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LAWS SEPARATING COMMERCIAL BANKING AND SECURITIES ACTIVITIES AS AN IMPEDIMENT TO FREE TRADE IN FINANCIAL SERVICES: A COMPARATIVE STUDY OF COMPETITIVENESS IN THE INTERNATIONAL MARKET FOR FINANCIAL SERVICES

Sarah A. Wagman*

INTRODUCTION

In recent years, the market for financial services\(^1\) has experienced significant internationalization.\(^2\) In response to this change in the structure of the financial services market, banks have increasingly sought new business opportunities abroad and, in the process of doing so, have encountered new sources of competition. The ability of banks to meet this competition, although a product of many factors, is closely related to the domestic regulatory regime under which they operate.\(^3\) This Note contends that, in the context of the international market for financial services, domestic regimes which substantially restrict the range of banks' permissible activities impede their banks from effectively competing with banks operating under less restrictive regimes.

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1. “Financial services” may be broadly defined to comprise deposit-taking, lending, underwriting and distribution of new issues of debt and equity securities, securities trading and brokerage, investment management, fee-based advisory activities, insurance foreign exchange transactions, and derivative instruments related to risk management (e.g., futures and options). Anthony Saunders & Ingo Walter, Universal Banking in the United States 5 (1994).

2. Between 1960 and 1985, the presence of foreign banks in Organization for Economic Co-operation and Development (OECD) Europe increased from 141 to 1187 and in OECD Asia the increase was from 40 to 127. G. Bröker, Competition in Banking 42 (1989). Between 1970 and 1985, the presence of foreign banks in North America increased from 79 to 291. Id. Countries have also dramatically increased their banking presence abroad during this time. Between 1960 and 1985, the presence of domestic banks abroad increased from 131 to 916 for the United States, from 34 to 666 for OECD Europe, and from 37 to 346 for Japan. Id.

3. Factors other than domestic regulation which may affect a bank's ability to compete in the international market include: book and market capitalization, credit standing, wholesale and retail funding access, wholesale and retail placing power, wholesale and retail borrower access, scale economies, scope economies, financial product and process technologies, human resources (both professional and support), staying power, cross-subsidization ability, organizational structures, cost structures, and risk management. Saunders & Walter, supra note 1, at 56. For an assessment of how the United States, Europe, and Japan fare in each of these areas, see id. at 56. For discussion of these factors, see id. at 55–68.
There has been much debate, both domestically and internationally, about the advisability of retaining the Glass-Steagall Act, the U.S. law which imposes a separation between commercial and investment banking activities. In the domestic context, this debate has traditionally focused on the U.S. market for financial services, with little attention to the international implications of the law. However, as the nature and scope of the market for financial services has changed, the United States has begun to look to the more liberal banking laws of other countries, both as possible models for reform, and as potential sources of threatening competition for U.S. banks. Thus, increased trade in financial services has created an additional pressure for the reform of the Glass-Steagall Act—the need for U.S. banks to be able to compete effectively with their foreign counterparts. Arguably, the Glass-Steagall Act has imposed increasing costs on the U.S. economy, both as a result of the increased internationalization of the market for financial services and the financial liberalization undertaken by the United States' trading partners, notably the European Union and Japan. By comparing U.S., Japanese, and European institutions' competitiveness in the international market for financial services, this Note focuses on the possible implications of the Glass-Steagall Act in the international trade context as a means of exploring some of the additional arguments which have emerged in favor of reforming U.S. bank regulation.

In Part I, the scope of the comparison is delineated. In order to establish a basis for comparison, Part II discusses the institutional structures relating to commercial banking and securities activities in the United States, the European Union, and Japan. Part III introduces some of the arguments which have been made for and against imposing a separation between securities and banking activities in an economy by exploring the function of laws which accomplish such a division. Part IV discusses some of the implications of the Glass-Steagall Act in the international context, with a focus on the Act's potential to impede the ability of U.S. banks to compete with European and Japanese banks. Alternatives to the Act are discussed in a general manner in order to explore the types of


5. "The United States is virtually alone as a nation where these discussions have traditionally relegated international competitiveness consequences to a subordinate position." SAUNDERS & WALTER, supra note 1, at 8.

6. See id. at 229; infra notes 190–94 and accompanying text.
structural changes which may be used to achieve the goals of profitability, efficiency, and stability.

I. DEFINING THE SCOPE OF COMPARISON

A. "Competitiveness" in the Context of the International Market for Financial Services

In order to effectively measure the relative "competitiveness" of different countries' banks, it is first necessary to choose a definition of "competitiveness" which encompasses the proper goals of a financial system. For the purposes of this Note, profitability, efficiency, and stability are adopted as the most useful indicators of bank competitiveness in the international context. Profitability is defined in traditional terms of return on equity or return on assets. It is a useful measure of competitiveness because it encompasses characteristics of cost, productivity, and innovation which cause certain firms to achieve higher profits than others. Efficiency is defined to encompass those characteristics which allow a bank to offer innovative, high-quality services at the lowest cost among competitors.
possible cost.\textsuperscript{9} Efficiency is closely related to a bank's ability to achieve an optimal level of risk by balancing the variety of activities in which it engages with profitability considerations.\textsuperscript{10} Stability is defined to encompass safety and soundness concerns of a financial system.\textsuperscript{11} Stability is ultimately dependent to some degree on profitability and efficiency because an institution which is unprofitable and inefficient will have difficulty maintaining a level of capital sufficient to preserve stability.\textsuperscript{12}

Different types of empirical data have been proposed as reflecting the relative "competitiveness" of various countries' financial institutions.\textsuperscript{13} This data is confusing in the different measures it reflects and is mixed in its implications for the competitiveness of U.S. banks.\textsuperscript{14} However, by focusing on antecdotal evidence of bank competitiveness in the international market and by attempting to reconcile this evidence with the empirical data, the measures of profitability, efficiency, and stability emerge as the most useful measures of competitiveness. Antecdotal evidence seems particularly relevant since it reflects those measures upon which banks have focused in responding to the pressures of market forces. A comparison of empirical and antecdotal evidence suggests that comparative market shares and size rankings are not very useful as measures of competitiveness. Market share arguably reflects a number of

\footnotesize{
\textsuperscript{9} See SAUNDERS \& WALTER, supra note 1, at 17. The efficiency of a financial services industry has implications for national and global resource allocation because the financial services sector is the means by which capital is allocated in an economy. Id. at 19.

\textsuperscript{10} See Greenspan Warns Against "Unnecessary" Regulation, Reuters, May 26, 1993, available in LEXIS, Curnws Library, Reuters File; Time to Leave; Banks Meet the Marketplace, ECONOMIST, May 2, 1992, at 3. Diversification is not a useful goal in itself for a financial institution. Rather, it is a means of achieving efficiency, both in terms of profitability and risk allocation. See id.; Pruning the Universal Bank, ECONOMIST, Aug. 21, 1993, at 57.

\textsuperscript{11} Safety and soundness concerns are discussed in more detail, infra at part III.A.2. There inevitably are trade-offs between stability and efficiency in a financial system. The goal should be to "find a socially optimum balance in a globally competitive environment," a determination which is beyond the scope of this Note. SAUNDERS \& WALTER, supra note 1, at 18. See Time to Leave; Banks Meet the Marketplace, supra note 10, at 3.

\textsuperscript{12} For further discussion of the relationship among profitability, efficiency, and stability, see infra parts II.B.1, IV.E.2.


\textsuperscript{14} See sources cited in note 14.
}
market structure and cost factors other than profitability.\textsuperscript{15} For example, a declining market share, rather than reflecting a decline in profitability, may reflect a shift by banks to more efficient methods of doing business.\textsuperscript{16} A bank’s size may reflect factors besides profitability, including factors controlled by domestic regulation such as geographical integration and ownership structure, and inefficiencies in the bank’s institutional structure and choice of activities.\textsuperscript{17}

The recent experiences of some European and Japanese banks suggest that a focus on profitability and efficiency is preferable to focusing on size and market share. For example, under the traditional European model of universal banking, many of the European universal banks attempted to carry on the full variety of activities in which they were allowed to engage.\textsuperscript{18} As competition in the market for financial services increased, these banks have begun to recognize which of their offered services are unprofitable and the cross-subsidization costs imposed by the retention of these activities.\textsuperscript{19} In response to these concerns, European banks have begun to focus on those services in which their risk-adjusted returns are the highest, which may either involve current activities or may involve diversifying into new activities.\textsuperscript{20} They have also aggressively pursued efficiency by consolidating operations with the goal of cutting costs.\textsuperscript{21}

Japanese banks, as they respond to increased competition and the deregulatory reform of their financial system, appear to be experiencing pressures similar to those experienced by the European universal banks.\textsuperscript{22} As limitations on activities have been relaxed, Japanese banks have lost traditionally profitable niches and have begun to compete with one another more on the basis of quality and price.\textsuperscript{23} However, it is predicted that, as deregulation proceeds and banks are permitted to engage in an increasing variety of activities, it will take some time before Japanese

\textsuperscript{15} SAUNDERS \& WALTER, supra note 1, at 24. However, market share does suggest something about the results of competition, since those financial institutions that are most efficient and profitable are likely to hold a greater share of the market compared with less efficient and profitable institutions. \textit{Id.}

\textsuperscript{16} See \textit{Time to Leave; Banks Meet the Marketplace, supra} note 10, at 3.

\textsuperscript{17} See \textit{id.}

\textsuperscript{18} Pruning the Universal Bank, supra note 10, at 57.

\textsuperscript{19} \textit{Id.}

\textsuperscript{20} \textit{Id.}; \textit{Time to Leave; Banks Meet the Marketplace, supra} note 10, at 3.

