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A Banker’s Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services

Discount brokerage is a relatively new business, dating from the elimination of fixed brokerage commissions in 1975.1 Although discount brokerage has no single definition, the business focuses on executing customer-initiated orders.2 This concentration of function has two aspects. First, discount brokers generally do not employ a research staff or commissioned account executives,3 and so do not


Though new, discount brokers are making inroads into the business of traditional brokers. See Carrington, Discounters Are Taking Ever-Wider Slice of Broker Commissions, SIA Study Finds, Wall St. J., Mar. 7, 1983, at 7, col. 1 (market share of discounters rose from 4.5% in 1979 to 8.4% in 1982).

2. See Wriggling through the loopholes, Banker, Jan. 1982 at 7 (“Discount brokers . . . offer cheap, no-frills stockbroking services, usually doing no more than executing a client's buy or sell order.”). The Federal Reserve Board’s notice requesting comment on BankAmerica’s discount brokerage application stated that the “business would be retail-oriented and would be characterized as ‘discount brokerage.’ . . . [BankAmerica] would give no investment advice, would not recommend the purchase or sale of specific securities and would not offer to buy or sell specific securities.” Application of Bank Holding Company to Own a Securities Firm, [Current] Fed. Banking L. Rep. (CCH) ¶ 99,132, at 85,961 (Apr. 13, 1982) [hereinafter cited as BankAmerica Application].

In limiting their business to executing transactions in which they act as agents, discount brokers illustrate the typical distinction between brokers and dealers. “[A] ‘broker’ is a ‘person’ engaged in the business of effecting transactions in securities for the account of others, whereas a dealer is a person engaged in the business of buying and selling securities for his own account.” E. WEISS, REGISTRATION AND REGULATION OF BROKERS AND DEALERS 3 (1965) (footnotes omitted). The Securities Act of 1933 defines “dealer” as “any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.” 15 U.S.C. § 77b(12) (1976). The Securities and Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 all define broker and dealer separately. See 15 U.S.C. §§ 78c(a)(4), 78c(a)(5); 15 U.S.C. §§ 80a-2(a)(6), 80a-2(a)(11); 15 U.S.C. §§ 80b-2(a)(3), 80b-2(a)(7) (1976). The main distinction under all three statutes is that a broker effects securities transactions for the account of others, while a dealer acts for his own account.

3. See Shapiro, Shakeout in the discount game, INSTITUTIONAL INVESTOR, Dec. 1981, at 146, 156; cf. Behind the Shakeout in discount brokering, FIN. WORLD Feb. 15, 1982, at 46, 47 (“But the idea behind discounting is to pare down overhead by offering no research or other retail services. . . . “). One discounters's operation is almost clerical in nature: a “customer is not assigned a personal representative but deals with any available representative, who in many cases enters the customer's order in an automated execution system, which can execute

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offer any investment advice to customers. By acting only as agents in these transactions, discount brokers can charge much lower rates than traditional "full-service" brokers, as much as seventy percent lower in some cases. Second, discount brokers generally do not engage in the underwriting, market making, and dealing for their own account typical of traditional securities firms. A discount broker derives its profit from a charge on transactions, not from the promotion of an investment in particular securities.

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tion to enter the discount brokerage business, and the Federal Reserve Board is considering a rule listing discount brokerage as an acceptable bank holding company activity. The securities industry


In November 1981, Bank of America moved through its holding company, BankAmerica Corp., to acquire the parent of Charles Schwab & Co., a discount broker. See The bans are read for a bank and a broker, The Economist, Nov. 28, 1981, at 83; Friedman, Bank Bids $53 Million for Broker: BankAmerica Seeks Schwab in Stock Swap, N.Y. Times, Nov. 25, 1981, at D1, col. 6. The holding company applied to the Federal Reserve Board for permission to acquire Schwab in 1982. See BankAmerica Application, supra note 2. The Board granted permission in January 1983, see Federal Reserve Board, supra note 3, and the acquisition has since been accomplished. See Carrington, supra note 1.

