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COMMENTS

GLASS-STEAGALL: LEST WE FORGET*

LAWRENCE F. ORBE III

I. INTRODUCTION

In response to the Great Depression, federal legislation was enacted to separate commercial and investment banking. However, the gradual sophistication of the banking industry and the creation of a plethora of new financial services offered by banking institutions have blurred this statutorily mandated division. This comment will trace the history of this legislation and delineate the principle actors responsible for its formulation. Next, an analogy

between the investment banking industry of the 1920's and the industry of the 1980's will demonstrate a recurrence of those factors which precipitated the banking reform legislation of the 1930's. Finally, a proposal for remedial legislation to redefine the eroded line of demarcation between commercial and investment banking will be offered.

II. LEGISLATIVE HISTORY

The Banking Act of 1933 was signed by President Franklin D. Roosevelt on June 16, 1933,¹ culminating a long series of reform legislation affectionately or otherwise known as the "first 100 days" of the New Deal. This Act has become known as the Glass-Steagall Act, named for Senator Carter Glass, (D.-Virginia), and Representative Henry Steagall, (D.-Alabama), the sponsors of the legislation.

Senator Glass had considered the creation of the Federal Reserve System his crowning achievement.² He and other sponsors of this 1913 legislation believed that they had created the ideal financial structure to thwart panic and virtually eliminate depression.³ The 1929 market crash, the ensuing depression, and the inability of financial institutions to spark economic recovery was taken by Glass as a bitter personal defeat. This led Glass to begin a three-year search for those factors which he believed had crippled his "invincible" system. During preliminary investigations in 1930, Glass and his associates searched the practices of commercial banks not specifically authorized by then-current legislation which might have contributed to the crash and the resultant malaise.⁴ Glass made up his mind early that a major cause of the depression had been that commercial banking had become subservient to investment banking.⁵

Columbia University Professor H. Parker Willis, generally recognized as the country's foremost banking expert, was invited to

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3. Perkins, supra note 2, at 498.
4. Id. at 498-500.
5. Id. at 500. See generally Operation of the National and Federal Reserve Banking Systems: Hearings on S. Res. 71 Before a Subcommittee of the Senate Comm. on Banking and Currency, 71st Cong., 3d Sess., Part I (1931) [hereinafter cited as 1931 Hearings].
Washington to assist in conducting hearings and drafting new legislation.\textsuperscript{6} Willis, other academicians at Columbia and banking scholars generally believed, based on what they perceived to be a successful model in England, that by limiting a bank's lending activities solely to bona fide commercial lending purposes, the nation's economy would rebound. Permanent capital investment funds were to come from "real savings" and not from banking activities.\textsuperscript{7} This theory has strongly affected the United States monetary policy for decades.\textsuperscript{8}

Both Willis and Glass had warned the banking community throughout the 1920's of the dangers of market speculation, which they believed was substantially encouraged by the passage of the McFadden Act in 1927.\textsuperscript{9} The McFadden Act modified earlier legislation which had provided for prohibition of certain investment banking activities by commercial banks.\textsuperscript{10} The investment banking activity enlarged by the McFadden Act was conducted by means of security affiliates.\textsuperscript{11} These security affiliates were highly visible because they were engaged in retail distribution, and this became an early target of the Glass investigation. Willis and Glass believed that banks with security affiliates operated with lax loan standards because a quick public offering could bail the bank out if the loan was improvident.\textsuperscript{12} Willis in particular believed that severe legislative restrictions imposing limited permissible financial activities on commercial banks could recreate the stable financial world of 1915-1917.\textsuperscript{13} However, the political situation in 1930 was such that a banking bill with strict provisions would probably not pass the Re-

\textsuperscript{6} Perkins, \textit{supra} note 2, at 501.

\textsuperscript{7} Id. For an example of this philosophy, written during the tumultuous 1930's see Willis, \textit{The Banking Act of 1933 in Operation}, 35 \textit{COLUM. L. REV.} 697 (1935).

\textsuperscript{8} L. MINTS, \textit{A HISTORY OF BANKING THEORY IN GREAT BRITAIN AND THE UNITED STATES}, 1-10 (1956); Perkins, \textit{supra} note 2, at 501-2.


\textsuperscript{10} Ch. 191, 44 Stat. 1224 (1927). This Act modified the National Bank Act, ch. 106, 13 Stat. 99 (1864). The Act permitted direct bank underwriting of investment securities with certain requirements as to bank capital and marketability. Three conditions were set forth for the marketability test: 1) the large size of the issue, 2) public distribution of the security, and 3) a trustee independent of the issuer. \textit{See Rogowski, Commercial Banks and Municipal Revenue Bonds}, 96 \textit{BANKING L.J.} 155, 157 (1978).

\textsuperscript{11} For a more detailed description of security affiliate, see \textit{infra} notes 61-68 and accompanying text.

\textsuperscript{12} \textit{1931 Hearings}, \textit{supra} note 5.

\textsuperscript{13} Perkins, \textit{supra} note 2, at 503.
publican-controlled Senate. The Hoover administration was unlikely to support legislation unpopular on Wall Street. Further, many Hoover advisors, including Secretary of the Treasury Andrew Mellon, had an ideological commitment to self-reform. Yet, Hoover's administration posed no barriers to the conduct of a thorough investigation by Glass. In fact, it was not until after the 1932 election defeat that Hoover let his personal convictions be known.

Hearings on early drafts of the Glass Banking Bill were held during 1931 and 1932. The hearings received widespread publicity, and Glass made use of them to promote reform proposals. Senator James Couzens, (R.-Michigan), who had been a partner of Henry Ford prior to his election to the Senate was a sharp critic of the financial community and provided Glass with valuable support because of his extensive business background. Testimony was given by representatives of some of the banks with security affiliates, the New York Federal Reserve Bank, the Federal Reserve Board, and the American Bankers' Association. Several key witnesses advocated a complete separation of commercial and investment banking. Fervent supporters of the existing structure later changed their minds:

Mr. PECORA. I addressed a question to Mr. Wiggin [retired Chairman, Chase National Bank] just prior to your having been sworn, in which I asked him to give the committee the reason or reasons for the change that was made in May of 1933 in the charter or bylaws of the Chase Securities Corporation.

Mr. ALDRICH. [President and Chairman, Chase National Bank] Mr. Chairman, that goes into a great many things. The answer to that question requires consideration of a number of things. Sometime ago—I think it was in March of this year when that policy was announced of divorcing the securities affiliate of

14. G. SMITH, THE SHATTERED DREAM, 55-82 (1970). Mellon was a social Darwinist who detested any thought of tinkering with the system. Id. at 57.
15. Perkins, supra note 2, at 504.
16. Id. at 505; SMITH, supra note 14, at 235-39.
17. Senate Resolution 71 led to these hearings and to the ultimate passage of the legislation.
18. Note, supra note 2, at 748; Perkins, supra note 2, at 506.
21. These included Adolf Miller, a member of the Federal Reserve Board; John Broderick, New York Superintendent of Banking; Owen Young, Chairman of General Electric Company and a Director of the New York Federal Reserve Bank, and of course Willis. See 1931 Hearings, supra note 5, at 123, 271. See also Perkins, supra note 2, at 506-515.
Chase National Bank and changing the charter of the Chase Securities Co. so that it could not deal in securities - I took occasion to make a statement as to what I thought should be done with regard to the divorcement of investment banking from the banking done by the large commercial banks.

The reasons for the conclusion that I had reached go back quite a long distance in the past. And I had come to the conclusion that it was not desirable for commercial banking and investment banking to be conducted in close affiliation. But I think that for the purpose of the record at this time I might say that I had come to the conclusion, for a great many reasons, that the business of commercial banking and investment banking should be absolutely divorced, and for that reason at that time we started dissolution proceedings of the Chase Harris Forbes Companies, and we changed the charter of the Chase Securities Corporation so that it could no longer deal in securities, and changed its name, and that corporation also is in course of liquidation.\

Concentration of economic power and conflicts of interest, accentuated by bank operation of security affiliates, were perceived to have caused a loss of public confidence in banks. The hearings enumerated the following adverse elements of the commercial bank/security affiliate relationship:

1. The security affiliate may borrow money from the parent bank or sell securities to the parent bank.
2. The parent bank might freely lend money to security affiliate investment banking clients to facilitate distribution of securities.