\textsuperscript{21} \textit{Banks Meet the Marketplace, supra} note 10, at 3. “After a decade of failed expansion and lending gone bad, some [European] banks are changing their ways. They prefer profitability to asset growth and pursue efficiency more keenly than market share. Overcapacity is their bugbear, and some seek to eliminate it through mergers.” \textit{Id.} at 3.

\textsuperscript{22} See \textit{Time to Leave; the Convoy Scatters, ECONOMIST, May 2, 1992, at 44. For a discussion of Japanese financial regulation and deregulatory reform, see infra Part II.C.2.}

\textsuperscript{23} See \textit{Time to Leave; the Convoy Scatters, supra} note 22, at 44.
banks learn the importance of narrowing their focus in order to achieve efficiency, a lesson that European banks have already learned.

B. "International Banking:" Defining the Market

The term "international banking" may be used to refer to several different types of activities. Traditional international banking consists of cross-border transactions — payments and credits received from or extended to customers in other countries. "International banking" may also be used to refer to the entry of financial institutions into foreign markets via the creation of offices, agencies, branches, or subsidiaries. Finally, "international banking" may be used to refer to the offshore banking activities of domestic or foreign banks. This Note is only concerned with the former two activities and does not discuss offshore banking, an area which has been characterized by significant liberalization for many years.

International banking is further defined by the relevant product market. There are two main product markets for banking services. The wholesale market is geared primarily toward medium and large-sized businesses, as well as other banking organizations, and relies mainly on the money markets as a source of funds. The retail market is geared primarily toward individuals and small businesses and relies mainly on deposits from those two groups as a source of funds.

In the context of international trade in banking services, many commentators suggest that there are greater opportunities for financial institutions in the wholesale sector, rather than the retail sector, of foreign financial services markets. However, the effects of increased competition

24. Id. at 44.
25. Dufey, supra note 7, at 183.
26. Id.
27. Id.
28. Id. at 174.
30. Id.
31. Id. at 66, 108; Oversight Hearings on European Community's 1992 Program: Hearings Before the Subcommittee on Financial Institutions' Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, 101st Cong., 1st Sess. 140-41 (1989) (statement of L. William Seidman, former Chairman, FDIC) [hereinafter Oversight Hearings]; Id. at 42 (statement of Sir Jeremy Morse, Chairman, Lloyds Bank PLC, London, England); see Dufey, supra note 7, at 190-91. The perceived advantages for domestic financial institutions in the retail market are attributed to a number of factors, including locational convenience, familiarity with the local market, and ease of establishing business relationships with customers. Id. See INGO WALTER, BARRIERS TO TRADE IN BANKING AND FINANCIAL SERVICES 36-45 (1985).
and liberalization in the European Union suggest that significant opportunities in the retail sector may exist for those foreign financial institutions able to establish branches or subsidiaries which are geographically convenient for local customers and competitive, in price and range of services, with local institutions.  

II. BANKING LAWS GOVERNING COMMERCIAL BANKING AND SECURITIES ACTIVITIES IN THE UNITED STATES, THE EUROPEAN UNION, AND JAPAN

A. The United States

1. The Glass-Steagall Act

The Glass-Steagall Act restricts the ability of banks to engage in certain types of securities-related transactions. It was enacted in 1933 in response to perceived abuses by banks during the 1920s which were thought to have contributed to the 1929 stock market crash and the subsequent banking crisis of the early 1930s. The Act limits the securities activities of banks to the purchase and sale of securities solely upon the order of, and for the account of, customers, and it prohibits banks from underwriting securities or purchasing or selling securities for their own accounts. Similarly, securities firms are prohibited from receiving deposits. Member banks of the Federal Reserve system are prohibited from maintaining affiliations with organizations whose principal business consists of securities activities. In addition, officers, directors, and employees of securities firms are prohibited from simultaneously serving as officers, directors, or employees of Federal Reserve member banks. However, banks are permitted to underwrite and trade certain types of

34. See S. REP. No. 455, 73d Cong., 2d Sess. 1 (1934). For a more detailed discussion of the traditional reasons for separating securities and commercial banking activities, see infra part III.A.
36. Id. § 21.
38. Glass-Steagall Act § 32; see id. § 21 which, in effect, extends the management interlock prohibition of section 32 to all banks.
government securities for their own accounts. Banks also may purchase for their own account other types of securities, as permitted by federal bank regulatory authorities and subject to a limit of ten percent of unimpaired capital stock.

The effect of the Glass-Steagall Act is to impose a basic separation between commercial and investment banking. However, this separation is not absolute. As discussed above, the Act permits banks and bank holding companies to purchase and sell securities pursuant to customer orders and solely for customer accounts. The judiciary and the federal banking agencies have further expanded the scope of permissible bank activities through a series of decisions interpreting the Act, although the basic separation of functions has remained in place.

2. Nonbanking Activities of Foreign Banks in the United States

The general approach of U.S. banking authorities to the activities of foreign banks located in the United States is national treatment — foreign banks are basically subject to the same regulatory regime as domestic banks and are thus generally forbidden from engaging in those activities prohibited for U.S. banks. However, there are several possible exceptions under which foreign banks may engage in securities activities in the United States. Foreign banks which engaged in nonbanking activities in the United States prior to the enactment of the International

39. Id. §§ 16, 21. Bank holding companies are permitted to hold a somewhat broader range of securities. Bank Holding Company Act § 4(c).

40. Glass-Steagall Act §§ 16, 21. Bank holding companies are permitted to hold up to five percent of the outstanding voting shares of any company. Bank Holding Company Act § 4(c).


42. Golembe & Holland, supra note 29, at 80. For a detailed discussion of securities activities in which various types of banks may engage, see Isaac & Fein, supra note 4, at 323–42.

43. See Isaac & Fein, supra note 4, at 323–42.


46. See SYMONS & WHITE, supra note 45, at 762.
Banking Act of 1978 are permitted, under a grandfather provision, to continue engaging in nonbanking activities, subject to Federal Reserve Board discretion.47 If a foreign bank does not qualify for grandfather status, it may nonetheless be permitted to invest in certain foreign corporations that are principally engaged in business outside the United States, provided that the foreign bank's principal business is banking.48 Also, a foreign bank, the majority of whose international business is banking and more than half of whose banking business is outside the United States, may engage in certain limited securities activities within the United States.49 An additional exemption permits foreign banks, whose business is primarily conducted outside the United States, to engage in nonbank activities in the United States if the Federal Reserve Board determines that such activities are consistent with the purposes of the Bank Holding Company Act and in the public interest.50

3. Activities of U.S. Banks Operating Abroad

Technically, the prohibitions of the Glass-Steagall Act do not apply to U.S. banks operating abroad.51 However, the Glass-Steagall Act does apply in effect, since it limits the ability of U.S. banks engaging in securities activities abroad to market foreign securities in the United States, their principal market.52

There are two mechanisms by which U.S. banks may engage in securities activities abroad. The first is Regulation K of the Bank Holding Company Act, which provides that foreign subsidiaries of U.S. banks and bank holding companies may underwrite and deal in equity securities outside the United States, within specified dollar limitations, and subject to certain capital levels.53 These limits, which are to be approved by the Federal Reserve Board, have been set at a fairly restrictive level.54

49. Regulation K, 12 C.F.R. § 211.23(b), (f) (1991).
50. Bank Holding Company Act § 4(c)(9). The Federal Reserve Board's discretion in granting this exemption is guided by its policy that foreign banks should not enjoy substantially broader powers than are permitted domestic bank holding companies. SYMONS & WHITE, supra note 45, at 762.
53. Regulation K, 12 C.F.R. § 211.5.
54. Id. In 1990, U.S. banks operating abroad were required to limit any single underwriting commitment to two million dollars or twenty percent of the issuer's capital and surplus or voting shares. Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says, supra note 52.
The second mechanism by which U.S. banks may engage in securities activities outside of the United States is by establishing an Edge Act subsidiary. Section 25 of the Federal Reserve Act, known as the Edge Act, permits subsidiaries of banks or bank holding companies established under that section to engage in activities which the Federal Reserve Board has determined are "usual . . . in connection with the business of banking or other financial operations in the countries in which [the subsidiaries] act."  

B. The European Union

1. Introduction to European Union Financial Systems

In order to understand the current state of European Union (E.U.) banking law, it is necessary to have some knowledge of the historically diverse financial systems of the E.U. Member States. The most relevant system, for purposes of examining current E.U. law, is universal banking, which is found in Germany, Denmark, Luxembourg, and the Netherlands. Although the characteristics of particular universal banking systems may vary, under a universal banking system banks generally are allowed to engage in a full range of financial activities, which includes both traditional commercial banking and securities activities, and may include additional nonbanking activities.

Universal banking may be viewed as having a number of distinct advantages over traditional banking systems such as that of the United States. Some commentators believe that diversification in the range of financial services which a bank may offer lowers the risk of financial failure arising from losses in a particular area of activity. Proponents of the system also argue that the variety of financial services offered by each bank enhances competition in the market for financial services; that universal banks are able to react quickly and flexibly to changing market conditions; and that overregulation of financial activity will only drive

55. Walter, supra note 31, at 91.
57. The European Community became the European Union (E.U.) as a result of the twelve Member States' ratification of the Maastricht Treaty. See Treaty on European Union [TEU].
58. Golembe & Holland, supra note 29, at 80.
59. OECD, supra note 7, at 14. For a more in-depth discussion of universal banking, see Saunders & Walter, supra note 1, at 84–126.
60. OECD, supra note 7, at 14. However, diversification must be viewed in terms of efficiency. See supra note 10 and accompanying text; supra text accompanying notes 18–24.
activity into unregulated sectors, where it is difficult to monitor and, therefore, more destabilizing to the financial system. As discussed in Part III.A below, in the context of traditional justifications for laws separating securities and commercial activities, opponents of a universal banking system have raised a number of important arguments to refute the claims of supporters of the system.

