealer regulations); *see also* SEC Final Rule, *supra* note 10, at 28,387–88 (discussing disparity between banking and securities laws); Note, *National Banks and the Brokerage Business*, *supra* note 3, at 1347 n.243.

167. *See* NASD By-Laws, sched. C, NASD Manual (CCH) ¶ 1102A (1983).

168. *See* Exchange Act § 15(b)(4)(E), 15 U.S.C. § 78*o*(b)(4)(E).

169. NASD Rules of Fair Practice, art. III, § 27, NASD Manual Reprint (CCH) ¶ 2177 (1982); NYSE Rules 342.16, 405(2), 2 NYSE Guide (CCH) ¶¶ 2342.16, 2405(2) (1973).

170. Exchange Act §§ 6(b)(1), 15A(b)(2), 15 U.S.C. §§ 78f(b)(1), 78*o*-3(b)(2).

171. *See* 12 C.F.R. § 9.18(b)(5) (1983) (restriction of common-trust funds); *id.* § 225.125(1) (Federal Reserve advertising restrictions on advisory services for investment companies).

ers.[172] Finally, investor funds held by bank broker-dealers are not insured by the Securities Investor Protection Corporation (SIPC), which protects such funds held by SEC-regulated broker-dealers.[173]

Furthermore, the bank regulatory agencies may not be the most appropriate institutions to regulate bank securities brokerage. Banking laws are designed to protect bank depositors and prevent bank insolvency;[174] banking agencies lack any mandate to protect securities investors. On the other hand, the SEC and the securities acts operate both to protect investors and to police fraudulent securities practices.[175] Banking agencies regulate banks in a discreet, secretive manner necessary to preserve the nation's banking system and to maintain public confidence.[176] This discreet nature is in contrast to the full and public disclosure demanded by securities-acts provisions that regulate brokerage practices.[177] The Congress that enacted the securities acts and Glass-Steagall, thereby providing for separate regulation of securities and banking activities, intended the statutes to achieve different goals and therefore "could not have intended one [system and one piece of legislation] to replace the other."[178]

Not only are the bank regulators operating under disparate goals but their supervision has, in the past years, exhibited a regulatory laxity, even where the welfare of depositors is concerned.[179] Relying on

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172. *See* NASD Rules of Fair Practice, art. III, § 35, NASD Manual Reprint (CCH) ¶ 2195 (1982) (guidelines concerning content and review of advertisements).

173. *See* 15 U.S.C. § 78ccc-3(a). SIPC was created by the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa–78*lll* (1982). All broker-dealers registered with the SEC are required to become members of SIPC. *Id.* § 78ccc. SIPC has the authority to liquidate insolvent broker-dealers and pay customer claims up to a maximum of $500,000. *Id.* § 78fff-3.

174. *See* Note, *Bank Securities Activities: Memorandum for Study and Discussion,* 14 SAN DIEGO L. REV. 751, 790–91 (1977) (stating that primary concerns of banks are bank stability and depositor protection necessary to instill public confidence in nation's banking system); *see also* Note, *Curbing Preemption of Securities Act Coverage in the Absence of Clear Congressional Direction,* 72 VA. L. REV. 195, 210 (1986) (noting that banking laws require reporting and inspection requirements) [hereinafter Note, *Curbing Preemption*].

175. Note, *Curbing Preemption, supra* note 174, at 210.

176. *See* Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services,* 81 MICH. L. REV. 1498, 1529 (1983) (emphasizing that "[t]o avoid depositor runs on potentially troubled banks, the banking authorities enforce the regulations in a spirit of *familial secrecy*").

177. *See id.* at 1530 (suggesting that "goals and approaches" of bank regulatory structures are antithetical to regulation of securities brokerage and thus provide "less protection to securities investors").

178. Note, *Curbing Preemption, supra* note 174, at 210. The author supports the contention that Congress intended all securities investors to be protected by the securities laws, by pointing to the cumulative-remedies clause in the securities acts. *Id.* at 210 (citing 1933 Securities Act § 16, 15 U.S.C. § 77p (1982); Exchange Act § 28, 15 U.S.C. § 78bb(a)).