22. Stock Exchange Practices: Hearings on S. Res. 84, and S. Res. 56 Before the Comm. on Banking and Currency, 73d Cong., 1st Sess. 2294-95 (1933) [hereinafter cited as 1933 Hearings]. Some testimony was incredulous, particularly to the public which had lost so heavily in the preceding months. See especially the testimony of Stanley Russell, Montclair, New Jersey, Vice President of National City Co., security affiliate of National City Bank. Russell testified that National City Co. loaned funds to a company to facilitate a merger, purchased $20 million of securities from the combined companies, allowed a principal of the company to participate in the syndicate as a "silent partner," sold the common stock portion of the securities package at $48 per share (having purchased the stock immediately prior to the offering at $10 per share) and beat Eastman, Dillon & Co. entirely out of its banking relationship because, as a security affiliate, National City Co. could secure the business by loaning funds when needed as seed money to effectuate the merger, which made the offering possible. The public financing repaid the bank loan. Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 239 Before the Subcomm. of the Senate Comm. on Banking and Currency, 72d Cong., 2d Sess. 2269-97 (1933).

3. Close public identification of the security affiliate with the bank could create the possibility of a run on the bank if large market losses were sustained by the security affiliate.

4. A temptation might exist to shore up the affiliate through unsound loans or to purchase securities from it.

5. Unneeded price volatility might be created in the bank's stock because of the security affiliate's activities in the stock market.

6. The parent bank might permit the affiliate to assume higher risks than the parent bank could or would.

7. The promotional needs of investment banking might cause the bank to lend its reputation for prudence and restraint to the enterprise of selling stocks.

8. The parent bank might freely loan money to customers to facilitate the purchase of securities offered by its security affiliate.

9. The parent bank could market unsound or speculative investments to correspondent banks.

10. If the parent bank operates a trust department, the possession of a security affiliate may adversely affect the independence of the trust department.

11. Knowledge of the existence of the security affiliate might cause the bank to consider unwise commitments, knowing such positions could be shifted to the security affiliate.

12. Trading of the affiliate in the bank's own stock could lead to unnecessary and speculative price fluctuations in the bank's stock.

13. When an affiliate acts as a receptacle for problem loans and related assets, its very existence aids the liquidity of the bank. When the bank finances the affiliate, however, the illiquidity simply becomes disguised. The mere existence of the affiliate could reduce the caution exercised by bank management.24

Evidence that some banks had diverted customer deposits into unsound investments by financing underwritings added a sensational note to the hearings.25 The credibility of assertions by bankers who testified that such abuses were very rare was shattered by the fact that over 4,000 banks failed during the course of the hearings.26 Two banking practices were of particular concern to the committee: the sale of securities underwritten by the security affiliate to the bank's trust accounts and correspondent banks, and the

24. 1931 Hearings, supra note 5, at 1058, 1063-64.
25. Note, supra note 2, at 748.
26. Id.
use of bank loans to finance the affiliate’s underwriting activities.\textsuperscript{27}

Amidst a storm of lobbying and acrimonious personal exchanges,\textsuperscript{28} a compromise bill was introduced in the Senate on January 21, 1932.\textsuperscript{29} Debate continued through filibuster and the November election of Roosevelt; Glass reintroduced a similar bill in January 1933. Willis told Glass to “get as much as you can now and we can amend the bill later if necessary.”\textsuperscript{30} In January, 1933, the Glass Banking Bill passed the Senate by a margin of fifty-four to nine.\textsuperscript{31} Glass, through the passage of this bill, had set out to confine bankers to the banking business, to subject them to additional governmental regulation, and to promote the unification of banks through permission to conduct branch banking.\textsuperscript{32} The basic purposes of the legislation were to restore public confidence in commercial banks, to promote economic stability and to eliminate conflicts of interest.\textsuperscript{33}

When the bill reached the House, Representative Steagall opposed unification, and sought to protect depositors by federal guarantees, thereby culminating efforts for a cause that he had championed for some twenty years.\textsuperscript{34} Steagall’s quest for deposit guarantees met with success in the House and by the end of May, 1933, the Glass Bill and the Steagall version, which was the basis for the Federal Deposit Insurance Corporation, were sent to conference.\textsuperscript{35} Glass himself was not pleased with Steagall’s changes, but at the advancing age of seventy-five, and increasingly sour on the New Deal, he acquiesced.\textsuperscript{36} In conference, the Act was modified as to the Senate’s plan for branch banking. The compromise bill was changed markedly by the addition of deposit insurance.\textsuperscript{37} Roosevelt was not enthusiastic; he almost vetoed the bill because it

\begin{itemize}
  \item 27. Rogowski, \textit{supra} note 10, at 158; 1931 \textit{Hearings}, \textit{supra} note 5, at 1063-68.
  \item 29. 75 Cong. Rec. 2403 (1932).
  \item 30. Perkins, \textit{supra} note 2, at 519 n. 75 (citing letter from Willis to Glass, Nov. 19, 1932).
  \item 31. S. 4412, 72d Cong., 2d Sess., 76 Cong. Rec. 2517 (1933).
  \item 32. 75 Cong. Rec. 9912-15 (1932).
  \item 33. 75 Cong. Rec. 9882-84 (1932).
  \item 34. 77 Cong. Rec. 5895 (1933).
  \item 35. The House version passed 262-19 on May 23, 1933, 77 Cong. Rec. 4058 (1933), and went to conference two days later. \textit{Id.} at 4182.
  \item 36. See Perkins, \textit{supra} note 2, at 521. Glass remained jealous of his accomplishments. When, during the course of his own legislative efforts, the Securities Act of 1933 reached the floor, he “broke out into a tirade to the effect that he was the proponent of legislation dealing with banks and their relationship to the sale of securities and that he wanted no interference with his handling of these issues.” Landis, \textit{The Legislative History of the Securities Act of 1933}, 28 Geo. Wash. L. Rev. 29, 44 (1959).
  \item 37. 77 Cong. Rec. 3835-36 (1933).
\end{itemize}
contained the deposit guaranty experiment. According to one commentator, Roosevelt was fully aware of the threat of additional disruptive hearings, and even though he withdrew his support of the legislation under pressure from bank lobbyists, he nevertheless signed the Act as it emerged from conference to thwart further hearings and to placate what had become, by that time, a thoroughly disenchanted public. In fact, public acrimony and concern were so widespread that seven of ten security affiliates were voluntarily liquidated before passage of the Act.

As enacted into law, effective June 14, 1934, the Act separated investment banking and commercial banking, established the Federal Deposit Insurance Corporation, restricted the use of bank credit for speculation, established new minimum capital for national banks, and permitted savings banks and Morris Plan banks to become members of the Federal Reserve System. Branch banking became a strictly local issue; bank holding companies were required to obtain permission from the Federal Reserve Board before voting their holdings; interest was eliminated on demand deposits; interest on time deposits was subject to regulation; loans by banks to their officers were prohibited, and bank officers or directors could be removed for violations.

A discussion of many aspects of this legislation is beyond the scope of this comment. The focus here is on banking involvement in the underwriting business.

The principal provisions of the Glass-Steagall Act affecting the separation of commercial and investment banking are sections 16, 20, 21, and 32. Section 16 revised the McFadden Act to prohibit national banks and state member banks from purchasing equity

38. Rogowski, supra note 10, at 161, 161 n.25.
39. 77 Cong. Rec. 3955 (1933).
40. 48 Stat. 162, at §§ 16,20,21,32.
41. Id. at § 8.
42. Id. at §§ 11, 16.
43. Id. at § 17.
44. Id. at § 5. Morris Plan banks were the forerunners of present day credit unions.
45. Id. at § 23.
46. Id. at § 19.
47. Id. at § 11.
48. Id. at § 16.
49. Id. at § 12.
50. Id. at § 30.
securities for their own account. Limitations are imposed on a bank's investment authority with respect to debt instruments. Banks are prohibited from underwriting securities except for obligations of the federal government and general obligations of states and municipalities. Commercial banks are limited to three narrow areas of the securities business; agency, investment portfolio, and federal, state, and municipal bonds traded for their own account. Section 16 was amended in 1935 to clarify the position "that a national bank may buy stock for the account of customers but not for its own account."