Nonuniversal banking systems in E.U. Member States take a variety of forms, spanning the spectrum from near universal banking to strict separation of commercial banking and securities activities. Banks in the United Kingdom, for example, function essentially like universal banks, in that they are able to perform both commercial and investment banking activities within the same institution. They differ, however, in that the two types of activities are subject to separate systems of regulation and legislation. In contrast, Italian commercial banks are very limited in the range of activities in which they may engage.


The Second Banking Directive was adopted by the E.U. Council in 1989. The stated purpose of the Directive is to allow, by means of mutual recognition, freedom for banking institutions licensed in a Member State to perform a full range of activities throughout the Community, without the need for licensing in each Member State. On a broader level,

[t]he ultimate objective of the Community is . . . to speak as a single European banking market, where it will be as easy for a bank to establish branches anywhere in the Community as in its home Member State, and offer the full range of its banking services across the entire Community, and also offer European securities and capital market [sic] with enough capacity to meet European industry’s

61. OECD, supra note 7, at 14.
63. Saunders & Walter, supra note 1, at 237.
64. Szegó, supra note 7, at 190. For more detailed discussions of the particular banking systems of the E.U. Member States, see OECD, supra note 7, at 15–16; George S. Zavvos, Banking Integration and 1992: Legal Issues & Policy Implications, 31 Harv. Int’l L.J. 463, 481 (1990); Brøker, supra note 2, at 63; Golembe & Holland, supra note 29, at 80.
financing needs, which will attract investors from all over the world.  

The Second Banking Directive applies only to credit institutions, which are defined as "[undertakings] whose business is to receive deposits or other repayable funds from the public and to grant credits for [their] own account[s]." Credit institutions may be viewed as analogous to commercial banks, and are to be distinguished from financial institutions, which are analogous to investment banks, and are not within the scope of the Directive.

The Second Banking Directive, which is modeled on the universal banking system, permits credit institutions to engage in a variety of activities. These activities include traditional commercial banking activities; trading for customers or the institution's own account in a variety of instruments, including futures, options, and transferable securities; and underwriting activities. The only major nonbank activities which are not permitted under the directive are insurance activities, guarantees, and commitments.

The Directive does not restrict the ability of a Member State to limit the range of activities in which banks established within its jurisdiction may engage, provided that the Member State complies with the mutual recognition provisions of the Directive. However, it is likely that Member State regulatory systems will converge toward universal banking as a result of competitive forces, which will cause an outflow of banking business from those Member States with greater restrictions on bank activities. This process may be viewed as part of E.U. efforts to harmonize banking and securities regulation in order to permit undistorted trade in the financial services sector.

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68. Second Banking Directive, supra note 65, art. 1.
69. Dufey, supra note 7, at 179.
70. Zavvos, supra note 64, at 480.
72. Golemb & Holland, supra note 29, at 73.
73. See Second Banking Directive, supra note 65, art. 18.
74. Zavvos, supra note 64, at 484. It is possible that this resulting inflow of business to Member States with more liberal regulations may be differential, i.e., banks may find it most profitable to specialize in certain financial services and locate in the Member State with the least restrictive regulatory scheme with respect to that particular service. Szegő, supra note 7, at 194. However, under the liberalization of financial services embodied by the Second Banking Directive, it would seem that regulatory convergence would still be the ultimate result.
75. Clarotti, supra note 67, at 178; Zavvos, supra note 64, at 466-67.
3. Activities of Foreign Banks in the European Union
   Under the Second Banking Directive

Under the Second Banking Directive, the treatment of foreign (non-Union) banks located in the European Union will depend upon whether they are subsidiaries or branches of foreign banks. Subsidiaries are governed by the Directive and are subject to the restrictions of the Member State in which they are established. They are entitled to engage throughout the Community in the variety of activities which the Directive permits. Branches of foreign banks are not within the Directive's jurisdiction and remain subject to individual Member State regulation. A further distinction is made between subsidiaries of foreign banks which were already established in the European Union at the time of the Second Banking Directive and subsidiaries which have been established after the Directive. The former benefit from the Directive's grandfather clause, while the latter must meet the Directive's reciprocity requirements in order to enjoy its freedoms.

4. Activities of E.U. Banks Operating Abroad

Because the Second Banking Directive permits E.U. credit institutions to engage in a wide variety of activities, the activities in which they may engage abroad are only limited by the regulatory regimes of the foreign countries in which they establish a presence. Through the national treatment provision of the Second Banking Directive, the European Union seeks to ensure that foreign countries do not restrict the activities of E.U. credit institutions to a greater extent than they restrict domestic institutions, so that E.U. institutions may enjoy the same competitive opportunities available to domestic institutions. The European Union may enforce this provision against foreign regulators through retaliatory use of the reciprocity provision of the Directive.

76. Oversight Hearings, supra note 31, at 139 (prepared statement of L. William Seidman, former Chairman, FDIC). The basis of the distinction between subsidiaries and branches is article 58 of the EEC Treaty, which permits foreign companies or firms to enjoy all the freedoms granted to E.U. companies or firms, provided that the company or firm is established in accordance with the law of a Member State and has its registered officer, central administration, or principal place of business in the European Union. Clarotti, supra note 67, at 186. However, Member States are limited to the extent that they are prohibited from giving outside providers of services more favorable treatment than they give E.U. providers (the Most Favored Nation (MFN) principle). Id. at 187.

77. Golembe & Holland, supra note 29, at 74. The reciprocity provisions are discussed infra part IV.B.2.

78. Second Banking Directive, supra note 65, art. 9(4).

79. Id. art. 9(3); Giorgio Sacerdoti, The International Regulation of Services: Basic Concepts and Standards of Treatment, in LIBERALIZATION OF SERVICES AND INTELLECTUAL
C. Japan

1. Introduction to the Japanese Financial System

Until recently, the Japanese financial system has been characterized by a "rigid compartmentalization" of financial services.90 There are a variety of financial institutions in Japan, and each traditionally has been restricted to specific functions within the system.91 Commercial banks, which are the focus of this Note's analysis of Japanese financial institutions, fall into four categories: ordinary, long-term credit, trust, and foreign exchange banks.92 Ordinary banks (futsuu ginkou) are short-term credit facilities, and are further subdivided into city banks, which restrict their activities to business based in the large cities, and local banks, which restrict their activities to business based in regional areas.93 Long-term credit banks (chouki shinyou ginkou) provide long-term financing to Japanese industry. They engage in securities activities, as well as participate in the international money markets.94 Trust banks (shintaku ginkou) engage concurrently in ordinary and trust banking to provide long-term financing to Japanese industry.95 Foreign exchange banks (gaikoku kawase ginkou), of which there is currently only one (Bank of Tokyo), specialize in international finance, including foreign exchange transactions and trade financing.96 Securities companies, which are analogous to investment banks, are even more compartmentalized in their activities, and they must gain

91. Id. at 94.
92. The various institutions constituting Japan's financial system include: (1) the Ministry of Finance (the central government regulatory body for the financial system); (2) the Bank of Japan (the government central bank); (3) ordinary banks (which include city, local, and foreign banks); (4) long-term credit banks; (5) trust banks; (6) specialized foreign exchange banks; (7) specialized financial institutions for small and medium-sized businesses; (8) financial institutions for agriculture, forestry, and fisheries; (9) government financial institutions; (10) securities companies; (11) securities finance companies; (12) insurance companies; and (13) the postal savings system. Id. at 93, 95.
94. Id. at 17–18; Semkow, supra note 80, at 99.
95. Yamane, supra note 83, at 18; Semkow, supra note 80, at 102–03.
96. Yamane, supra note 83, at 18; Semkow, supra note 80, at 103.
97. Yamane, supra note 83, at 18; Semkow, supra note 80, at 105.
separate licenses for each category of business in which they wish to engage. They may obtain a license for dealing for or trading on their own accounts, a license to perform brokerage activities for customers, a license for the underwriting of and subscription to shares at the time of issuance, and a license for the distribution of securities to the public. Most securities companies do not possess all four types of licenses, and many restrict their activities to brokering, dealing, and distributing securities.

The Japanese financial system is distinct from the financial systems of the United States and European Union in several respects. The banking system is structurally more important to the Japanese economy than the banking systems in the United States or the E.U. Member States are to their respective countries. This is because Japanese corporations, which are highly leveraged, obtain a large portion of their financing from banks rather than from the capital markets. Japan's financial services sector is much more concentrated than that of the United States or the European Union. As of 1990, the United States had more than 14,000 commercial banks, while Japan only had 158. The combined market value of Japan's twenty-five largest ordinary banks was $550 billion, compared to a market value of only $110 billion for the fifty largest U.S. banks.