179. Di Lorenzo, *Public Confidence and the Banking System: The Policy Basis for Continued Separation of Commercial and Investment Banking,* 35 AM. U.L. REV. 647, 686–91 (1986). Di Lorenzo argued that fear of negative depositor reaction leads bank regulators either to delay

federal banking agencies to protect bank securities investors may be unwise because of pressures exerted by banks on banking agencies and competition between federal and state banking regulators. Banking agencies are subject to constraints from the banks they regulate: "banks, not banking agencies, [may] dictate the regulation imposed on banks."[180] For example, proposals by banking agencies to regulate bank brokerage activities were dropped by the agencies following unfavorable bank comments.[181] Indeed, the constraints banks place on their regulators can be seen in the *American Bankers* decision: the position ultimately accepted by the court was proffered not by the FDIC or the Federal Reserve, but by a banker's trade association.[182] Furthermore,

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taking corrective actions or to take actions that prove ineffective. *Id.* at 690. The collapse of Continental Illinois National Bank is an example of the latter. *Id.* at 690–91.

At a recent Conference of State Bank Supervisors, Wisconsin Banking Commissioner Richard Galecki noted the dearth of trained bank examiners on both the federal and state levels. *State Regulators Outline Challenges of Changing Banking Environment*, 47 Wash. Fin. Rep. (BNA) No. 22, at 895 (Dec. 8, 1986). Galecki pointed out that "federal regulators are so strained that 56 percent of banks operating in Wisconsin have not been examined by federal supervisors in nearly two years," *id.* at 895, suggesting that new securities activities of banks pose added burdens for the already over-taxed federal and state bank-examination systems. *Id.* at 896.

180. I. JOHNSON & W. ROBERTS, MONEY AND BANKING 227–28 (1985) (theorizing that banking agencies may be co-opted by banking industry and arguing that banks, not banking agencies, dictate the regulations imposed upon themselves); *see also infra* notes 181–83 and accompanying text (explaining how banks regulate regulators).

181. In 1984, five months after the SEC proposed rule 3b-9, the Comptroller proposed a rule to supervise and examine national banks that engage in discount securities-brokerage activities. *See* 49 Fed. Reg. 15,089 (1984) (to be codified at 12 C.F.R. §§ 5.52, 12.6). The rule would have required that any bank brokerage activities be conducted by a bank subsidiary unless an exemption was available. *Id.* at 15,091. These exemptions included banks that average less than 200 securities transactions per year, transactions in municipal securities or federal-government or federal-agency securities, transactions conducted by a bank for the investment portfolio of affiliated banks or for sweep accounts, and transactions effected as part of dividend reinvestment services and employee stock-purchase plans. *Id.* The regulation was based on a coordinated regulatory scheme among the banking agencies, the SEC, and self-regulatory organizations, which the Comptroller described as having been successful in regulating banks as municipal-securities dealers and as clearing and transfer agents. *Id.* at 15,090. Separate subsidiaries so formed would have been regulated by the SEC.

However, the regulation was later withdrawn after bank criticism. *See* 50 Fed. Reg. 31,605, 31,605–07 (1985). Negative comments expressed by banks concerned increased compliance costs, unnecessary intrusion into the bank's business judgment, complication of present regulatory scheme, and adoption of a rule before knowing congressional intent. *Id.* at 31,607. Ironically, the Comptroller specifically rejected a coordinated regulatory scheme such as that he had espoused in the proposed rule. *Id.* at 31,606–07.

In 1984, the FDIC proposed a rule governing both the nonbanking powers of banks insured by the FDIC but not members of the Federal Reserve and the manner in which such banks could provide brokerage services. *See* 49 Fed. Reg. 48,552 (1984) (to be codified at 12 C.F.R. pt. 332) (proposed Dec. 13, 1984) (restricting securities activities of banks and their subsidiaries). A revised proposal eliminated all restrictions on brokerage services. *See* 50 Fed. Reg. 23,964, 23,966 (1985) (to be codified at 12 C.F.R. pt. 332) (proposed June 7, 1985) (citing bank comment letters objecting to original proposal).