Section 20 prohibits the establishment of security affiliates, if such affiliate is "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities." Section 21 provides that an investment bank may not engage in commercial bank activities. Section 32 prevents interlocking and overlapping personnel relationships. No partner, employee or officer of an investment bank may serve as an officer, director or employee of a commercial bank. These four key provisions affecting commercial-investment banking relationships should be considered in connection with the structure of the investment banking industry.

III. INVESTMENT BANKING: THEN AND NOW

In 1908 "the first security affiliate on record was organized by the First National Bank of New York City," and its method of creating a subsidiary was adopted by many banks in organizing their own affiliates. The First Security Co. was organized as a corporation with a capitalization of ten million dollars, equal to that

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53. 48 Stat. 162, at § 8; Clark & Saunders, supra note 52, at 727.
54. 48 Stat. 162, at §§ 16,20; Clark & Saunders, supra note 52, at 727.
55. 48 Stat. 162, at §§ 16,20; Clark & Saunders, supra note 52, at 727.
57. Clark & Saunders, supra note 52, at 726.
59. Id. at § 21.
60. Id. at § 32; Board of Governors of the Fed. Reserve Sys. v. Agnew, 329 U.S. 441 (1947); Clark & Saunders, supra note 52, at 726-27.
61. 1931 Hearings, supra note 5, at 1052; See also 75 Cong. Rec. 9909 (1932).
62. 1931 Hearings, supra note 5, at 1052.
The bank then declared a cash dividend of 100% but it was not dispersed to the stockholders. With the stockholders prior approval, this initial capitalization was directly subscribed to the stock of the affiliate and was deposited under a trust of which six officers of the bank were made trustees. The bank's shareholders then had inscribed on their stock certificates a statement that they had a beneficial interest in an equal number of shares in the affiliate, inseparable from those of the bank. The trustees were to exercise the powers of ownership, elect the same directors as that of the bank and collect dividends for distribution to shareholders. "The National City Bank, also of New York City, followed the lead of the First National Bank in 1911, and during the following decade, most of the other large banks in the city and in other money centers followed suit."66

Other methods of forming securities affiliates included shares sold in units in combination with shares of the bank, a controlling interest held by the same interests which controlled the bank, and a controlling interest held by another security affiliate of the bank.67 In most cases these security affiliates engaged in a wide range of activities. They could act diversely as: wholesalers of securities issues, retailers of securities, holding companies, investment trusts, loan liquidation companies, as a medium for marketing the bank's stock, and as real estate holding companies.68 The wholesale underwriting of securities at times caused security affiliates to carry large unsold commitments. At the end of 1930, for example, several large security affiliates each had several million dollars of unsold commitments in Bethlehem Steel Corporation common stock, some eight hundred thousand shares of which were underwritten in 1929. The offering price to stockholders had been $110 per share, and at the end of 1930 the unsold commitment had reduced in value by sixty percent.69

The rise in commercial bank involvement with investment banking was evident. "By 1922 there were 62 commercial banks directly engaged in investment banking and 10 others had formed security

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63. Id. (emphasis added).
64. Id. at 1052-53.
65. Id. at 1053 George F. Baker, president of the First National Bank, explained this technique in a letter to shareholders which is reproduced in its entirety in the record of the 1931 hearings at 1053.
66. 1931 Hearings, supra note 5, at 1054; See also 75 Cong. Rec. 9909 (1932).
67. 1931 Hearings, supra note 5, at 1054.
68. Id. at 1057.
69. Id. at 1057-58.
affiliates for that purpose. . . In New York this movement was headed by the First National Bank, Chase National Bank, National City Bank, and the Guaranty Trust Co.; in Boston the leaders were the Old Colony Trust Co. and the First National Bank.\(^7\)

However, prior to 1927 private banking houses such as J.P. Morgan & Co. and Kuhn Loeb & Co. controlled about eighty percent of the business.\(^7\) After the passage of the McFadden Act in 1927, the movement toward broad distributing and elaborate merchandising by security affiliates became widespread.\(^7\) This remarkable change in the composition of the industry can be seen in Exhibit I.

**EXHIBIT I**

Underwriting of Investment Securities*

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<td>1927</td>
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<td>Percent</td>
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<tr>
<td>Private banks, etc.</td>
<td>78.0</td>
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<td>Commercial bank affiliates</td>
<td>12.8</td>
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<td>Commercial banks</td>
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*Source: 77 Cong. Rec. 3955 (1933).

The major banks generally were the only banks engaged in origination and underwriting because securities issues were ordinarily in the millions of dollars.\(^7\) By 1930, the most conspicuous underwriting firms were National City Co., New York and Chase Harris Forbes Corporation, New York; First National Old Colony Corporation, Boston; Continental Illinois Co., Chicago; Bancamerica-Blair Corporation, New York; Bancamerica Co., San Francisco; First Detroit Co., Detroit; Guaranty Co., New York; Security First National Co., Los Angeles and First Chicago Corporation, Chicago.\(^7\) Some banks became so aggressive that they acquired private distributing houses to form their security affiliates, such as when Blair & Co. sold out to the Bank of America in New York and W.R. Compton & Co. sold out to Chatham Phenix National Bank.

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70. Perkins, *supra* note 2, at 492 (footnote omitted).
71. 77 Cong. Rec. at 3955 (1933).
72. 77 Cong. Rec. 3954 (1933). *See also* 75 Cong. Rec. 9910 (1933).
73. 75 Cong. Rec. at 9909 (1932).
74. *Id.* at 9909-10.
Bank & Trust Co., New York.\textsuperscript{75}

At the peak of investment banking activities in 1929, there were approximately three hundred security affiliates, of which two hundred belonged to national banks, seventy to state bank members of the Federal Reserve System, and thirty to non-member banks.\textsuperscript{76}

The magnitude of these securities operations has been overlooked by commentators and historians alike. A glimpse of the significance of these security affiliates to the overall success and profitability of major banks can be gleaned from unrehearsed testimony. For example, Albert H. Wiggin, generally regarded as the guiding force behind the modern Chase Manhattan Bank, was president of Chase National Bank during the heyday of security affiliate activity. During hearings pursuant to Senate Resolutions 84 and 56,\textsuperscript{77} conducted in 1933 after passage of the Glass-Steagall Act, the following discourse took place:

[Mr. WIGGIN.] The Chase Securities [sic] Corporation was organized in 1917. Its original capital was $2,500,000, and was, in effect, a dividend from the bank to its stockholders. And in order that there can be no question of where profits went, where the organizations were so closely allied, the equities were exactly the same. Each share of Chase National Bank stock carried with it a share of the Chase Securities Corporation.

The CHAIRMAN. And what was the capital?

Mr. WIGGIN. When the Chase Securities Corporation was originally started it was 2 ½ million dollars. In December of 1930, the high point in the banking business, the capital of the Securities Co. was 95 million dollars and the surplus was 13 million dollars.

. . . .

. . . It might interest you to know that the total offerings of the Securities Co., the total issues that they offered, have amounted to $6,158,000,000.\textsuperscript{78}

At the end of 1928 the capital of the bank was $60 million with a

\textsuperscript{75} Id. at 9910.
\textsuperscript{76} Id.
\textsuperscript{77} Senate Resolution 84 was a resolution to investigate practices of the stock exchange with respect to the buying and selling and the borrowing and lending of listed securities of the 72d Congress. Senate Resolution 56 was a resolution to investigate the the matter of banking operations and practices, the issuance and sale of securities and the trading therein of the 73d Congress.
\textsuperscript{78} 1933 Hearings, supra note 22, at 2281-82.
surplus of $60 million. By 1933 Chase was the largest bank in the world.