2. Laws Separating Commercial Banking and Securities Activities in Japan

a. Background

During the first half of the twentieth century, Japan had a universal banking system under which banks were permitted to engage in a full

88. Semkow, supra note 80, at 109–10.
90. Semkow, supra note 80, at 110.
91. Id. at 94–95.
92. Id.
94. SAUNDERS & WALTER, supra note 1, at 61.
95. Hale, supra note 93, at 156.
96. Id. at 150.
range of financial activities, including all types of securities activities. As part of the U.S. occupation of Japan following World War II, the United States demanded that the Japanese government enact a new securities and exchange law modeled on the U.S. Glass-Steagall Act. The resulting provision, article 65 of the Securities and Exchange Law of 1948, imposed a separation between commercial and investment banking activities. The United States' purpose in demanding the change in law was to make the Japanese economy more democratic and to decentralize the economic power of the zaibatsu, the enormous pre-World War II holding companies, which the United States believed were largely responsible for financing the Japanese war effort.

b. The New Banking Law and the Amended Securities and Exchange Law

It was not until fairly recently that Japan modified its laws separating securities and banking activities. Beginning in the mid-1970s, following the first oil crisis, Japan began to experience difficulties in financing its heavy government borrowing. Under the government debt-financing system which existed at the time, the various types of Japanese financial institutions, including commercial banks and securities companies, were required to underwrite some portion of government bond offerings. The underwriting requirements became so strict following the oil crisis that financial institutions were forced to devote a large proportion of their deposit base to underwriting government bonds. This development created a need for financial institutions to free up bank funds in order to realize greater profits in the holding and disposing of the bonds. The need for greater profits was particularly acute for commercial banks, which were prohibited from selling government bonds directly to the public (where the majority of profit would be realized, as commission fees could be charged on public sales) and were instead required to sell

97. Osamu Karihara, Recent Developments in the Securities and Exchange Law in Japan, in JAPANESE BANKING, SECURITIES & ANTI-MONOPOLY LAW, supra note 83, at 77, 80; Semkow, supra note 80, at 118.
98. Semkow, supra note 80, at 117–19.
99. Id. at 119–20.
100. Id. at 119; ANDREW MULLINEUX, INTERNATIONAL BANKING AND FINANCIAL SYSTEMS: A COMPARISON 67 (1987).
101. Karihara, supra note 97, at 81; BRÖKER, supra note 2, at 62.
102. Semkow, supra note 80, at 122–23.
103. Id.
104. Id.
the bonds to securities companies, which would then reap the profit from sales to the public.\textsuperscript{105}

The government addressed these problems by passing the New Banking Law of 1981\textsuperscript{106} and, also in 1981, amending article 65 of the Securities and Exchange Law of 1948.\textsuperscript{107} The New Banking Law broadened the activities in which banks\textsuperscript{108} could engage to include the buying and selling of government securities for the bank’s own account and for customers; underwriting and handling the placement or secondary sale of government bonds; “other businesses incidental to the banking business;” and other business related to national government bond offerings, to the extent not inconsistent with the bank’s principal business.\textsuperscript{109} Japanese banks also are permitted to purchase, for investment purposes, shares of corporations for their own accounts, as well as corporate bonds, subject to a five percent limit of the outstanding stock of a domestic corporation.\textsuperscript{110} This power contrasts with the power of U.S. banks, which is limited to purchasing corporate bonds for their own accounts.\textsuperscript{111}

The provisions of the New Banking Law which permit banks to engage in securities activities, with respect to government securities, mark a significant change from prior practice under the Old Banking Law, because they explicitly extend the permissible range of “banking-related business.”\textsuperscript{112} Although the law on its face does not seem to liberalize the Japanese banking system in comparison with systems such as that of the United States, whose banks have long been permitted to sell government securities to the public, the real effects are significant.\textsuperscript{113} These effects

\begin{itemize}
  \item \textsuperscript{105} Id. at 123.
  \item \textsuperscript{106} New Banking Law (Ginkoho), Law No. 59 of 1981, repealing Old Banking Law (Ginkoho), Law No. 21 of 1927, in JAPANESE SECURITIES REGULATION, supra note 89, at Appendix F [hereinafter New Banking Law].
  \item \textsuperscript{107} Amended Securities and Exchange Law, supra note 89, art. 65.
  \item \textsuperscript{108} Specifically, the law applies to all institutions that engage in “banking,” which is defined as the acceptance of deposits or installment savings, the making of loans or the discounting of notes, and the performance of exchange transactions. Semkow, supra note 80, at 115.
  \item \textsuperscript{109} New Banking Law, supra note 106, arts. 10, 11; Semkow, supra note 80, at 115–16, 123. The Old Banking Law of 1927 was silent as to securities activities — it merely stated that banks were permitted to engage in “banking related business.” Id. at 118. However, administrative rulings under the Old Banking Law made clear that “banking related business” included the purchase, sale, and lending of government securities. Id. at 115–16. Thus, the New Banking Law may be viewed, to some extent, as a codification of practices previously permitted. Id.
  \item \textsuperscript{110} Amended Securities and Exchange Law, supra note 89, art. 65; Shimojo, supra note 93, at 111–12.
  \item \textsuperscript{111} Shimojo, supra note 93, at 111–12.
  \item \textsuperscript{112} Semkow, supra note 80, at 115–16.
  \item \textsuperscript{113} Id. at 124.
\end{itemize}
include increasing the competitiveness of banks by permitting them to engage in activities formerly reserved to securities companies.\textsuperscript{114} Securities companies benefit as well, by being permitted to engage in certain activities formerly reserved to banks.\textsuperscript{115}

Article 65 of the amended Securities and Exchange Law defines the scope of expansion of banks' activities which is effected by the New Banking Law.\textsuperscript{116} It prohibits banks from engaging in securities business,\textsuperscript{117} with the exceptions of purchases or sales of securities upon the order of, and solely for the account of, customers and purchases or sales of securities on a bank’s own account for investment purposes.\textsuperscript{118} However, the second paragraph of amended article 65 codifies the New Banking Law’s broadening of bank activities by specifically exempting from the prohibitions of the Securities and Exchange Law the government bond activities in which banks may engage under the New Banking Law.\textsuperscript{119}

Japanese banks and securities companies also have broadened the scope of their activities by taking advantage of loopholes in amended article 65.\textsuperscript{120} Banks have relied on the article’s lack of any prohibition against bank affiliates owning securities companies to effect substantial control positions in such institutions.\textsuperscript{121} This trend also includes the shifting of bank personnel to the securities affiliate in which the bank holds a stake.\textsuperscript{122} Securities firms have similarly made significant inroads into traditional banking activities by establishing money market funds

\begin{itemize}
  \item \textsuperscript{114} Id. \\
  \item \textsuperscript{115} These activities include making loans secured by government bonds, underwriting commercial paper and import-negotiable certificates of deposit, dealing in certificates of deposit in the secondary markets, and dealing in bankers' acceptances. Id. at 125; Bröker, supra note 2, at 63. \\
  \item \textsuperscript{116} Yamane, supra note 83, at 21, citing A. Viner, Inside Japan’s Financial Market 22–27 (1987). \\
  \item \textsuperscript{117} The law defines "securities business" to include: (1) the purchase or sale of securities; (2) acting as an intermediary, broker, or agent with respect to the purchase or sale of securities; (3) acting as an intermediary, broker, or agent with respect to entrustment of transactions on a securities market; (4) underwriting securities; (5) engaging in public offerings of securities; and (6) handling public offerings of new or outstanding securities. Amended Securities and Exchange Law, supra note 89, art. 2(8). \\
  \item \textsuperscript{118} Amended Securities and Exchange Law, supra note 89, art. 65. The intent in permitting banks to purchase and sell securities for their own account for investment purposes is to encourage profitable use of surplus funds. Semkow, supra note 80, at 120–21. \\
  \item \textsuperscript{119} The article states that "[t]he provisions of the foregoing Paragraph shall not apply to national and local government bonds, corporate debentures and other debt issues with respect to which principal redemptions and interests are guaranteed by the Government." Amended Securities and Exchange Law, supra note 89, art. 65(2). \\
  \item \textsuperscript{120} Jonathan Isaacs & Takashi Ejiri, Japanese Securities Market 86 (1990). \\
  \item \textsuperscript{121} The banks have used this control to enjoy commission savings on their securities trading and by taking advantage of the larger capital base available to them. See id. at 86–87. \\
  \item \textsuperscript{122} Id.
\end{itemize}
which can be accessed through automatic teller machines, in effect engaging in deposit-taking.\textsuperscript{123} These pressures from both sides of the financial services industry, as well as concerns about anticipated competition from the growing European universal banks, have led Japan to begin reforming article 65.\textsuperscript{124} On April 1, 1992, the Law to Provide for the Reform of the Financial and Securities Systems took effect. Under this law, banks and securities firms are permitted to engage in each other's business through majority owned subsidiaries.\textsuperscript{125}

3. Activities of Foreign Banks in Japan

The New Banking Law and regulations of the Ministry of Finance and the Bank of Japan govern the activities of foreign banks in Japan.\textsuperscript{126} Since 1985, Japan has allowed foreign securities firms owned by commercial banks to conduct securities activities in Japan, provided that the parent bank's equity holding in the subsidiary does not exceed fifty percent and that the remaining share is held by a nonfinancial institution.\textsuperscript{127} Although the New Banking Law's applicability to foreign banks suggests that foreign banks have the same powers as domestic banks,\textsuperscript{128} the actual effect of these provisions of the New Banking Law is unclear. Because the Bank of Japan and the Ministry of Finance could continue to limit by regulation, as they do currently, the branching abilities of foreign banks, the ability of foreign banks to build an adequate deposit base for widespread growth in Japan may be limited.\textsuperscript{129}

\textsuperscript{123} \textit{Id.} at 87.

\textsuperscript{124} See \textit{id.} at 87-88; \textsc{Mullineux, supra note 100}, at 86; Michelle Celarier, \textit{Glass-Steagall is a Global Issue}, \textsc{United States Banker}, May 1989, at 72.