182. *American Bankers Ass'n*, 804 F.2d at 740.

additional pressure on bank regulators comes from the competition between federal and state bank regulators, who must enact favorable banking laws or risk having banks change to another chartering agency.[183]

Federal regulation of bank securities-brokerage activities by federal banking regulators would not necessarily lead to uniform regulation. There are three federal regulators: The Comptroller, the FDIC, and the Federal Reserve.[184] The regulation of the securities-brokerage activities of a national bank by the Comptroller and the Federal Reserve could be widely divergent from the securities-brokerage regulation of a state-chartered bank by the FDIC and (in some instances) by the Federal Reserve. Thus, it is not surprising that even the federal banking regulators support SEC regulation of bank securities activities.[185]

In conclusion, the court's decision in *American Bankers* endorsed two parallel regulatory systems for securities-brokerage activities, each

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183. See I. JOHNSON & W. ROBERTS, *supra* note 180, at 231 (noting that competition between agencies tempers severity of bank regulation). If one agency becomes stricter than the others, banks can change their charter and shift to the less stringent agency. *Id.* Thus, the authors argue, leniency in regulations can lead to a less stable financial sector. *Id.* For example, although the FDIC insures most state-chartered banks, its regulations are not permitted to restrict the usually more liberal powers granted by state charter. *See* 79 Fed. Reg. 48,552 (1984) (to be codified at 12 C.F.R. pt. 332) (discussing position of FDIC in supporting expansion of bank powers and warning of increased risks to deposit-insurance system).

Recently, New York has reinterpreted its "little Glass-Steagall" to allow banks not only securities-brokerage powers but underwriting authority. *See* Ruling on Securities Firm Affiliations (N.Y. Banking Super. Dec. 30, 1986), *reprinted in* American Banker, Jan. 2, 1987, at 2, col. 2; *see also NY Ruling to Pressure Congress*, American Banker, Jan. 2, 1987, at 1, col. 2 (indicating executives of national banks, which are members of Federal Reserve, have threatened to drop federal charter or to withdraw from federal membership if barriers to investment banking are not removed); *Big New York Banks Press Bid to Open Securities Business to Units in Delaware*, Wall St. J., Jan. 2, 1987, at 4, col. 2 (noting pressure on Federal Reserve and Congress to drop barriers restricting bank underwriting).

184. *See supra* note 9 and accompanying text (describing federal banking regulators).

185. *See* A Panel of Federal Regulators on the Challenges of Increased Regulatory Supervision, Panel Discussion at a Conference at Boston University School of Law (May 2, 1986) (comments of Robert L. Clarke, Comptroller of the Currency) (concluding that bank regulators should not oversee bank securities activities in the event such activities are permitted because "that is already the function of the SEC"), *reprinted in* 6 ANN. REV. BANKING L. 257, 269 (1987). In addition to Clarke, the panel comprised representatives of the other federal agencies regulating banks and savings and loans—the Federal Home Loan Bank Board, the FDIC, and the Federal Reserve. 6 ANN. REV. BANKING L. at 257. None of the other participants expressed disagreement with Clarke's statements. *See id.* at 269.

In the same vein, Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, testified before a House banking subcommittee in support of the repeal of Glass-Steagall and the restriction of bank brokerage activities to a non-banking affiliate of the bank holding company. *Let Banks Enter Securities Field, Greenspan Says*, N.Y. Times, Nov. 17, 1987, at A1, col. 1.

with differing requirements.[186] One system, under banking-agency regulation, imposes less strict standards on its members.[187] The other system, under SEC regulation, imposes comprehensive, extensive regulation developed and applied over fifty years.[188] Since it is anticipated that banks will soon provide twenty percent of all securities-brokerage services, this regulatory disparity conclusively gives the banking industry, with its less stringent requirements, a distinct competitive advantage over the securities-brokerage industry.[189]

### *B. Proposals for Regulating Bank Securities Activities*

A number of proposals have been offered for the regulation of bank securities-brokerage activities. One proposal would parallel the 1975 amendments to the Exchange Act, which authorize banking agencies and the SEC to coordinate regulation of banks that deal in municipal securities.[190] Likewise, Congress could authorize the SEC to coordinate regulation of bank securities-brokerage activities with banking agencies, as the SEC in fact tried to do in rule 3b-9.[191]

A second proposal would extend to banks the current regulatory structure applicable to bank holding companies and their subsidiaries that engage in brokerage activities to cover bank securities brokerage.[192] Bank holding companies and their subsidiaries are not entitled to the Exchange-Act bank exemption and are currently registered with and regulated by the SEC as broker-dealers.[193] In fact, use of a bank

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186. *See* S. JAFFE, *supra* note 3, at § 2.06.

187. *See supra* notes 164–73 and accompanying text (comparing bank brokerage regulation with SEC broker-dealer regulation); *see also Supreme Court Widens Banks' Brokerage Role,* Wall St. J., Jan. 15, 1987, at 2, col. 2, 20, col. 3 (noting precarious position of bank discount-brokerage customers).