The importance of investment banking to commercial banks before Glass-Steagall is further underscored by data developed in the House during the course of deliberations over the banking legislation. During the years 1922-31, $74 billion of new issues were sold. In 1924, for example, annual commercial loan volume was about $8 billion and new issues were about one-half that amount. In contrast, by 1929 commercial loan volume had increased to only $9 billion while new issues had increased to $10 billion. Investment banking had become more important to the long-term financing of industry than commercial banking. Large money center commercial banks were fully cognizant of and participated in this development. By 1930 commercial bank security affiliates had become the major factor in investment banking. The industry trade association (The Investment Bankers Association) was headed by security affiliate personnel during this era.

That banks appear to have neglected commercial banking in favor of investment banking is evidenced in part by data gathered for Congress concerning bank failures. During the period 1921-32, 10,500 banks failed. This represented more than one-third of the then existing banks. Banks in existence as of December 30, 1932, are shown in Exhibit II. Of this total, approximately 6,900 banks were members of the Federal Reserve System. During this time Canada experienced twenty-six bank failures; while England and Scotland experienced none. Banks in these countries were totally separate from investment functions.

79. Id. at 2285.

80. Id. at 2280-81. The bank made several important acquisitions, and by early 1930 reported total capital and surplus of $243 million. Wall St. J., Mar. 27, 1933, at 15. The capital and surplus of National City Bank at this time was $242 million. Id.

81. 77 Cong. Rec. at 3957 (1933).

82. Perkins, supra note 2, at 495. See also supra Exhibit I.

83. Perkins, supra note 2, at 496.

84. 77 Cong. Rec. at 3949 (1933).

85. Id. at 3841, 3949-50.

86. Id. at 3950.
During this era private investment banks prospered. A brief profile of the leaders of the business follows.

**J.P. Morgan & Co.**—The "Tiffany" of the investment banking business conducted its activities on a wholesale basis and had no distributive facilities for securities. The firm had no branches or offices in locations other than Drexel & Co. in Philadelphia. The firm did conduct a general banking business but separated upon enactment of the Glass-Steagall Act into J.P. Morgan & Co., which continued commercial banking activities, and Morgan Stanley & Co., which continued investment banking activities. The House of Morgan was and is the most powerful factor in the investment banking business. During hearings conducted in connection with the banking legislation, the appearance of J.P. Morgan himself usually brought the gallery to its feet. His personage became a ready target for populists such as Senator Huey Long, (D.-Louisiana).

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88. 1933 Hearings, supra note 22, at 3-4.
89. For example:

[Mr. LONG.] Mr. President, this disclosure as to the House of Morgan, and as to the financial market-rigging set-up of this country and of the whole world, shows that they have taken the prospective persons of influence, the great and the near-great and the maybe-to-be great, and have absorbed them in the incubator. They have reached them in their days of youth and in their days of growing promise. They have bandaged them and they have banded them. They have given them the balm of Gilead that the House of Morgan gives only to the select, and those whose services may be of some benefit to the country, so that when the fateful hour may have arrived no man will have escaped the confidence of the house through which he has been a recipient of the blessings of this kind of conduct, assuming, therefore, that he will be in no position to do anything to upset it if he reaches a place of power in the life of the Government where he might be of service to the people.

77 Cong. Rec. at 4260.

Dillon Read & Co., Inc.—Commencing business in 1913 as Wm. A. Read & Co., this firm became Dillon Read in 1922 and was primarily an underwriting manager. It assembled a relatively small group of aggressive individuals who rapidly built the firm to a position of leadership in the investment banking business. Among these men were Clarence Dillon, James V. Forrestal, William H. Draper, Jr., and later, C. Douglas Dillon.91

Smith Barney, Harris Upham & Co.—The forerunner of this major investment banking firm was organized as Edward B. Smith & Co. in 1873. It conducted a general investment banking business at the time of the enactment of Glass-Steagall and was a large organization for the era, with total personnel of about five hundred.92

Kidder Peabody & Co., Inc.—This firm was founded in 1865, and was very active in the utilities business. Kidder also was active in providing services to foreign governments. In 1934 Kidder took over the Office of the Security Affiliate of Philadelphia National Bank and most of its employees. Personnel from Guaranty, Chase and National City also joined Kidder.93

Blyth Eastman Paine Webber Inc.—Eastman Dillon & Co. was founded in 1910, and was active in the Pennsylvania area with a total of thirteen partners in 1929.94 Blyth & Co., Inc. was formed in 1914 as Blyth Witter & Co. In 1924 the firm separated into Dean Witter & Co. and Blyth. Both firms specialized in the representation of west coast firms, principally utility companies.95 Union Securities Corp. was formed in 1938.96 These firms combined and merged over the years and were the base of the present Blyth Eastman Paine Webber.

Lehman Brothers Kuhn Loeb, Inc.—Kuhn Loeb & Co. was

92. Id. at 658-61.
93. Id. at 663-65.
94. Id. at 668-69.
95. Id. at 672-75.
96. Id. at 678-80; S. Birmingham, Our Crowd—The Great Jewish Families of New York, 132-67 (1967).
founded in New York City in 1867 and for many years was strictly a family affair whose partners included Jacob Schiff, Felix Warburg, Otto H. Kahn, and Mortimer Schiff. It was not until 1911 that the first partner who was not related by marriage or otherwise was hired. Elisha Walker and Hugh Knowlton became partners in 1933. The firm was historically associated with the growth of railroads.97

Lehman Brothers, formed in 1850, has always been an important factor in the investment banking business and members of its family were leading partners. These included Robert, Philip, Arthur, Harold, Allan, and Herbert. The firm acted in all capacities for issuers in the field of negotiated transactions. Commencing in 1906, the firm entered into an informal partnership with Goldman Sachs that lasted for twenty years.98 Lehman and Kuhn Loeb combined forces in 1976.

Goldman Sachs & Co.—This firm was founded in 1869 by Marcus Goldman. Samuel Sachs joined him as a partner in 1882. Sidney J. Weinberg became a partner in 1927. The principal business of the firm was commercial paper, brokerage, and investment banking.99

Merrill Lynch White Weld Capital Markets Group—White Weld & Co. was formed in 1895 and was engaged in block trading as well as a general brokerage and underwriting business. White Weld made a specialty of private placements and the long term positioning of the securities of foundling companies.100


The modern investment banking business bears little resemblance to activities of the 1922-31 period. This is due principally to the revolution that has taken place in the financial services industry, largely without legislation.101 While many of the names of important financial institutions are the same, the proliferation of products and variety of services offered to the investor has created far-reaching changes in the industry.

Investment was separated from commercial banking on June 16, 1934. No less than five major investment banking firms trace their

97. See Birmingham, supra note 96, at 176-84, 401-13.
98. Id. at 358-67; Morgan, 118 F. Supp. at 661-63.
99. Morgan, 118 F. Supp. at 665-67; See also Birmingham, supra note 96, at 362-65.
100. Morgan, 118 F. Supp. at 667-68.
origins directly to the separation which occurred at that time. These include, in addition to Morgan Stanley & Co., The First Boston Corporation; Smith Barney, Harris Upham & Co.; Drexel Burnham Lambert, Inc.; and Blyth Eastman Paine Webber, Inc.

The First National Bank of Boston and Chase National Bank in New York entered into a complex arrangement whereby First Boston was spun off from the First National Bank of Boston, effective June 16, 1934. This new public company retained an option, which it exercised, to acquire Harris Forbes & Co., part of the security affiliate of Chase. Many key employees of the Chase security affiliate became key employees of First Boston. Today First Boston ranks as one of the most prestigious investment banking firms in the world, and has been particularly effective in the field of mergers and acquisitions.