\textsuperscript{125} Law to Provide for the Reform of the Financial and Securities Systems (\textit{Kinyu Seido oyobi Shokentorihiki Seido no Kaikaku no Tame no Kankei Horitsu no Seibito ni Kansuru Horitsu}), Law No. 87 of 1992. The reform of article 65, although significant in theory, has been somewhat disappointing in practice. Banks' expansion into securities activities has been restrained by the Japanese Ministry of Finance. This restraint has been justified as gradualism necessary to protect the banks, although the reluctance to act may be better explained as protectionism of the securities firms. See \textit{Japanese Regulation: Hold the Bouquets, Please}, \textsc{Economist}, July 31, 1993, at 67. See also Michael Hirsch, \textit{It's Bankers Versus Brokers as Japan's Glass-Steagall Starts to Break Down}, \textsc{Institutional Investor}, Apr. 1993, at 27.

\textsuperscript{126} See Shimojo, \textit{supra note 93}, at 93; Semkow, \textit{supra note 80}, at 117.

\textsuperscript{127} Brian Semkow, \textit{The Deregulation of Japan's Financial Markets}, \textsc{Int'l Fin. L. Rev.}, Aug. 1987, at 34, 35; OECD, \textit{supra note 7}, at 39. This power of foreign banks to operate securities subsidiaries in Japan, which is not permitted to domestic Japanese banks, is cited by Japanese commercial banks as additional evidence that the reform of article 65 is necessary for their increased competitiveness. Semkow, \textit{supra}, at 35.

\textsuperscript{128} See Shimojo, \textit{supra note 93}, at 93.

\textsuperscript{129} Semkow, \textit{supra note 80}, at 127.
4. Activities of Japanese Banks Operating Abroad

Japanese banks operating abroad may engage in securities activities, when not prohibited from doing so by the host country, through the establishment of offshore subsidiaries known as "overseas security subsidiaries" (kaigai shouken genchihoujin). However, Japanese banks are further regulated in their activities abroad by the Three Bureaux Agreement, a 1974 agreement reached by the three bureaus of the Ministry of Finance (Banking Division, Security Division, and International Finance Division). The Agreement separates the banking and securities activities of Japanese bank branches and subsidiaries located in the same foreign country (i.e., the branch is limited to banking activities, while the subsidiary is limited to securities activities). The Agreement also limits the ability of a foreign subsidiary of a Japanese bank to act as a lead manager for the issuance of foreign bonds of Japanese corporations. The status of the Three Bureaux Agreement under the New Banking Law is yet unclear, although it appears that the principles of the Agreement will gradually be abolished under the New Banking Law.

III. The Function in the Domestic Economy of Laws Separating Securities and Commercial Banking Activities

A. Traditional Justifications for Imposing a Separation Between Securities and Commercial Banking Activities

1. Conflict of Interest Concerns

A basic reason for separating the performance of securities and commercial banking activities is to prevent conflicts of interest when banks have an equity interest in nonbanks. Commentators claim that such conflicts threaten the safety and soundness of the financial system. Their concern is that the combination of functions within a single institution

130. Shimojo, supra note 93, at 114; Yamane, supra note 83, at 21.
133. Id. Foreign subsidiaries of U.S. banks are under no similar restrictions. Karihara, supra note 97, at 82. The restriction, the original purpose of which was to protect Japanese securities companies from competition with the subsidiaries of Japanese banks operating abroad, is thought by some commentators to be no longer necessary, in light of the current size and strength of the securities companies. Id.
134. Shimojo, supra note 93, at 115. See Yamane, supra note 83, at 21.
135. OECD, supra note 7, at 14; Brøker, supra note 2, at 82.
may result in mismanagement and excessive risk-taking.\textsuperscript{136} Banks may be tempted to assist failures arising from their nonbanking activities and likely would be legally responsible for such failures.\textsuperscript{137} The desire to increase business could induce banks to underwrite and distribute low quality stocks or to overlend to underwriting clients engaging in risky offerings.\textsuperscript{138} Conflicts of interest also could arise in situations where the bank is both shareholder and lender to a firm.\textsuperscript{139} In such a situation, the bank could attempt to influence the management of the issuer-borrower, could abuse its access to inside information, or might allow ownership considerations to influence lender-customer relations.\textsuperscript{140} Perceived conflicts of interest could threaten public confidence in a country’s financial markets and make investors hesitant to enter the market.\textsuperscript{141}

2. Safety and Soundness Concerns

A second rationale supporting the separation of banking and securities activities is the fear that conflicts of interest may lead to mismanagement and excessive risk-taking; both would threaten customer safety and the financial system’s stability.\textsuperscript{142} This concern is closely related to the general concern with conflicts of interest; however, it concentrates more on the necessity of maintaining the stability of the monetary system as a whole.\textsuperscript{143} Maintaining different regulatory systems for banking and securities institutions reflects the different types of risks involved in each type of activity as well as the necessity of the consequent protections.\textsuperscript{144} Under a combined system the risks of particular activities might not be clear, resulting in excessive risk taking and unprotected losses.\textsuperscript{145}

\textsuperscript{136} Bröker, supra note 2, at 83.
\textsuperscript{137} Fisher, supra note 4, at 226.
\textsuperscript{138} Pecchioli, supra note 62, at 58.
\textsuperscript{139} Id. at 61. An example of such a conflict would be a situation where a bank sells the securities of an overindebted customer to an unsuspecting public in an effort to recover its imprudent investment. See Japanese Securities Firms; Bankers’ Embrace, ECONOMIST, Nov. 28, 1992, at 88. However, in considering this concern, it is instructive to compare the Japanese experience. Economists have argued that the ability of Japanese banks to hold equity positions in firms to whom they are also lenders has lessened monitoring (information) costs to banks, resulting in lower financing costs to Japanese industry and a lesser likelihood, and cost, of bankruptcies. Sun Bae Kim, Should Banks Hold Shares in Nonfinancial Firms?, AM. BANKER, Apr. 24, 1991, at 4. But c.f. Time to Leave; The Convoy Scatters, supra note 22, at 44 (discussing Japanese accounting methods which cause banks to continue lending to overindebted customers, resulting in huge losses).
\textsuperscript{140} Pecchioli, supra note 62, at 61. See supra note 139.
\textsuperscript{141} See Fisher, supra note 4, at 226.
\textsuperscript{142} See Bröker, supra note 2, at 83.
\textsuperscript{143} See Fisher, supra note 4, at 215.
\textsuperscript{144} See OECD, supra note 7, at 13.
\textsuperscript{145} Furthermore, the combination of functions in a single institution raises difficult issues concerning the role of federal deposit insurance. See Fisher, supra note 4, at 261–62. If banks
3. Concentration of Power Concerns

Permitting a single institution to engage in both securities and commercial banking activities could also lead to economically unacceptable concentrations of power.146 This problem also is related to conflicts of interest concerns because banks' acquisitions of significant equity participations in securities firms could provide them with the power necessary to influence the management of the securities firms.147 Furthermore, a government may fear the economic implications of the concentration of financial power in a few large institutions.148

4. Concerns Related to the "Specialized" Nature of the Banking Industry

Because of the important economic role of banks in effective monetary policy, most governments believe it is necessary that they assume a central role in protecting the banking system.149 Some governments believe this protection can best be achieved by separating banking and securities activities in order to focus government control and safeguards on the banking system.150 Proponents of this view distinguish securities activities in this regard because such activities are perceived as involving voluntary risks which the informed investor may assume at his or her discretion.151 This rationale for the separation of banking and securities functions is also related to safety and soundness concerns because preserving the safety and soundness of the banking system is essential for effective monetary policy.

were permitted to engage in a wide range of activities, it is unclear the extent (if any) to which a government should assume the risks of those activities. Also unclear is the feasibility of separating the risks of activities if differential assumption of risk is desired.

146. Id. at 215.
147. PECCHIOLI, supra note 62, at 61. See supra text accompanying notes 139-40. See also supra note 139.
150. See OECD, supra note 7, at 13. For instance, U.S. safeguards particular to the banking system include the access of banks to FDIC insurance, discount window funds, preferential tax treatment, and special rules for loss carryovers. Fisher, supra note 4, at 215 (citing General Accounting Office, Bank Powers: Insulating Banks from the Potential Risks of Expanded Activities, GAO Doc. No. 87-35, at 11-12 (1987)).
151. OECD, supra note 7, at 13.
B. Arguments For Permitting Banks to Engage in both Commercial Banking and Securities Activities

1. Questionable Motives for the Retention of Laws Separating Commercial Banking and Securities Activities

Although supporters of a financial system separating banking and securities activities will always offer some combination of the justifications discussed above, to some extent their motives may be less laudable. For instance, some commentators have partly attributed the United States' retention of the Glass-Steagall Act to successful lobbying efforts by the U.S. investment banking industry.\footnote{152} If U.S. commercial banks were permitted to engage in securities activities, the investment banking industry might lose the profitable and exclusive niche it currently occupies in the U.S. economy. Another ulterior motive for retaining laws separating banking and securities activities is to protect domestic financial institutions from foreign competition.\footnote{153} Protectionism may be difficult to distinguish from legitimate national prudential regulation, especially where such regulation, on its face, treats foreign financial institutions in exactly the same manner as domestic institutions.\footnote{154} Regardless, in such a situation the effect of the regulation is to discriminate against foreign institutions and place them at a competitive disadvantage, with harmful economic consequences similar to those resulting from true protectionism.\footnote{155}

2. Harm to Domestic Economies by Laws Separating Securities and Commercial Banking Activities

Laws separating commercial banking and securities activities impose significant costs on domestic economies. These costs include the financial burden of compliance placed on banking institutions, a cost which may influence their choice of jurisdiction in which to locate.\footnote{156} Such laws also reduce the variety of financial services a bank may offer, thus potentially reducing bank efficiency and decreasing competition among financial institutions.