188. *See supra* note 31 and accompanying text (noting stringency of all aspects of SEC broker-dealer regulation).

189. *See* ARTHUR ANDERSON & CO. AND THE BANK ADMINISTRATION INSTITUTE, NEW DIMENSIONS IN BANKING: MANAGING THE STRATEGIC POSITION 18–19 (1983) (indicating that securities brokerage is "best new area for banks to enter" and predicting that "banks will provide twenty percent of all brokerage services by 1990"); Jacobsohn, *Banks and Securities: The Regulatory Agencies Get Tougher,* 6 SEC. REG. L.J. 213, 214–15 (1978) (noting that banks seek to gain competitive advantages through legislative and regulatory restrictions on their competitors).

190. *See supra* note 140 and accompanying text (discussing coordination by SEC and banking agencies of municipal-securities regulation).

191. *See* SEC Final Rule, *supra* note 10, at 28,393–94 (citing success of coordinated interagency regulation of municipal securities).

192. *See* Bank Holding Company Act, 12 U.S.C. §§ 1841–1850 (1982). A bank holding company is any company that has control over any bank or over any bank holding company. *Id.* § 1841(a)–(c). Bank holding companies are regulated by the Federal Reserve. *See id.* §§ 1841–1850; *see also* C. GOLEMBE & D. HOLLAND, *supra* note 1, at 23–24.

193. *See* SEC Final Rule, *supra* note 10, at 28,386 (noting that bank holding companies and their nonbank subsidiaries that engage in securities brokerage must register as broker-dealers with SEC).

securities affiliate or subsidiary to perform brokerage services was recommended in the Financial Services Competitive Equity Act, S. 2851.[194]

Third, Congress could require banking agencies to promulgate bank securities-brokerage rules similar to those imposed by the SEC on broker-dealers.[195] Originally proposed by the SEC in its 1977 Bank Study,[196] this recommendation would provide for regulation of bank securities-brokerage activities without additional SEC regulation.[197] This solution, however, fails to consider the deleterious effect that the absence of SIPC insurance would have upon bank securities customers.[198]

In addition, state securities regulators should continue to take an active role in regulating the securities-brokerage activities of banks.[199] All states enforce some form of securities laws to govern the offer and sale of securities and the regulation of broker-dealers.[200] Thirty-nine states have adopted the Uniform Securities Act,[201] under which both state and national banks are exempted from registration as broker-dealers by a provision paralleling that contained in the Exchange Act.[202] However, securities regulators in at least twenty-six states have

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194. 98th Cong., 2d Sess., 130 CONG. REC. 11,162–80 (daily ed. Sept. 13, 1984); *see also* Note, *A Proposal for the Reform of Glass-Steagall*, *supra* note 3, at 318–22 (proposing "depository institution securities affiliate").

195. *See* R. KARMEL, *supra* note 3, at 310–13 (1982) (advocating that Congress require banking agencies to act for protection of investors).

196. SEC INITIAL REPORT, *supra* note 10, at 1, *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 11; SEC FINAL REPORT, *supra* note 40, at 7–8, *reprinted in* SENATE COMM. PRINT, *supra* note 10, at 307.

197. *See* R. KARMEL, *supra* note 3, at 311 (noting that this proposal would maintain regulation of bank activities by federal banking agencies).

198. *See supra* note 173 and accompanying text (emphasizing that accounts of securities investors in banks are not insured by SIPC). Nor does the FDIC insure such accounts.

199. State regulation of securities activities is expressly permitted under the Exchange Act. 15 U.S.C. § 78bb(a) (1982 & Supp. IV 1986).

200. *See* H. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 1.05 (rev. ed. 1987–1988) (describing system of state securities regulation). All fifty states, the District of Columbia, and Puerto Rico regulate broker-dealer registration. *Id.*; *see also* Sargent, *Report on State Merit Regulation of Securities Offerings*, 41 BUS. LAW. 785, 788–95 (1986) (explaining interaction of state and federal securities regulation).

201. *See* Jurisdictions Adopting the Uniform Securities Act, 1 Blue Sky L. Rep. (CCH) ¶ 5500 (1987) (listing the 39 jurisdictions that have adopted the Act).