On June 16, 1934, several key employees of the security affiliate of Guaranty Trust Company, along with several hundred other employees, joined Edward B. Smith & Co., the predecessor of Smith Barney. Today Smith Barney, Harris Upham & Co. is one of the leading investment banking firms in the United States.

Drexel Burnham Lambert, Inc. traces its origins to the Philadelphia partnership affiliate of J.P. Morgan & Co., and the firm of Harriman Ripley & Co., Inc., which came into existence after the security affiliate of National City Bank liquidated and its principals formed the predecessor partnership to Harriman Ripley. Through subsequent mergers and acquisitions, Drexel Burnham Lambert has acquired a significant European business and is a leading underwriter of American securities.

Blyth Eastman Paine Webber, Inc. includes the original firms of Union Securities, Eastman Dillon, Blyth, and Paine Webber Jackson & Curtis. Its commercial banking connections included key former officers of National City Company, the security affiliate of National City Bank of New York and key personnel from Continental Illinois Bank and Trust of Chicago.

During the 1960's underwriting originations were concentrated among a few powerful firms. Morgan Stanley, First Boston, Kuhn Loeb, and Dillon Read were considered the power structure and

were known as the "special bracket." At the beginning of the sixties origination firms possessed strong bargaining power. Beginning in the early seventies growth in the importance of marketing securities provided increased investment banking opportunities for firms capable of broad distribution. Thus, today's special bracket includes Morgan Stanley, The First Boston Corporation, Merrill Lynch White Weld Capital Markets Group, Goldman Sachs & Co., and Salomon Brothers Inc., representing an amalgam of origination and distribution power.

The balance of the firms that dominate the investment banking industry today are as follows: Bear, Stearns & Co.; Blyth Eastman Paine Webber, Inc.; Dillon Read & Co., Inc.; Donaldson, Lufkin & Jenrette Securities Corp.; Drexel Burnham Lambert, Inc.; E.F. Hutton & Co., Inc.; Kidder, Peabody & Co.; Lazard Freres & Co.; Lehman Brothers Kuhn Loeb, Inc.; Prudential-Bache Securities; L.F. Rothschild, Unterberg, Towbin; Shearson/American Express Inc.; Smith Barney, Harris Upham & Co.; Warburg Paribas Becker; Wertheim & Co., Inc.; and Dean Witter Reynolds, Inc. These sixteen firms plus the five investment bankers of the special bracket account for approximately ninety percent of all corporate underwriting activity in the United States.

In 1981, the latest year for which data is available, the ten largest firms ranked as follows:

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106. Schneider, supra note 104, at 61, 65 n. 240. The characterization of a firm as an investment banker has traditionally related to its origination activities. Origination describes the process by which an underwriter develops the business and lead manages the ensuing underwriting. An integral part of the origination function is financial planning and forecasting with, and on behalf of, the client corporation. It is only after completion of this extensive financial analysis that conventional underwriting activity commences, which includes the preparation of registration statements, pricing, timing, organizing and managing the underwriting and distribution syndicate. The "special bracket" has traditionally referred to the most powerful originators in terms of dollar volume of underwritings managed.

107. Id. at 61-2.

108. Id. at 65. Both Dillon Read and Kuhn Loeb have been dropped.

EXHIBIT III*

<table>
<thead>
<tr>
<th>Firm</th>
<th>Underwritings Managed** (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merrill Lynch</td>
<td>8,276</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>8,107</td>
</tr>
<tr>
<td>Salomon Brothers</td>
<td>6,000</td>
</tr>
<tr>
<td>Goldman, Sachs</td>
<td>5,972</td>
</tr>
<tr>
<td>First Boston</td>
<td>5,508</td>
</tr>
<tr>
<td>Lehman Brothers</td>
<td>4,508</td>
</tr>
<tr>
<td>Kidder, Peabody</td>
<td>2,575</td>
</tr>
<tr>
<td>Blyth Eastman</td>
<td>2,331</td>
</tr>
<tr>
<td>Dean Witter</td>
<td>2,221</td>
</tr>
<tr>
<td>Drexel Burnham Lambert</td>
<td>1,784</td>
</tr>
</tbody>
</table>


**All managers given equal proportionate credit in comanagements.

Note that the five special bracket firms rank as the five largest investment banks as measured by dollar volume of underwritings managed.

Immediately after the enactment of Glass-Steagall, the aggregate capital of private investment banks was, in all probability, less than $100 million. Yet just one security affiliate of the three hundred in existence at the time, Chase, had capital of $110 million.\textsuperscript{110} Today the investment banking industry is well capitalized as a result of mergers, public offerings, and decades of industry prosperity. Capital of the largest firms is as follows:\textsuperscript{111}

EXHIBIT IV*

<table>
<thead>
<tr>
<th>Firm</th>
<th>Capital (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merrill Lynch White Weld</td>
<td>$1,264</td>
</tr>
<tr>
<td>E.F. Hutton</td>
<td>534</td>
</tr>
<tr>
<td>Shearson/American Express</td>
<td>527</td>
</tr>
<tr>
<td>Prudential-Bache</td>
<td>389</td>
</tr>
<tr>
<td>Dean Witter Reynolds</td>
<td>306</td>
</tr>
<tr>
<td>Paine Webber</td>
<td>240</td>
</tr>
</tbody>
</table>

*Source: Business Week, 12-20-82, p. 54.

\textsuperscript{110} 75 Cong. Rec. 9910 (1932).

\textsuperscript{111} How They Manage the New Financial Supermarkets, Bus. Wk. 54 (Dec. 20, 1982) [hereinafter cited as Financial Supermarket].
Morgan Stanley has capital of $220 million, Dillon Read about $35 million.\textsuperscript{112} While this modern industry capital base pales in light of the assets controlled by the major commercial banks,\textsuperscript{113} it represents an impressive advance over June 16, 1934, or even 1950.\textsuperscript{114}

Although senior managers in investment firms are few in number, as compared to the commercial banking industry, they constitute a disproportionate percentage of governmental leaders. After Glass-Steagall, the investment banking industry recruited directly from institutions such as Harvard Business School and also attracted prominent industrialists as partners. In recent years, the industry has provided members of the Federal Reserve Board, Treasury Department, Securities and Exchange Commission, Central Intelligence Agency, the military and both houses of Congress.\textsuperscript{115} More recently, the Chairman of Merrill Lynch became Treasury Secretary, a key cabinet post.\textsuperscript{116} This contribution to government, while not entirely unique to investment bankers, contrasts with the testimony of the 1931 and 1933 hearings, and the stereotype of the contemporary commercial banker.\textsuperscript{117}

IV. CIRCUMVENTION

 Shortly after the passage of Glass-Steagall, commercial banks commenced a steady incursion back into the securities business. In 1935, section 16 of the Act was amended to make it clear that

\textsuperscript{114} Morgan, 118 F. Supp. at 647.
\textsuperscript{115} To mention just a few: John Shad, head of E.F. Hutton, became Chairman of the SEC. William J. Casey, prominent Wall Street investor and securities lawyer was Chairman of the SEC and subsequently became Director of the CIA. Maurice Stans was President of Glore Forgan and became Secretary of Commerce. Nicholas Brady, head of Dillon Read, served as U.S. Senator from New Jersey. Gillis Long, a former partner of Kohlmyer & Co., is a U.S. States Congressman from Louisiana. William H. Black and Peter Saint Germain, partners of Morgan Stanley, served with the International Bank for Reconstruction and Development. Peter Peterson of Lehman Brothers was Secretary of Commerce. George Ball of Lehman, currently head of Prudential-Bache, was Under Secretary of State. Henry Fowler of Goldman Sachs was Treasury Secretary.
\textsuperscript{116} Donald Regan, Chairman of Merrill Lynch, became Treasury Secretary under President Reagan.
\textsuperscript{117} For an anecdote on this subject, see Zonana, \textit{The Porsches and Saabs at Schwab Aggravate Some at Bank America}, Wall St. J., Jan. 20, 1983, at 27, col. 1-2. See \textit{infra} note 205, and accompanying text.
banks could buy stock for the account of a customer. Since 1934, nine attempts have been made to pass legislation permitting banks to underwrite nonrevenue bonds. Bills were proposed to rescind the underwriting prohibition on corporate bonds in 1935 and 1938. Attempts to permit banks to underwrite new United States or other governmental agency securities were successful. Bonds of the Federal Housing Administration were approved for bank underwriting in 1935. Federal National Mortgager Association Bonds were approved in 1938. World Bank Bonds were approved in 1949. In that same year, local public housing bonds were approved. Bonds for the Central Bank for Cooperatives were approved in 1954. In 1959, Tennessee Valley Authority Bonds and Inter-American Development Bank Bonds were approved. Legislation has been introduced eight times since 1938 to permit bank underwriting of all revenue bonds.