Security Pacific National Bank was the next major entrant into the discount brokerage business. It initially announced only an "affiliation" with an existing discount broker, see Anything you can do . . ., The Economist, Dec. 5, 1981, at 90; Bennett, Banks Hail 2 Plans for Broker Tie: Some Wonder About Legality of Coast Move, N.Y. Times, Nov. 27, 1981, at D1, col. 6, but subsequently sought and obtained approval to organize a new discount brokerage business as an operating subsidiary of the national bank. See Security Pacific Application, supra note 7. Union Planters National Bank of Memphis, Tennessee, received similar approval from the Comptroller, see Brokerage Activities for Service Corporations, supra note 8, at 61,030. Many other large banks have entered the discount brokerage business through affiliation or otherwise. See, e.g., Wall St. J., Apr. 15, 1983, at 19, col. 1 (Citibank); Carrington, supra note 1 (Chase Manhattan Bank); Berman, Comerica breaks new ground with brokerage service, Detroit Free Press, Nov. 4, 1982, at 18, col. 2; Wall St. J., Oct. 20, 1982, at 15, col. 3 (First Wisconsin Corp.); Carrington & Gottschalk, Bank Sorties into Discount Brokerage Create Wall Street Fears of an Invasion, Wall St. J., Sept. 2, 1982, at 4, col. 2 (Citizens & Southern National Bank; Crocker National Bank); Much, Chemical Bank Joins the Wall Street Club, Industry Week, Aug. 23, 1982, at 63.

Several federal savings and loan associations have also proposed to enter the brokerage business. See S&L Brokerage Proposal, supra note 8; Brokerage Activities for Service Corporations, supra note 8. The Securities Industry Association recently estimated that 600 depository institutions are already offering some form of discount brokerage. See Carrington, supra note 1, at col. 2. The BankAmerica and Security Pacific actions have generated the most publicity to date. Each of these applications presents different legal questions, and together they cover the issues raised by the actions of other banks, so this Note will most often refer to them.

Though this Note will focus on national banks, see note 8 supra, it will refer to different regulatory authorities. Specifically, the Comptroller of the Currency regulates national banks, see 12 U.S.C. § 161 (1976) (bank examinations), while the Federal Reserve Board regulates bank holding companies and their nonbanking subsidiaries. See 12 U.S.C. §§ 1841-52 (1976). This difference in regulatory coverage does not impair legal analysis of the Glass-Steagall Act, see note 12 infra, but complicates the application of the analysis to bank holding companies. See note 138 infra.

has contested this entry, asserting that the Glass-Steagall Act re­
quires separation between investment and commercial banking. 
Though the Act does mandate some division between the two lines
of business, this Note argues that bank discount brokerage services
do not violate the Act. Part I examines the competing “accommo­
dation” and “agency” interpretations of the relevant statutory sec­
tions, concluding that the agency interpretation, which permits bank
discount brokerage operations, is superior. Part II scrutinizes this
interpretation in light of the policies of the Glass-Steagall Act and
concludes that allowing discount brokerage operations is consistent
with the statutory goals. Part III considers fairness and investor pro­
tection concerns raised by the securities industry and recommends
that bank regulations satisfy these concerns by requiring separate in­
corporation of bank discount brokerage services.

I. THE GLASS-STEAGALL ACT

The Glass-Steagall Act poses an interpretation problem because
one section seems to authorize banks to engage in discount broker­
age, while three others apparently forbid such activity. Section
24(7) of Title 12 of the United States Code, in enumerating the powers of national banks, provides that "[t]he business of dealing in securities and stock [by a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account." \(^{15}\) This language seems to allow the agency transactions typical of discount brokerage. \(^{16}\) Sections 78 and 377, however, prohibit management and ownership ties between banks and firms engaged "in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities. . . ." \(^{17}\) Simi-

\(^{15}\) 12 U.S.C. §24(7) (1976). Section 24 outlines the corporate powers of national banking associations. Paragraph 7 states, in pertinent part, that a national bank shall have the power: To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund . . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation.


17. Section 78 provides in full as follows:

No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly
larly, section 378 prohibits any person or organization "engaged in the business of issuing, underwriting, selling or distributing, at wholesale or retail, . . . stocks, bonds, debentures, notes or other securities" from also engaging in deposit banking. 18 The phrases "public sale" of securities and "selling . . . at retail" of securities arguably preclude banks from acting as brokers for the general public. 19 Although sections 78, 377, and 378 apparently operate at cross

 influence the investment policies of such member bank or the advice it gives its customers regarding investments.

 12 U.S.C. § 78 (1976). The exception clause at the end suggests that the section is primarily concerned with conflicts of interest. See also Clark & Saunders, supra note 16, at 826 (discussing potential conflicts of interest in the private placement activities of banks).