202. Uniform Securities Act § 401(c)(3), 1 Blue Sky L. Rep. (CCH) ¶ 5541 (1957), exempts banks from broker-dealer registration by providing that "[w]hen used in this act, unless the context otherwise requires: 'Broker-dealer' does not include . . . (3) a bank, savings institution, or trust company . . . ." *Id.*

The Commissioners on Uniform State Laws drafted this provision in 1957 and based it upon the corresponding provision of the Exchange Act. *Compare id. with* Exchange Act § 3(a)(5), 15 U.S.C. § 78c(a)(5); *see also supra* notes 7–8 and accompanying text (defining federal exemption of banks from broker-dealer registration). The Commissioners drafted the exclusion based upon then-existing conditions in the banking industry. *See* 12A J. LONG, BLUE SKY LAW 6-29 to -31 (1987). The exemption for banks was based on the limited ability of commercial banks to

denied the exemption to banks that actively solicit brokerage customers, take and execute orders, render investment advice, or receive commissions.[203]

## V. CONGRESSIONAL ACTION

### *A. The SEC's Reaction to the Reversal of Rule 3b-9:[204] The Bank Broker-Dealer Act of 1987*

Following the appellate court's denial of the SEC's petition for rehearing en banc,[205] the SEC submitted a proposal to Congress on May 5, 1987, that would require most banks offering securities services to register with the SEC.[206] Introduced as the Bank Broker-Dealer Act of 1987 ("Broker-Dealer Act"), the legislation was sponsored in the Senate by Senator Alfonse D'Amato[207] and in the House by Representative Edward Markey.[208] Noting the necessity for congressional action, Senator D'Amato pointed to court decisions that have consistently supported bank regulators and banks in expanding the permitted range of

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participate in securities brokerage as established by Glass-Steagall. *Id.*

203. *See* Wigder & Rigler, *Banks and the Discount Brokerage Business,* 18 Sec. & Commodities Reg. 81, 91 (April 10, 1985) (reporting results of a 1984 survey of fifty states and District of Columbia). The twenty-six states that require registration of banks as broker-dealers are: Colorado, Connecticut, Hawaii, Idaho, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New York, Ohio, Oklahoma, Pennsylvania, South Carolina, Washington, West Virginia, Wisconsin, and Wyoming. *Id.*

For example, Montana has a qualified exemption, granted only if certain conditions are met. Mont. Sec. Dep't Interim Op. 83-1 (Feb. 8, 1983), 2 Blue Sky L. Rep. (CCH) ¶ 36,503 (1984). Similarly, Wisconsin has set forth restrictions for using the broker-dealer exemption. *See* Wis. Office of Comm'r of Sec., "Commissioner Comments," Wis. Sec. Bull., March 1983, 3 Blue Sky L. Rep. (CCH) ¶ 64,928 (1984). Under Wisconsin law, banks that "hold themselves out generally to the public as broker-dealers" must register as broker-dealers under the state Uniform Securities Law. Wis. Blue Sky Reg. § 4.10 (1985), 3 Blue Sky L. Rep. (CCH) ¶ 64,590 (1984).

*See* J. LONG, *supra* note 202, at 6-32 to -36.1 (noting that state securities commissioners have no objection to banks engaging in securities brokerage so long as investors are protected).

204. Rule 3b-9, *supra* note 54.

205. American Bankers Ass'n v. SEC, No. 85-02482 (D.C. Cir. Jan. 12, 1987), *denying rehearing to* 804 F.2d 739 (D.C. Cir. 1986); *see also D.C. Circuit Declines to Rehear Case Striking Down SEC Bank Brokerage Rule,* [Jan.-June 1987] Sec. Reg. & L. Rep. (BNA) 125 (SEC attorney reported that no judge favored rehearing).

206. Executive Communication No. 1337, Letter from Chairman, Securities and Exchange Commission, 100th Cong., 1st Sess., 133 CONG. REC. H3190 (daily ed. May 5, 1987) (transmitting proposed amendments to Exchange Act that would ensure regulatory equality of all participants in securities markets, promote fair competition among providers of identical securities-brokerage services, and adequately protect investors).

The SEC's proposal was based upon the Bush Task Group Proposals recommending bank regulation according to function, not industry classification. *SEC to Ask Congress to Require Banks to Register Securities Affiliates,* 19 Sec. Reg. & L. Rep. (BNA) 626 (1987).