On another front, banks found from operating under the holding company format, that many activities that were held to be non-bank activities could be performed indirectly by a non-bank subsidiary of the holding company. Fearing circumvention of the Glass-Steagall Act, Congress enacted the Bank Holding Company Act of 1956 which was intended to separate banking from assets having no close relationship to banking. Under the Act, multibank holding companies were required to divest many non-banking activities.

In 1961, James J. Saxon, a supporter of bank expansion, was appointed Comptroller of the Currency. Saxon believed that increased bank flexibility would improve the competitive posture of

119. Rogowski, supra note 10, at 162.
120. Id.
127. Rogowski, supra note 10, at 164.
129. Securities Industry Association, supra note 51, at 804; Comment, supra note 128, at 785; Note, supra note 23, at 988.
130. Comment, supra note 128, at 785-86.
131. Id. at 770.
banks. He authorized national banks to engage in the insurance business, courier services, data processing, leasing, and the travel agency business.\textsuperscript{132} Then, in 1962, Congress transferred jurisdiction of most of the trust activities of national banks from the Board of Governors of the Federal Reserve System to the Comptroller of the Currency.\textsuperscript{133}

During the 1960's, many one-bank holding companies emerged, creating a loophole between the Holding Company Act and the Glass-Steagall Act. These new holding companies were not "multibank," subject to the 1956 Act, nor "bank," subject to Glass-Steagall or the National Bank Act. Congress responded with the Bank Holding Company Act Amendments of 1970.\textsuperscript{134} These amendments reflected the same congressional concerns as those expressed in the formulation of the 1956 Act, and in addition, concern over concentration of economic power in bank holding companies.\textsuperscript{135} The primary purpose of the amendments was to close the one-bank holding company loophole and preserve the basic separation of bank activities from other business activities.\textsuperscript{136} In these amendments, Congress rejected a proposal to create a list enumerating permissible activities, but instead permitted non-bank subsidiaries of bank holding companies to engage in activities that are "so closely related to banking or managing or controlling banks as to be a proper incident thereto."\textsuperscript{137}

After the passage of the 1970 amendments, banks and bank holding companies made a concerted effort to enter the business of investment management.\textsuperscript{138} Also during the 1970's, foreign banks made significant inroads into the investment banking business through the establishment or acquisition of interests in security affiliates. During this period, twenty-eight major foreign banks entered the securities industry in this fashion.\textsuperscript{139} Another significant post-amendment trend involved the aggressive movement by banks into private placement activity, either directly or through bank holding companies.\textsuperscript{140} The Comptroller and the Federal Reserve

\begin{itemize}
  \item \textsuperscript{132} Id.
  \item \textsuperscript{133} Camp, 401 U.S. at 621.
  \item \textsuperscript{135} 115 Cong. Rec. 32,893, 32,903 (1969).
  \item \textsuperscript{136} Id. at 32,890. See Hearings on H.R. 6778 Before the House Comm. on Banking and Currency, 91st Cong., 1st Sess. 197 (1969).
  \item \textsuperscript{137} 12 U.S.C. § 1843(c)(8) (1976).
  \item \textsuperscript{138} Note, supra note 23, at 991.
  \item \textsuperscript{139} Securities Industry Association, supra note 51, at 820-22 app. V.
  \item \textsuperscript{140} In a private placement, a company wanting to raise capital will place its securities
\end{itemize}
Board have concluded that private placement activity where the bank acts as placement agent lies outside the reach of the Glass-Steagall Act. A Federal Reserve study released in 1977 had reversed earlier positions of the Board and the Comptroller. The study expressed the view that private placement activity does not expose a commercial bank to the risks of fluctuating securities values which the Glass-Steagall Act was designed to prevent. Particularly active in this field are Citibank, First National Bank of Chicago, Northern Trust Company, and Chase Manhattan Bank, the same banks who were active prior to the Glass-Steagall Act.

Due to the specific exemption provided commercial banks through section 16, banks have been permitted to underwrite and distribute U.S. government securities and general obligations of states and subdivisions. In a recent year, commercial banks accounted for an estimated sixty-five percent of total underwriting activity in this segment of the industry. The proliferation of new investment products has enabled banks to become active in a wide range of investment services and other non-underwriting activities previously relegated to the securities industry. Commercial banks apparently seek diversification to obtain higher rates of return on invested capital and at the same time gain firmer control of corporate and trust business.

Amidst this tide of legislative and administrative change, the industry turned to the judiciary. The first Glass-Steagall Act interpretation to reach the Supreme Court was Board of Governors of the Federal Reserve System v. Agnew. Employees of the partnership of Eastman, Dillon & Co. were ordered removed from office as directors of the Paterson National Bank by the Board of Governors of the Federal Reserve System. The Supreme Court up-

directly with a small group of sophisticated investors. This placement might be made directly by the issuer or through a placement agent. Properly structured, these transactions are exempt from the registration requirements of the Securities Act of 1933.

142. See Federal Reserve Board, Commercial Bank Private Placement Activities (1977) (staff study).
144. Id. at 763 n.22.
145. See supra note 54 and accompanying text.
146. Rogowski, supra note 10, at 165.
147. 329 U.S. 441 (1947).
held the order, relying on section 32 of the Act.\textsuperscript{148} Under section 30, the Board had full power to order the removal.\textsuperscript{149} The Court strongly endorsed the Glass-Steagall policy divorcing commercial banks from involvement in the underwriting business. The Court reinforced the congressional objective of avoiding possible conflicts of interest:

Section 32 is directed to the probability or likelihood, based on the experience of the 1920's, that a bank director interested in the underwriting business may use his influence in the bank to involve it or its customers in securities which his underwriting house has in its portfolio or has committed itself to take . . . . It is a preventive or prophylactic measure. The fact that respondents have been scrupulous in their relationships to the bank is therefore immaterial.\textsuperscript{150}

The second time that the Supreme Court was called upon to interpret Glass-Steagall was in Investment Company Institute v. Camp.\textsuperscript{151} The Supreme Court held that the fund of First National City Bank was prohibited under sections 16 and 21 of the Act.\textsuperscript{152}

In examining the legislative intent of the Act, the Court stated:

Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system.\textsuperscript{153}

The Court pointed to congressional concern over damage to member banks because of direct and indirect involvement in speculative securities.\textsuperscript{154} The Court focused on hazards the Congress had perceived, the most obvious being that a bank might invest its own funds imprudently. The more subtle hazards included those factors enumerated during the course of the 1931 Hearings.\textsuperscript{155}

\begin{itemize}
  \item \textsuperscript{148} Id. at 446, 449.
  \item \textsuperscript{149} Id. at 444.
  \item \textsuperscript{150} Id. at 447, 449.
  \item \textsuperscript{151} 401 U.S. 617 (1971).
  \item \textsuperscript{152} Id. at 639. Clark and Saunders, supra note 52, at 730.
  \item \textsuperscript{153} Camp, 401 U.S. at 634.
  \item \textsuperscript{154} Id. at 630.
  \item \textsuperscript{155} See supra note 22 and accompanying text.
\end{itemize}
the Court's concern over both obvious and subtle hazards, it prohibited bank involvement in pooled investment funds.\footnote{156}