\footnote{153} Cf. Global Competition, supra note 47, at 195 (noting that protectionist measures are often disguised as, for example, antitrust issues).

\footnote{154} See Id. at 194–95.

\footnote{155} See Id. at 195.

\footnote{156} See Dufey, supra note 7, at 187.
institutions, ultimately resulting in increased prices for services offered. As is the trend in the United States, commercial banks may further find themselves at a competitive disadvantage where the range of activities in which they may engage is limited, while nonbanks are permitted to engage in a greater number of traditional banking activities. Such laws separating securities and banking activities may actually increase the risk of bank failure because the laws prevent banks from efficiently diversifying their risk.

Imposing a separation in a financial system between securities and banking activities may result in economic harm resonating far beyond the banking sector. U.S. bank regulators have expressed concern that the Glass-Steagall Act raises the cost of capital for banks because the Act prevents banks from offering an efficient variety of services. However, increasing the cost of capital for banks has repercussions far beyond the banking industry. Firms, especially those of small and medium size, rely primarily on banks for their capital needs. In countries with laws separating securities and banking activities, domestic industries are forced to pay a higher price for banking services, a cost which is passed on to consumers in the form of more expensive goods and services. This increased cost of capital ultimately puts domestic producers of goods and services at a competitive disadvantage in the world market. Intermediate purchases by domestic firms may account for a substantial amount of bank business. Thus, these cost-increasing effects may be significant. For instance, for the European Union as a whole, more than half of the total output of credit and insurance institutions consists of intermediate purchases by other industries.

157. Id. A law separating securities and banking activities acts like a government “tax” on production and trade in the industries which purchase financial services. However, unlike a real tax, in which revenue accrues to the government, the increased costs imposed by the law are borne by domestic industry and gained by domestic producers of financial services. GLOBAL COMPETITION, supra note 47, at 184.

158. Bacon, supra note 152, at A22; Trachtman, supra note 44 at 255. See also Greenspan Warns Against “Unnecessary” Regulation, Reuters, May 26, 1993, available in LEXIS, Banks Library, FINRPT File.

159. See Bacon, supra note 152, at A22; MULLINEUX, supra note 100, at 58.

160. Bacon, supra note 152, at A22; Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says, supra note 52, at 521 (statement of Robert L. Clarke, former Comptroller of the Currency).

161. Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says, supra note 52, at 521; See GLOBAL COMPETITION, supra note 47, at 119; WALTER, supra note 31, at 116. For the economic implications of this inefficiency, see supra note 157.

IV. THE EFFECTS IN THE INTERNATIONAL MARKET FOR FINANCIAL SERVICES OF LAWS SEPARATING SECURITIES AND COMMERCIAL BANKING ACTIVITIES

A. Is Increased International Competition in Financial Services Desirable?

Before discussing the distortions in international trade of financial services caused by laws separating banking and securities activities, it is useful to briefly examine whether increased competition in the financial services sector is desirable. There are many advantages to increased competition in financial services, including dynamic gains as domestic producers respond to competitive pressures by becoming more efficient and consumers gain by being able to obtain a greater variety of financial services at lower cost. However, increased international competition in financial services creates pressures for deregulation; thus, one's view concerning the desirability of increased trade in financial services is likely to be related to views about the desirability of deregulation.

Commentators who predict a high degree of deregulation resulting from increased competition in financial services cite fears such as excessive risk taking, insolvencies, and bank crises of major proportions.

B. Distortions in International Trade Flows Resulting from Laws Separating Securities and Banking Activities

1. Differential Regulation and the Use of Reciprocity in International Trade in Financial Services

In order to understand the remaining impediments to the free flow of international trade in financial services and, specifically, those impediments which are related to laws separating securities and commercial banking activities, it is useful to examine certain provisions of the


165. See Too Much Competition?, Fin. Reg. Rep., Mar. 1992, available in, LEXIS, News Library, FRR file. These concerns are closely related to the traditional justifications cited for imposing a separation between securities and banking activities. See supra part III.A. For responses to these arguments, see supra part II.B.1; infra part IV.D.1; infra part IV.E.1.
proposed General Agreement on Trade in Services (GATS), an annex to the Dunkel Draft. The Dunkel Draft is a draft agreement of the Uruguay Round of multilateral trade negotiations drafted in 1991 by Arthur Dunkel, the Secretary General of the General Agreement on Tariffs and Trade (GATT). A subannex of GATS, the Annex on Financial Services, defines the scope and treatment of financial services in the multilateral context. Although the Financial Services Annex does not adopt a specific financial services model, some commentators have viewed it, by focusing on the issues which currently impede successful agreement on financial services, as putting pressure on the United States to reform its banking laws. These issues are discussed below.

Two provisions of the GATS are particularly relevant in the context of discussing the effects of laws separating securities and banking activities. The national treatment provision of the draft, article XVII, requires that "each [Party to the agreement] shall accord to services and service providers of any other Party, in respect of all measures affecting the supply of services, treatment no less favorable than it accords to its own like services and service providers." However, there are several caveats to this standard of national treatment. Article XVII goes on to provide that "[c]ommitments assumed under this Article shall not be construed to require any Party to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service providers." Allowance for differences in national regulations is recognized further in the Annex on Financial Services, which provides that Parties may take measures for prudential reasons, including the protection of the integrity and stability of national financial

166. THE URUGUAY ROUND TRADE NEGOTIATIONS COMMITTEE, "THE DUNKEL DRAFT" FROM THE GATT SECRETARIAT Annex II (1991) [hereinafter GATS]. Although the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) was formally concluded on December 15, 1993, the Contracting Parties were unable to reach agreement on the liberalization of financial services, and initial commitments in the financial services sector were postponed for further negotiation. See Uruguay Round Agreement is Reached; Clinton Notifies Congress Under Fast Track, 10 Int'l Trade Rep. (BNA) 2103 (1993).

167. GATS, supra note 166. See Gerhard Wegen, Transnational Financial Services — Current Challenges for an Integrated Europe, 60 FORDHAM L. REV. S91, S97 (1992). The Dunkel Draft was intended to be a proposal for compromise among the parties to the GATT and covers the various aspects of the Uruguay Round of negotiations. Two draft agreements on financial services preceded the Dunkel Draft: A 1990 Canadian draft and a draft circulated by the SEACEN countries (a combination of the Association of Southeast Asian Nations (ASEAN), Nepal, and Korea). Fisher, supra note 4, at 139.

168. GATS, supra note 166, Annex on Financial Services.

169. Fisher, supra note 4, at 140.

170. GATS, supra note 166, art. XVII(1).

171. Id.
systems, provided that the Party does not use such measures to avoid its obligations under the agreement.\textsuperscript{172}

These provisions raise an important, recurrent issue in discussions of international trade in financial services: when a country maintains a prudential regulation (such as a law separating securities and banking activities) that is not protectionist on its face, yet limits the ability of foreign service providers in that country to act with the degree of freedom permitted in their home country, how is this resulting discrepancy in treatment to be addressed in international trade relations? This question is commonly addressed under the label of reciprocity, of which there are two basic types.\textsuperscript{173} Mirror image reciprocity is an approach under which a country denies certain legal rights to nationals of another country, if that country does not grant the same rights to its own nationals.\textsuperscript{174} Reciprocal national treatment is an approach under which a country treats nationals of a foreign country as it treats its own nationals, provided that the foreign country treats the home country's nationals, when located in the foreign country, as its own nationals.\textsuperscript{175}

Reciprocity issues recently have been prominent in both multilateral and bilateral negotiations of international trade in financial services.\textsuperscript{176} The problem with adopting either reciprocity approach is that both result in a distorted flow of international trade. For example, if the United States and the European Union were to adopt a mirror image reciprocity standard of treatment between them, U.S. banks, acting under the Second Banking Directive, could engage in universal banking in the European Union (as they are currently able to do under certain circumstances).\textsuperscript{177} Under this standard, however, the United States would be obligated to permit E.U. banks to engage in universal banking in the United States.\textsuperscript{178} Clearly, this

\begin{itemize}
  \item \textsuperscript{172} Id. Annex on Financial Services, at (2).
  \item \textsuperscript{173} Sacerdoti, supra note 79, at 36.
  \item \textsuperscript{174} Id.
  \item \textsuperscript{175} Id.
  \item \textsuperscript{176} See Hale, supra note 93, at 151–53; R. Brian Woodrow, Sectoral Coverage and Implementation within a Uruguay Round Services Trade Agreement: Paradox and Prognosis, in A NEW GATT FOR THE NINETIES AND EUROPE '92, at 221, 237 (Thomas Opperman & Josef Molsberger eds., 1991); Walter, supra note 31, at 51–52; Global Competition, supra note 47, at 156–57, 194.
  \item \textsuperscript{177} Sacerdoti, supra note 79, at 37. For a discussion of permissible activities of U.S. banks located in the European Union, see supra part II.B.3.
  \item \textsuperscript{178} Sacerdoti, supra note 79, at 37. Theoretically, an alternative approach under mirror image reciprocity would be for the country with the less liberal banking law to provide the "mirror," in the sense that the less liberal range of activities would become the standard for both countries' banks when acting in each other's markets. A form of this approach has been adopted by the European Union in the form of article 9 of the Second Banking Directive, a retaliatory tool which combines reciprocal national treatment with effective market access. Article 9 is discussed infra part IV.B.2.
\end{itemize}
would violate the Glass-Steagall Act, among other U.S. laws, and generally would be an untenable result. At a broader level, mirror image reciprocity fails to acknowledge a country’s right to subject all financial service providers within its borders to national prudential regulations.