207. S. 1175, 100th Cong., 1st Sess., 133 CONG. REC. S6235 (daily ed. May 8, 1987).

208. H.R. 2557, 100th Cong., 1st Sess., 133 CONG. REC. H4056 (daily ed. May 28, 1987).

bank securities-brokerage activities well beyond the plain meaning of Glass-Steagall,[209] while at the same time restricting the jurisdiction of the SEC to regulate these expanded securities activities.[210]

The Broker-Dealer Act would amend the definitions of broker and dealer in the Exchange Act to withdraw the current blanket exemption, which, since the reversal of rule 3b-9, continues to permit banks to engage in securities-brokerage activities without SEC registration or regulation.[211] A bank would no longer be exempted from SEC registration if it solicits brokerage business for transaction-related compensation, receives transaction-related compensation for providing brokerage services for trust or other accounts to which the bank provides advice, or deals in or underwrites securities.[212] Banks that limit their securities activities to transactions in exempted securities would retain their exemption from SEC registration.[213] In contrast with rule 3b-9, which allowed banks themselves to register with the SEC and thus created a potential jurisdictional conflict between the SEC and bank regulators,[214] the Broker-Dealer Act would eliminate this conflict by amending section 15(a) of the Exchange Act to make it unlawful for banks

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209. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

210. 133 CONG. REC. S6235–36 (daily ed. May 8, 1987) (statement of Sen. D'Amato). Stating that this "legislation was precipitated" by the *American Bankers* decision, Sen. D'Amato included the full text of the case in the Congressional Record. *Id.* at S6235, S6238.

211. S. 1175, *supra* note 207, §§ 101–102. Exchange Act § 3(a)(4)–(5) would be amended to read as follows:

> (4)(A) The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others, but such term does not include a bank except as provided in subparagraph (B) of this paragraph.
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> (B) The term 'broker' includes any bank that (i) publicly solicits brokerage business, (ii) receives transaction-related compensation for brokerage services provided to trust, managing agency, or other advised accounts, or (iii) underwrites securities on an agency basis, except that a bank is not a broker if it restricts its activities to transactions in exempted securities.
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> . . . .
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> (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 such term does not include a bank, except as provided in subparagraph (B) of this paragraph, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business.
>
> (B) The term 'dealer' includes any bank that (i) publicly solicits securities transactions to be effected on a principal basis, whether in a riskless principal capacity or otherwise, (ii) receives transaction-related compensation for effecting transactions in securities on a principal basis for trust, managing agency, or other advised accounts, or (iii) deals in or underwrites securities, except that a bank is not a dealer if it restricts its activities to transactions in exempted securities.

212. S. 1175, *supra* note 207, § 102(5)(B)(ii).

213. *Id.* § 102(5)(B)(iii).

214. SEC Final Rule, *supra* note 10, at 28,388.

themselves to act as broker-dealers.[215] Instead, banks would have to create separate, SEC-regulated bank subsidiaries or affiliates to deal in securities transactions.[216] Thus, the Act would resolve the jurisdictional concerns the court relied upon in striking down rule 3b-9.[217] Indeed, even the Comptroller has argued that the SEC should supervise bank securities-brokerage activities.[218]

### *B. The Senate's Response: S. 1886,[219] the Proxmire Financial Modernization Act of 1988*

On March 30, 1988, the Senate recognized that the Glass-Steagall separation was more fiction than fact[220] and overwhelmingly passed S.

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215. S. 1175, *supra* note 207, § 104(15)(a)(2). The full text of Exchange Act § 15(a)(2), as amended, would read as follows:

> (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. This section does 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.

216. Senator D'Amato noted that the requirement that banks establish a separate securities affiliate solved the jurisdictional conflicts objected to in rule 3b-9. 133 CONG. REC., *supra* note 210, at S6237 (statement of Sen. D'Amato). First, the Broker-Dealer Act would not require banks to comply with the SEC net-capital rule, which differs from the net-capital rule applied to banks by bank regulators. *Id.* Second, in the event of bank failure and subsequent liquidation, the FDIC would liquidate a bank whereas SIPC would liquidate the bank securities affiliate. *Id.*

Under the Broker-Dealer Act, the SEC would maintain the power, however, to exempt banks from the definitions of broker or dealer under certain circumstances. *See* S. 1175, *supra* note 207, § 103(3)(c). New § 3(e) of the Exchange Act would read as follows:

> (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 this title.