Other federal courts have had occasion to interpret the Act and have, until recently, been uniformly adverse to any lessening of the regulatory framework of the Act. In \textit{Russell v. Continental Illinois National Bank and Trust Co.},\footnote{157} the Seventh Circuit held that the purpose of the Act was to minimize the risk of loss or insolvency to a bank, to maintain confidence in the bank system, and to protect depositors and the public from the hazards and financial dangers that arise when commercial banks engage in investment banking activities.\footnote{158} The court observed that there is no express statutory authorization for private action in the Act.\footnote{159}

In \textit{Port of New York Authority v. Baker, Watts & Co.},\footnote{160} the court held that bonds issued by the Port Authority were obligations secured by all its resources but not by its taxing power. Consequently they were not within the general obligations section of the Act.\footnote{161} The court reviewed the debates and reiterated the congressional intent to confine banks to the underwriting of general obligations requiring tax support.\footnote{162}

In \textit{New York Stock Exchange, Inc. v. Bloom},\footnote{163} the District of Columbia Court of Appeals declined to rule on the legality of automatic stock purchase services claiming that the challenged opinions of the Comptroller were not ripe for judicial scrutiny.\footnote{164} In so holding, the court vacated the district court's earlier decision in \textit{New York Stock Exchange, Inc. v. Smith},\footnote{165} which had upheld the validity of such stock purchasing services.

Two recent cases may signal a change in this uniformly strict interpretation of Glass-Steagall. In \textit{Board of Governors of Federal Reserve System v. Investment Company Institute},\footnote{166} the Supreme Court considered a bank activity similar to that prohibited in

\begin{thebibliography}{99}
\footnotesize
\bibitem{156} \textit{Camp}, 401 U.S. at 639. See Clark and Saunders, \textit{supra} note 52, at 732.
\bibitem{157} 479 F.2d 131 (7th Cir.), \textit{cert. denied}, 414 U.S. 1040 (1973).
\bibitem{158} \textit{Id.} at 133-34.
\bibitem{159} \textit{Id.} at 134.
\bibitem{160} 392 F.2d 497 (D.C. Cir. 1968).
\bibitem{161} \textit{Id.} at 504.
\bibitem{162} \textit{Id.} at 502. The Court pointed out that in the previous thirteen years, seven attempts to allow bank underwriting of obligations not secured by the taxing power had been made, but no legislation was enacted. \textit{Id.} at 503.
\bibitem{164} \textit{Id.} at 743.
\bibitem{166} 450 U.S. 46 (1981).
\end{thebibliography}
Camp. In Camp, a broad definition of the term "security" permitted the Court to prohibit bank involvement in a pooled investment fund. In Investment Company Institute the Court considered the Board's amendment to Regulation Y, which permitted bank holding companies and non-banking subsidiaries to act as investment advisors to closed-end investment companies. The Court held that the Regulation Y amendments were consistent with the 1970 amendments to the holding company act, overruling the lower court on this issue. However, the Court agreed with the lower court by finding that no violation of Glass-Steagall had occurred.

The Court gave great deference to the Federal Reserve Boards' determination of what activities are closely related to banking, and also deferred to their judgment that benefits to the public outweighed possible adverse effects. The Court stated that its holding was consistent with Camp and Glass-Steagall in that "bank affiliates may be authorized to engage in certain activities that are prohibited to banks themselves." The Court further stated: "Even if we were to assume that a bank would violate the Glass-Steagall Act by engaging in certain investment advisory services, it would not follow that a bank holding company could never perform such services." The Court further distinguished Camp by stating that its holding related to a mutual fund which was the functional equivalent of an open-end investment company, whereas in this case the authorization was expressly limited to closed-end investment companies. The Court also stated that "[i]nvestment advisors and closed-end investment companies are not 'principally engaged' in the issuance or the underwriting of securities within the meaning of the Glass-Steagall Act. . . ." The Supreme Court thus appears to have established a significant distinction on the basis of a bank's organizational structure; the standard applied to the permissive activities of banks is far more stringent than that applied to the permissive activities of bank holding companies.

In a case decided in November 1982, the District of Columbia Court of Appeals held that commercial paper is not a security. In

167. See supra note 153 and accompanying text.
169. Id. at 56-57.
170. Id. at 60 (footnote omitted).
171. Id. at 63-64.
172. Id. at 64-67.
173. Id. at 71.
GLASS-STEAGALL

A.G. Becker, Inc. v. Board of Governors of the Federal Reserve System, the court took a very narrow definition of security in its examination of section 16 and 21 of the Act and concluded that a commercial bank may purchase and sell commercial paper. The court stated: "Because commercial paper is like a loan rather than a security, marketing of commercial paper by the bank does not have the same economic impact on the bank as would marketing of securities." This definition of security appears inconsistent with earlier pronouncements as to what constitutes a security. An analysis of the legislative intent behind Glass-Steagall likewise indicates that this definition of security appears inconsistent with the Act. It is not known whether this decision will be appealed to the Supreme Court.

Absent new legislation, current developments in the industry will surely bring significant additional litigation to the judiciary. The A.G. Becker decision could spur additional industry activity as commercial banks continue to expand.

V. CURRENT DEVELOPMENTS

During 1982 Chase Manhattan Bank created a separate investment banking unit with $175 million of stated capital. The bank may also acquire a major discount brokerage firm. The Security Pacific Bank created a joint venture with Fidelity Brokerage Services, and Bankamerica Corp. announced the acquisition of Charles Schwab. Citicorp announced the planned acquisition of Quick & Reilly. Crocker National Bank announced a joint venture with Bradford Settlement for clearing of its securities transactions, and Chemical Bank made a similar joint venture arrangement with Pershing & Co. J.P. Morgan, Bankers Trust and

175.  Id. at 150.
182.  Id.
Citicorp have been approved as traders of futures contracts.\textsuperscript{183} Union Planters Bank announced the acquisition of Brenner Steed & Associates.\textsuperscript{184} United Jersey Banks announced the acquisition of Richard Blackman & Co.\textsuperscript{185} Certain savings and loan associations have been permitted to enter the brokerage business.\textsuperscript{186} These commercial banks have been relying on their interpretation of the 1935 Act.\textsuperscript{187} The Security Industry Association (SIA) has instituted at least one lawsuit challenging many of the transactions enumerated above.\textsuperscript{188} 

It appears that the only bank-brokerage acquisition which has been challenged by the Federal Reserve Board is the acquisition by Dreyfus Corp. of Lincoln State Bank, a small commercial bank in New Jersey. The Federal Reserve Board maintains that this transaction violates the Bank Holding Company Act.\textsuperscript{189} The controller has permitted Dreyfus to establish a national bank in New York City.\textsuperscript{190} 

On another front, major financial institutions with insurance rather than banking as their basic business have announced substantial acquisitions in the securities industry. For example, the Kemper Group has acquired Prescott Ball & Turben, Loewi & Co., and Bateman Eichler, Hill Richards, Inc.\textsuperscript{191} Further, Sears Roebuck & Co. acquired Dean Witter Reynolds, Inc. in 1981. This combination is expected to challenge Merrill Lynch, presently the largest investment supermarket in the world.\textsuperscript{192} 

Shearson's capital base prior to its acquisition by American Express was approximately $500 million. Now it is allied with American Express' $22 billion in assets. Likewise, Prudential paid $385 million for Bache, allied with Prudential's $60 billion in assets.\textsuperscript{193} All of this merger, acquisition and expansion activity does not ap-
pear to directly involve underwriting activity at this time, but if commercial bankers' efforts to underwrite revenue bonds are any indication, there are certain to be incursions concurrent with rapid expansion into a full range of financial services. This surge of recent activity and consequent pending litigation indicates an urgent need for a legislative response.

All of this activity and ferment has spawned a new growth industry—banking consulting. City banks and country banks are acquiring or affiliating with discount brokers. Deregulation of the banking industry to permit money market accounts and perhaps money market funds is sure to be challenged by the securities industry. The recently formed Depository Institutions Regulation Committee can be expected to actively assist banks in creating financial products to compete in the securities industry. The new head of the SIA, Robert Linton, Chairman of Drexel Burnham Lambert, Inc., believes that legislation is mandatory in this period of controversy. The Reagan administration has announced plans to allow banks to expand securities activities through separate subsidiaries. Such deregulation can be expected to receive broad support, largely in disregard for the historic problems which have manifested themselves when commercial banks engage in investment banking.