Reciprocal national treatment may also result in distorted trade flows where countries have differentially liberal regulations with respect to bank activities. Under reciprocal national treatment, a financial institution from a country which separates securities and banking activities (such as the United States) can engage in both activities in a country which has a universal banking system (such as the European Union). However, a financial institution from a universal banking country cannot engage in securities activities in the country which maintains a separation between securities and banking activities. In countries which maintain a separation between functions, the real effect of this discrepancy is to substantially limit competition from institutions based in countries with more liberal banking laws and to capture a greater share of trade benefits than would occur under a more competitive regime. Although this result is clearly beneficial to the country which limits competition, more permissive countries are likely to notice its protectionist implications. Indeed, the European Union in its trade relations with the United States and Japan has noticed these implications and has adopted potentially retaliatory safeguards, as discussed below.

2. The E.U. Approach to Reciprocity Under the Second Banking Directive

Article 9 of the Second Banking Directive combines reciprocal national treatment with effective market access. The provision ties the ability of a non-Member State financial institution to obtain or maintain a single banking license and engage throughout the European Union in the full range of activities permitted under the Second Banking Directive, to the non-Member State’s treatment of E.U. financial institutions and its

179. OECD, supra note 7, at 43.
180. Id.
181. Id.; FEKETEKUTY, supra note 163, at 107.
182. FEKETEKUTY, supra note 163, at 107. This result is analogous to a one-sided removal of tariffs in the case of trade in goods. Id.
willingness to provide E.U. institutions "effective market access." It yet unclear how the European Union will choose to interpret this provision. U.S. and Japanese commentators have expressed concern that the European Union could use the ambiguous concepts of effective market access and equivalent treatment as retaliatory tools to negotiate increased access to the U.S. and Japanese financial markets, both in terms of market share and permissible activities. Indeed, the European Union has already used the provision to threaten the Japanese with restrictions in the E.U. financial market if they fail to increase European access to the Japanese financial market. The provision could also become a powerful tool by which the European Union could exert pressure on the United States to effect deregulatory reform. European Union use of the provision as leverage in lobbying for reform of the Glass-Steagall Act seems likely in light of existing E.U. pressure for reform of the U.S. law.

184. Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says, supra note 52, at 521 (Statement of Sir Leon Brittan, Commissioner of the European Union). Specifically, article 9 provides, in relevant part, that:

Whenever it appears to the Commission . . . that a third country is not granting Community credit institutions effective market access comparable to that granted by the Community to credit institutions from that third country, the Commission may submit proposals to the Council for the appropriate mandate for negotiation with a view to obtaining comparable competitive opportunities for Community credit institutions . . . . Whenever it appears to the Commission . . . that Community credit institutions in a third country do not receive national treatment offering the same competitive opportunities as are available to domestic credit institutions and the conditions of effective market access are not fulfilled, the Commission may initiate negotiations in order to remedy the situation.

Second Banking Directive, supra note 65, art. 9(3), (4) (emphasis added). The current version of article 9 stands in contrast with a prior version, which also required both market access and reciprocal national treatment but premised the initial authorization for foreign financial institutions to obtain a banking license on meeting these conditions. Hymas, supra note 41, at 1673. In contrast, under the current version of article 9, the Commission may find at any time that reciprocity and effective market access are lacking. Id.

185. Matsushita, supra note 183, at 298.

186. Matsushita, supra note 183, at 297; Golembe & Holland, supra note 29, at 94; Hale, supra note 93, at 153.

The United States has responded to the European stance under article 9 by adopting a similar policy of reciprocity conditioned on national treatment, with the goal of ensuring market access for U.S. institutions in foreign markets. See U.S. to Seek Bilateral Deals in Asia for Financial Services, Bentsen Says, Int'l Trade Daily (BNA), Jan. 24, 1994, available in LEXIS, BNA Library, BNAITD File. Recently, the United States formalized this stance in the proposed "Fair Trade in Financial Services Act," which was approved by the U.S. Senate on February 10, 1994. S. 1527, 103d Cong., 2d Sess. (1994). See Senate Banking Panel Affirms Fair Trade Financial Services Bill, 11 Int'l Trade Rep. (BNA), at 247 (Feb. 16, 1994).


188. Hymas, supra note 41, at 1706.

C. The Costs of the Glass-Steagall Act to International Trade in Financial Services

1. Costs to the United States

The Glass-Steagall Act places the U.S. banking industry at a substantial competitive disadvantage to E.U. and Japanese financial institutions. The Act imposes costs on the U.S. economy, as discussed in Part III.B above. Even where U.S. financial institutions are able to engage in universal banking in the European Union, they are at a competitive disadvantage to European institutions. Although in such cases they are able to underwrite securities in Europe, the Glass-Steagall Act prevents them from marketing those securities in the United States, the location of their principal pool of investors, while most European banks will not face a similar dilemma. Some commentators warn that if the United States does not reform the Glass-Steagall Act, the U.S. banking industry will be competitively overtaken in the world market by powerful Japanese and European banks. Significantly, U.S. commentators, including top banking regulators, are among the most vocal of those advocating reform of the Glass-Steagall Act.

2. Costs to the United States' Trading Partners

The Glass-Steagall Act also imposes costs on the United States' trading partners. Some of these costs, which relate to differential gains from trade, are highlighted in Part IV.B above. Other costs result from the


192. Id.

193. 1992 Poses Competitiive Threat to U.S. Banks, Regulators Say, Banking Rep. (BNA), Oct. 2, 1989, at 464; Oversight Hearings, supra note 31, at 5 (statement of Manuel H. Johnson, former Vice Chairman, Board of Governors of the Federal Reserve); id. at 8 (statement of L. William Seidman, former Chairman, Federal Deposit Insurance Corporation); id. at 10 (statement of Robert L. Clarke, former Comptroller of the Currency); Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says, supra note 52, at 521; Hufbauer & Schmitz, supra note 183, at 320; Clarotti, supra note 67, at 184.

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limits the Glass-Steagall Act places on foreign institutions operating in the United States. Because financial institutions from countries with more liberal banking laws (such as the European Union and Japan) are not able to offer in the United States the full range of services they offer in their home countries, they lose a potential market for these services and may choose to focus their activities in countries with more liberal banking laws. Therefore, the Glass-Steagall Act has the same effect on these countries as would a tariff on financial services. The Glass-Steagall Act also imposes modification costs on foreign financial institutions because they may have to significantly tailor their U.S. operations to make them consistent with the Act.

D. Potential Ramifications of U.S. Retention of the Glass-Steagall Act

1. General Trends Resulting from the Internationalization of Financial Services

It is useful to examine the general trends predicted as a result of the increasing internationalization of financial services in order to understand how the Glass-Steagall Act will function in the resulting international market. First, increased competition, both at the national and international levels, blurs product divisions among different types of financial institutions. In jurisdictions where there is a division between banking and nonbanking activities, each type of institution seeks to increase its range of permissible activities in order to increase its competitiveness.

Regulatory convergence is a second trend resulting from the internationalization of the financial services market. As a result of increasing international competition, national regulatory standards are likely to converge to some degree. This trend does not suggest a complete erosion of prudential supervision; rather, those countries which are most

195. See Fisher, supra note 4, at 140; Hymas, supra note 41, at 1688.
196. Pecchioli, supra note 62, at 65.
197. Id. In the United States this trend is visible as nonbanks increasingly are permitted to engage in traditional banking activities and as banks seek to engage in more nonbanking activities. Bacon, supra note 152, at A22; Steven Lipin & Kenneth H. Bacon, Rise in Banks' Earnings In a Weak Economy Helps Them Rebuild, WALL ST. J., Oct. 30, 1992, at A1, A7. In the European Union the trend will become apparent at the Member State level as national regulatory systems converge toward universal banking. See discussion supra part II.B.2. In Japan, the trend is reflected in the increased securities activities permitted for banks and the increased banking activities permitted for securities companies under the New Banking Law and amended article 65 of the Securities and Exchange Law. See discussion supra part II.C.2.
199. Id.
efficient in producing financial services, where efficiency includes quality considerations as well as cost, will experience an inflow of capital.\textsuperscript{200} The effect of the competition arising from increased international trade in financial services will be to discipline domestic regulatory regimes and to force them to eliminate those inefficient regulations which impose costs on domestic industry that are disproportionate to their social benefits.\textsuperscript{201}

2. The Expected Hierarchy of Financial Service Producers
Under a Liberalized Regime of International Trade in Financial Services

U.S. and European commentators speculate that, assuming Japan continues to liberalize article 65 of its Securities and Exchange Law and that the United States retains the Glass-Steagall Act in its present form, a liberalized regime of international trade in financial services will result in the dominance of European and Japanese financial producers and the decline of the U.S. financial services industry in the world market.\textsuperscript{202} In the case of Japan, commentators attribute this result to the increasing strength of Japanese financial institutions resulting from the expansion of the domestic market for financial services and expected reform of article 65. In the case of the European Union, commentators base this prediction on the increasing dominance of E.U. financial institutions as a result of their ability to expand their asset bases and economic power under the Second Banking Directive.\textsuperscript{203}

3. Expected Effects on the U.S. Market of Increased International Trade in Financial Services

U.S. banks will not avoid competition from European and Japanese banks in the domestic U.S. market.\textsuperscript{204} As European and Japanese banks

\textsuperscript{200} Id.; The "Cost of Non-Europe" in Financial Services, supra note 163, at 249. Truly efficient production of financial services necessarily involves some degree of prudential supervision because without such regulation the international financial system will be unable to function smoothly. Id. See Global Competition, supra note 47, at 34; Mario A. Kakabadse, International Trade in Services: Prospects for Liberalisation in the 1990s, at 40 (1987).