Rule 3b-9, on the other hand, included express exemptions from SEC broker-dealer registration for banks that conduct only limited brokerage activities. *See supra* note 57 and accompanying text (noting seven exemptions). The SEC expects to use any authority such as that under new § 3(e) to exempt bank networking arrangements with SEC-registered broker-dealers, under which banks provide only limited clerical and ministerial services. *See SEC Submits Proposal to Require Banks to Register Securities Affiliates,* 19 Sec. Reg. & L. Rep. 675, 676 (1987); *see also infra* note 229 (describing similar SEC exemption powers under Senate-passed legislation).

217. 133 CONG. REC., *supra* note 210, at S6237–38 (statement of Sen. D'Amato) (proposing revision of rule 3b-9 to avoid regulatory conflicts between SEC and bank regulators). The provisions of the Broker-Dealer Act would maintain the safety and soundness of banks by separating banking and securities activities, providing SIPC insurance of bank securities accounts, and maintaining FDIC insurance for bank accounts. *Id.; see also* S. 1175, *supra* note 207, § 201 (affirming jurisdiction of Comptroller and Federal Reserve to regulate banks).

218. *See* Clarke, The Limits of Bank Regulation, Address at a Conference at Boston University School of Law on the Challenges of Increased Regulatory Supervision (May 2, 1986), *reprinted in* 6 ANN. REV. BANKING L. 227, 232 (1987) (arguing that securities laws protect customers and should be applied to "any provider of securities services, including banks").

219. 100th Cong., 134 CONG. REC. S3521 (1988).

220. *See* S. REP. NO. 305, *supra* note 24, at 12 (emphasizing reality that "American banks

1886.[221] S. 1886 would repeal sections 20 and 32 of Glass-Steagall and permit bank subsidiaries to engage in underwriting all types of securities except mutual funds and unsecured corporate debt and equity, which would be added later.[222] To protect the safety and soundness of the banking system, S. 1886 requires banks to conduct most securities-brokerage activities in a separate subsidiary or affiliate regulated by the SEC.[223] Banking agencies, however, would continue to regulate those securities-brokerage activities closely related to traditional banking services.[224] Furthermore, S. 1886 also expands the enforcement powers of banking agencies to regulate bank securities-activities conducted in a bank.[225] As a result, its enactment is supported by both the banking agencies and the SEC.[226]

To effectuate SEC regulation of bank securities-brokerage activities, S. 1886 would amend the definitions of "broker" and "dealer" in the Exchange Act.[227] A bank would not be exempt from the definition of "broker" and would be required to register a separate securities affiliate or subsidiary with the SEC if the bank publicly solicits brokerage business or receives incentive compensation for brokerage.[228] Certain traditional bank brokerage activities would be exempted from SEC registration and may be conducted by the bank itself under bank agency supervision.[229] Likewise, bank security-dealership activities would be

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underwrite securities all over the world, except in America"). The Senate Banking, Housing and Urban Affairs Committee noted that there was little left of Glass-Steagall to repeal because banking regulators and courts had, over the last fifty-five years, exploited interpretational loopholes in the statutory language. S. REP. NO. 305, *supra* note 24, at 12.

In addition, the Committee determined that bank securities activities "were not a substantial cause" of the 1929 crash and that it was no longer necessary to separate banks from the securities industry. *Id.* at 8–9.

221. *See* 134 CONG. REC. S3542 (94–2 vote). The vote is expected to pressure the House to approve a bill repealing Glass-Steagall. *See Senate Passes Glass-Steagall Reform Bill, Adopts Stiffer Restrictions in Amendment*, 50 Banking Rep. (BNA) 563 (Apr. 4, 1988).

222. *See* S. 1886, *supra* note 219, § 101. Six months after enactment, banks would be permitted to engage in underwriting unsecured corporate debt and mutual funds. *Id.* § 102. Congress would be required to vote, by April 1, 1991, on a joint resolution granting bank securities affiliates the right to underwrite corporate equity. *Id.* § 113.

223. *Id.* § 304.

224. *See* S. REP. NO. 305, *supra* note 24, at 78–79 (noting that split of regulatory authority between banking agencies and SEC is consistent with functional regulation).

225. S. 1886, *supra* note 219, § 501–542.

226. *See* S. REP. NO. 305, *supra* note 24, at 8–22.

227. *See id.* at 79 (citing § 301).