The House and the Senate will give careful consideration to these proposals in 1983. The Senate plans to hold hearings on proposals to let banks underwrite municipal revenue bonds, offer mutual funds, and engage in many other securities activities. The House, however, plans a broad, detailed review of all of the financial laws. Senate Banking Committee Chairman, Jake Garn (R-Utah), has been pressing to deregulate many aspects of banking, but Chairman of the House Banking, Finance, and Urban Affairs Committee, Fernand St. Germain (D-Rhode Island), plans a more detailed and methodical review of the whole area.

198. Id. at col. 3.
199. Id.; 14 SEC. REG. & L. REP. (BNA) 70 (Jan. 13, 1982).
200. Carrington, supra note 197, at 7, col. 3; 14 SEC. REG. & L. REP. (BNA) 70 (Jan. 13, 1982).
The securities industry itself is divided on how to meet the various threats of increased concentration and competition.\textsuperscript{201} The new diversity of ownership of Wall Street firms has created differing viewpoints. For example, Sears Roebuck's attitude and views are different from those of Morgan Stanley & Co. This divergence of ownership and hence attitude has made it difficult for the securities industry to formulate a united position.\textsuperscript{202} Changes in the Glass-Steagall Act can be expected.\textsuperscript{203} The foregoing chronology has been offered to put the upcoming debate into perspective.

VI. PROPOSAL

Additional factors not dealt with by commentators, historians, the legislature or the judiciary are worthy of consideration. First, commercial and investment banking require very different types of temperament and training.\textsuperscript{204} A commercial banker is educated and trained to protect principal and secure repayment of a loan. Even a well-trained commercial banker is not competent to evaluate risks other than the possible failure of repayment. The investment banker, on the other hand, is educated and trained to think and act like an entrepreneur.\textsuperscript{205} His function on behalf of the client upon completion of investigation, evaluation, and pricing is to market a long-term investment rather than to seek repayment of the funds that he has placed with a client. This philosophical division was accentuated when Glass-Steagall forced commercial and investment banking to separate. Personnel of commercial banks imbued with the investment banker's philosophy, and trained to be skilled in that art, left commercial banks en masse by June 16, 1934, and, in fact, became key principals of the investment banking community. Few senior investment banking personnel remained at the major commercial banks to educate or train new employees in the investment banker's philosophy of finance.

Recent debacles in commercial banking circles highlight this dichotomy. During the seventies, over a span of less than four years, commercial banks poured over $10 billion into the real estate market. These investments were made through captive real estate in-

\textsuperscript{202} Id.
\textsuperscript{203} 14 SEC. REG. & L. REP. (BNA) 71 (Jan. 13, 1982).
\textsuperscript{204} 77 CONG. REG. 3956 (1933).
vestment trusts (REITS) or through loans to other real estate investment trusts. In 1973, at the peak of this activity, REIT assets approximated $20 billion, divided amongst some two hundred trusts. As swiftly as these trusts grew, their investments soured. In 1974, eighteen of the twenty biggest losers on the New York Stock Exchange were REIT's. Commercial banks either swapped loans and assets with the trusts or allowed them to seek protection under bankruptcy laws. Some of the more successful REIT's were not affiliated with commercial banks.

Aggressive loan syndication, increasingly popular because of the broad geographic reach of large commercial banks, can be tantamount to a commercial bank engaging in private placement activity. The originating commercial bank in a large loan syndication or private placement takes little if any of the loan or placement for its own account and markets the balance to other banks or institutions. This marketing effort violates the very heart of the policy embodied in Glass-Steagall. In fact, federal regulators have started examining national banks more regularly because of this activity.

When the Penn Square Bank of Oklahoma City failed during the summer of 1982, it was discovered that several large money-center banks had purchased several billion dollars of Penn Square origina- tions. While it is true that these activities were ostensibly commercial banking activities, it appears that the marketing efforts associated with them are what led to the difficulties. If commercial banks, for example, were not permitted to syndicate any portion of a private placement unless they retained sixty-five percent of the loan, their expertise in lending would outweigh marketing efforts associated with the balance of the placement. This requirement would operate to preserve the traditional qualities of commercial banking and at the same time permit reasonable participation by other lenders.

Several of the largest money center banks in this country who

206. Clark and Saunders, supra note 52, at 724.
208. Id. at 462 n.81.
209. Id. at 455.
210. See supra text accompanying notes 13-42.
212. Id. For an interesting discussion of permissive syndication practices, see Helyar, Lenders' Lament, Wall St. J., Jan. 5, 1983, at 1, col. 6.
have made active plans to re-enter the investment banking business lost in excess of $300 million by skirting on the fringes of the complex government securities trading business. These large commercial banks apparently lacked the experience needed to properly evaluate their involvement in the investment banking industry.

The division between commercial and investment banking is thus more extensive than that erected by legislation; it is a matter of education, training, motivation, and philosophy. In addition, prevalent methods of compensation discourage a commercial banker's successful practice of an investment banker's function. Commercial bankers are typically compensated by a salary and departmental bonus, whereas investment bankers have been traditionally compensated "by issue." This difference in incentive—one judged by management evaluation and the other judged by performance—tends to create different levels of motivation during the course of a project's financing. The direct compensation approach tends to create highly motivated risk takers. The salary plus bonus approach tends to create organization men, motivated to achieve organizational goals rather than project successes.

Turning to the legislative tasks facing Congress, it is urged that these fundamental philosophical and organizational differences be considered during the formulation of new legislative proposals. The basic purposes of Glass-Steagall are still very much a part of the American economic system. The Supreme Court has affirmed the fundamental purpose of this legislation. The failure of repeated attempts to whittle away at the Act piecemeal is an indication that Congress believes the allegations that commercial bank abuses contributed to the Depression. Attempts to "laundry list" permissive and impermissive non-banking activities have repeatedly failed. The "closely related" test has become subject to differing and conflicting interpretations.

Remedial legislation, designed to acknowledge the proliferation of new financial products and to anticipate an even greater proliferation in the future, should not be based on laundry lists or

216. Id.
217. Rogowski, supra note 10, at 172.
218. Comment, supra note 128, at 785.
219. See Board of Governors, 450 U.S. at 73-77; Comment, supra note 126, at 786-87.
a closely related test. Instead, adjustments to the Glass-Steagall Act should be based upon a clear division of marketing and lending. The commercial bank’s basic business is lending and the investment bank’s basic business is marketing. There is a clear difference between the sale of services and the sale of investments.\(^\text{220}\) The future segregation of activities should be based on the potential harms which can arise from an intermingling of lending and marketing rather than on a case by case analysis of agency versus principal, or closely related versus unrelated.\(^\text{221}\) It is not intended that this marketing-lending analysis be a litmus test for an industry as complex as the modern financial services industry. However, it is offered as a fundamental philosophical backdrop to assist in the upcoming legislative task.

The SIA and other investment banking trade groups have erroneously sought utilization of Glass-Steagall prohibitions to prevent unfair competition. The Glass-Steagall Act was never envisioned as a measure to promote competition or to lessen the evils of unfair competition.\(^\text{222}\) Rather, the Act was intended to restore and maintain public confidence in commercial banks, to promote economic stability by prohibiting imprudent banking activities, and to eliminate conflicts of interest between commercial and investment banking activities.\(^\text{223}\) By keeping these three basic objectives in mind, Congress should be able to formulate modern legislation which will endure.

\(^{220}\) Camp, 401 U.S. at 638. The Court stated: “In short, there is a plain difference between the sale of fiduciary services and the sale of investments.” Id. (footnote omitted).


\(^{222}\) Camp, 401 U.S. at 630; Russell 479 F.2d at 133-34; Karmel, supra note 212, at 637.