\textsuperscript{201} Trachtman, supra note 44, at 247.

\textsuperscript{202} Hufbauer & Schmitz, supra note 183, at 319–20, 323. Hufbauer and Schmitz comment that "[i]t seems likely that European firms will now join Japanese firms in pushing US-based firms further down the league of . . . financial giants." Id. at 319–20.

\textsuperscript{203} Golemb & Holland, supra note 29, at 96; Hufbauer & Schmitz, supra note 183, at 323; Szeg, supra note 7, at 196; United States Department of the Treasury, Modernising the Financial System: Recommendations for Safer, More Competitive Banks chapter XVIII, 27 (1991); Zavvos, supra note 64, at 481.

\textsuperscript{204} Rep. LaFalce Calls U.S. Banks Complacent About Need to Compete in Global Market, supra note 189, at 721. In 1990, Representative John LaFalce (D-NY) warned that, "[j]ust as
experience further consolidation and increased financial power, they will seek new markets for expansion, including the United States. U.S. multinational banks may choose to take advantage of increased business opportunities in Europe and Japan by relocating their full operations abroad, rather than merely establishing branches or subsidiaries, in order to avoid the restrictions of the Glass-Steagall Act. Such a trend would only serve to further weaken the U.S. banking industry by causing the attrition of its strongest players.

4. Expected Effects of Increased International Trade in Financial Services on the E.U. Market

Increased competition in the European market resulting from liberalized bank powers under the Second Banking Directive might lead to a consolidation of financial institutions, increased demand for financial services (stemming from the economic growth caused by the completion of the internal market), a fall in prices of financial services of approximately five to fifteen percent, and innovation of financial products. As discussed in Part IV.C.1 above, U.S. banks with subsidiaries in the European Union will be hampered by the Glass-Steagall Act, which will prevent them from taking full advantage of increased opportunities there. Despite substantial evidence that U.S. banks will be at a competitive disadvantage in the European market, however, some commentators predict increased opportunities for U.S. banks in Europe as a result of the Second Banking Directive. These arguments are analyzed below.

Some commentators emphasize that the Second Banking Directive will greatly expand the European opportunities for banks from all countries, including the United States, because non-Member State banks will no longer have to deal with twelve separate sets of national financial institution regulations and will thus benefit from lower operational costs of doing business in the Union. This is undoubtedly true. However, because these benefits will accrue to the United States' trading partners as well, countries with more liberal banking regimes such as Japan will realize proportionally greater benefits than the United States, making any relative U.S. gain negligible.

205. Golembe & Holland, supra note 29, at 109. However, it is important to note that the impact of increasing European and Japanese power on the U.S. market will be felt over the long term, rather than the short term. Id. at 87, 93.

206. Id. at 106–08.

207. Celarier, supra note 124, at 72; Clarotti, supra note 67, at 183.

208. Oversight Hearings, supra note 31, at 154 (prepared statement of Robert L. Clarke, former Comptroller of the Currency); Matsushita, supra note 183, at 298.
Some commentators argue that countries outside the European Union, including the United States, will benefit from the expansionary and trade-generating effects of European integration and that these effects will be greater than any deflection of economic activity to the European Union.\textsuperscript{209} This argument has some merit. However, it suffers from the same fallacy as the argument above concerning the benefits of the single banking license. Because \textit{all} countries outside the Community will benefit from these effects and because the United States is already at a competitive disadvantage due to the restrictions of the Glass-Steagall Act, it follows that any \textit{relative} gain by the United States will be negligible. Although European integration will likely increase demand for financial services,\textsuperscript{210} the United States, because of the Glass-Steagall Act, is not in a favorable position to take advantage of this increased business, which can easily be absorbed by financial institutions from countries with more efficient regulatory systems, such as Japan.

5. Expected Effects of Increased International Trade in Financial Services on the Japanese Market

There are currently very few foreign financial institutions in Japan.\textsuperscript{211} Although the Japanese market has been deregulated to some extent\textsuperscript{212} and deregulation continues, this deregulation has favored Japanese financial institutions over foreign entities.\textsuperscript{213} Furthermore, it is not clear that the United States would stand to gain from further liberalization of the Japanese financial markets, even though such deregulation has long been a U.S. goal.\textsuperscript{214} U.S. banks in the Japanese market have traditionally enjoyed specialized niches that Japan created in the mid-1980s to appease demands for extensive liberalization.\textsuperscript{215} If Japan liberalizes its banking laws further, the United States may lose these profitable sources of business.\textsuperscript{216}

\textsuperscript{209} Clarotti, \textit{supra} note 67, at 183–84.
\textsuperscript{210} Id. at 184.
\textsuperscript{211} Semkow, \textit{supra} note 80, at 101.
\textsuperscript{212} See \textit{supra} part II.C.2.
\textsuperscript{213} Szegö, \textit{supra} note 7, at 195.
\textsuperscript{214} Hale, \textit{supra} note 93, at 151, 160.
\textsuperscript{215} Id.
\textsuperscript{216} Id.
E. Alternatives to the Glass-Steagall Act

1. Proposed Alternatives to a Strict Separation of Securities and Commercial Banking Activities

The arguments discussed throughout this Note suggest that reform of the Glass-Steagall Act is necessary if the U.S. banking industry is to remain competitive in the world market. Although a discussion of specific alternatives to the Glass Steagall Act is beyond the scope of this Note, some general observations concerning the possibility of reform that would be consistent with maintaining the safety and soundness of the financial system are in order. It is not necessary to completely abolish the separation of securities and banking activities in order to improve the competitiveness of U.S. banks. Ideally, the goal in deregulatory reform should be to liberalize the range of activities in which banks may engage, while retaining those prudential safeguards which are necessary to protect against the valid concerns which led to the enactment of the Glass-Steagall Act.

A number of different corporate structures could achieve this goal. Commentators have proposed various types of holding structures which would maintain a degree of separation between the securities and commercial banking activities of banks. For instance, banks could engage in securities activities through separately capitalized subsidiaries in a manner which, if the subsidiary failed, would allow the bank to retain sufficient capital so that the subsidiary’s failure would not cause the bank substantial harm. Screening could prevent the exchange of information between banking and securities departments which would otherwise give rise to

217. A complete integration of securities and banking activities, much like the German universal banking model, may not be feasible in the United States for several reasons. First, such a regime would not be compatible with the current structure of the U.S. banking system. Reform Needed to Help U.S. Banks Compete Here and Abroad, Clarke Says, supra note 52, at 521. Second, it is not clear that, if completely integrated, U.S. banks could successfully blend the divergent business cultures of commercial and investment banking, at least in the short-run. Hale, supra note 93, at 162. Finally, the powerful U.S. investment banking industry strongly opposes further expansion of banks’ securities activities, making the adoption of a universal banking system politically unlikely. Id. But see SAUNDERS & WALTER, supra note 1, at 84–236 (arguing that universal banking is a feasible and advisable alternative to the current U.S. system).

218. See Oversight Hearings, supra note 31, at 24; TREASURY REPORT, supra note 13, at 55–61; BRÖKER, supra note 2, at 84. For a discussion of several recent legislative proposals in this regard, see Fisher, supra note 4, at 231–58; Isaac & Fein, supra note 4, at 302–10. For some recent academic proposals, see SAUNDERS & WALTER, supra note 1, at 84–236 (arguing for universal banking in the United States as an alternative to the Glass-Steagall Act).

conflicts of interest. Other prudential measures include adequate disclosure requirements, to fully inform clients of financial institutions about all aspects of the institution’s business, and implementation of detailed and binding codes of conduct for financial institutions in order to prevent abuses in conflict of interest situations.

2. Reform of the Glass-Steagall Act is Important to Maintain the Safety and Soundness of the U.S. Financial System

Reform of the Glass-Steagall Act is not only consistent with maintaining safety and soundness in the financial system, it is also an important factor in maintaining the health of the U.S. banking system. The efficiency and competitiveness of a financial system are fundamentally related to its safety and soundness. As banks lose business from traditional banking activities to nonbanks, they lose important sources of capital. If the permissible range of bank activities is not expanded, banks will be unable to attract sufficient amounts of capital, threatening their safety and soundness. In addition, permitting banks a broader range of activities allows them to choose efficiently an optimal level of risk and return, which will further contribute to their continued stability.

CONCLUSION

Reform of the Glass-Steagall Act is important for the continued strength of the U.S. banking industry, both in the domestic and international arenas. Liberalizing the range of activities in which U.S. banks may engage is essential for the U.S. banking industry to meet the competitive challenges posed by E.U. and Japanese banks in the increasingly international market for financial services. Liberalization of permissible bank activities also is consistent with maintaining the continued safety and soundness of the U.S. banking industry. As bank profits are threatened by the continuing trend of nonbanks to engage in traditional banking activities, the need for banks to broaden their activities in order to maintain healthy levels of capitalization becomes more urgent.

220. Bröker, supra note 2, at 84.
221. Id.
222. Treasury Report, supra note 13, at 29, 55.
224. See Bacon, supra note 152, at A22.
225. Bröker, supra note 2, at 97–98; Bacon, supra note 152, at A22.
It is possible to effect reform of the Glass-Steagall Act while maintaining those safeguards necessary to address safety and soundness concerns; however, it will be difficult for the U.S. banking industry to maintain its viability in the long term, in the domestic or international context, if the United States retains the Act in its current form.