228. *Id.*

229. *See id.* at 79–81 (citing § 301). Section 301 includes the following exemptions that allow a bank to continue to engage in brokerage activities subject to banking agency regulation, but without SEC regulation:

> (1) networking arrangements, in which a bank enters into contractual arrangements with a registered broker or dealer under which that broker or dealer would offer brokerage services on or off the bank's premises. Such arrangements must be fully disclosed and bank

regulated by the SEC unless the activities come within one of four exemptions.[230]

If enacted, S. 1886 would unify and modernize the financial system, ensure regulatory equality, protect investors and depositors, and enable banks to compete in securities markets both domestically and globally.

## VI. CONCLUSION

Since its enactment in 1933, Glass-Steagall[231] has mandated separation of the banking and securities industries. Banks accepted deposits and made loans; broker-dealers in the securities industry bought and sold securities to the public for profit. Because Glass-Steagall restricted bank brokerage activities to non-profit, banking-customer accommoda-

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employees must perform only ministerial functions, unless they are registered and regulated by the appropriate regulator;

(2) trust activities, provided the bank does not receive incentive compensation and publicly solicits brokerage business other than by advertising in connection with advertising its other trust activities;

(3) transactions in exempt securities, other than municipal securities;

(4) transactions in commercial paper;

(5) transactions in bankers' acceptances;

(6) transactions in commercial bills;

(7) transactions in municipal securities, provided the bank does not have a securities affiliate;

(8) employee and shareholder benefit accounts;

(9) "sweep" accounts for depositing funds into money-market accounts;

(10) transactions for the account of an affiliate of the bank;

(11) private placements, when the purchasers are institutional investors or individuals with a high net worth.

S. 1886, *supra* note 219, § 301.

Banks that limit their brokerage activities to fewer than 1,000 transactions per year (other than those specifically exempted from the *broker* definition) and that do not have a separate affiliate or subsidiary registered as a broker-dealer would be excluded from the revised definition of *broker*. S. REP. NO. 305, *supra* note 24, at 81. Moreover, the SEC may exempt "any person or class of persons from the definition of "broker" or "dealer." *See id.* at 83 (citing § 303).

230. S. REP. NO. 305, *supra* note 24, at 82–83 (citing § 302). Section 302 requires "any person engaged in the business of buying and selling securities for his own account through a broker or otherwise" to register with the SEC. S. 1886, *supra* note 219, § 302. The provision includes the following exemptions from SEC registration:

(1) trust and fiduciary activities;

(2) commercial paper;

(3) bankers' acceptances;

(4) commercial bills;

(5) transactions in exempted securities other than municipal securities;

(6) municipal securities, provided the bank does not have a securities affiliate;

(7) transactions for the bank's own investment and trading portfolio;

(8) securitization of bank assets.

*Id.* § 302.

231. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

tion services, regulation was unnecessary. Thus, banks were exempted from SEC regulation as broker-dealers. For many years, banks did not compete with the securities industry. Since 1982, however, banks have aggressively advertised securities-brokerage services in direct competition with the highly-regulated securities industry.

S. 1886,[232] the Proxmire Financial Modernization Act of 1988, represents a comprehensive attempt at a congressional solution to regulate bank brokerage activities within the existing securities regulatory structure while allowing banks a significant presence in securities activities. It incorporates many of the broker and dealer exemptions proposed in rule 3b-9[233] and adopts the concept of a separate securities affiliate or subsidiary recommended in the Bank Broker-Dealer Act.[234] Supported by the banking agencies and the SEC, the Proxmire Act would authorize the SEC to regulate bank securities-brokerage activities and protect bank securities-brokerage investors while bank regulators continue to supervise banking activities and protect depositors. In short, the Proxmire Act would equalize the current regulatory disparity between the securities industry and banks that engage in securities-brokerage activities.

Because rule 3b-9, which authorized SEC regulation of bank securities-brokerage services, was struck down in *American Bankers Association v. SEC*,[235] only congressional action can resolve the jurisdictional dilemma of who should regulate bank securities-brokerage activities. If Congress would ratify the recent expansion of bank securities-brokerage powers, it must first carefully examine the parameters of agency regulation of these new powers and affirmatively mandate the SEC to regulate banks as broker-dealers.

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232. S. 1886, *supra* note 219.

233. Rule 3b-9, *supra* note 54; *see also supra* note 57 and accompanying text (discussing exemptions from rule 3b-9).

234. S. 1175, *supra* note 207; *see also supra* note 216 and accompanying text (discussing separate SEC-regulated bank affiliates proposed in Broker-Dealer Act).

235. 804 F.2d 739 (D.C. Cir. 1986).