 Section 377 provides in pertinent part as follows:

 After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, floatation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. . . .

 12 U.S.C. § 377 (1976). Section 221a(b) provides that an affiliate shall include subsidiaries, firms with common ownership or same directors as the bank, and holding companies. See 12 U.S.C. § 221a(b) (1976). The test is direct or indirect majority control or majority identity of directors.

 18. 12 U.S.C. § 378 (1976). Section 378 provides in pertinent part as follows:

 (a) After the expiration of one year after June 16, 1933, it shall be unlawful —

 (1) For any person, firm, corporation, association, business trust or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: Provided, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title . . . .

 12 U.S.C. § 378 (1976). This section is a criminal statute that provides for punishment of willful violations by fines up to $5,000 and/or imprisonment up to five years. See 12 U.S.C. § 378(b) (1976).

 19. Two commentators have argued, however, that § 378 allows banks to engage in agency transactions because it permits national banks to buy and sell "investment securities . . . to the extent permitted . . . by the provisions of [§ 24(7)]." 12 U.S.C. § 378 (1976); see note 18 supra; Luse & Olson, supra note 12, at 23, col. 1. Luse and Olson contend that because § 378 refers to investment securities, which are by nature debt instruments, Congress intended to permit brokerage transactions involving equity securities. They base this reasoning on the fact that § 24(7) authorizes purchases and sales of "investment securities and stocks solely upon the order, and for the account of customers . . . ." 12 U.S.C. § 24(7) (1976) (emphasis added); see note 15 supra. If Congress intended § 378 to preclude purchases and sales of equity as well as debt securities, that prohibition would be inconsistent with the permissive language of § 24(7).

 Luse & Olson, supra note 12, at 23, col. 1. Similarly, the Federal Deposit Insurance Corporation has stated that "[t]he exception for dealing in securities upon the order of customers is incorporated into the first paragraph of § 378 and thus applies to member and nonmember banks alike." FDIC Policy Statement, supra note 8, at 38,985 n.3.

 However, § 24(7) specifically uses the term "investment securities" in the course of granting the Comptroller authority to allow a bank to "purchase for its own account investment securities." 12 U.S.C. § 24(7) (1976). Combining the proviso in § 378 with the specific language of § 24(7) lends support to the conclusion that banks can buy and sell "investment securities" with the Comptroller's permission — it does not indicate that § 378 is so inconsistent with § 24(7) that it must be read to permit agency transactions.
purposes with section 24(7), Congress intended the four together to “approach the legislative goal of separating the securities business from the banking business.”

Two interpretations have been advanced to reconcile these provisions. The “accommodation theory” would permit banks to execute brokerage services for existing customers, but would prohibit general public solicitation of brokerage clients. This approach interprets the prohibitions against “public sale” in sections 78 and 377, and against “selling . . . at retail” in section 378 to encompass solicitations of the public at large. The accommodation theory then reads

20. Board of Governors of Federal Reserve System v. Investment Co. Inst., 450 U.S. 46, 62 (1981); see notes 45-52 infra and accompanying text. Section 24(7) limits the securities activities in which banks can engage. Section 378 prohibits a securities firm from engaging in the banking business. 450 U.S. at 62. Sections 77 and 377 complete the separation by prohibiting the common management or common ownership of a bank and a securities firm. See generally Clark & Saunders, Judicial Interpretation of Glass-Steagall: The Need for Legislative Action, 91 BANKING L.J. 721, 727-28 (1980).

This separation of activities has a meandering statutory history. The National Bank Act was silent on the power of banks to deal in securities. See The National Bank Act, ch. 100, § 8, 13 Stat. 99, 101 (1864). Construing the corporate powers strictly, see note 15 supra, the Supreme Court read this omission as prohibiting a national bank from dealing in stocks for its own account. See First Natl. Bank v. National Exchange Bank, 92 U.S. 122, 128 (1875) (prohibition implied from failure to grant the power); California Bank v. Kennedy, 167 U.S. 362, 367, 370 (1897). State banks, however, started to engage in various aspects of the securities business, often through their trust departments. See Perkins, The Divorce of Commercial and Investment Banking: A History, 88 BANKING L.J. 483, 487-89 (1971). Federally chartered national banks responded to this competitive challenge by setting up securities affiliates. Id. at 489-90.

The McFadden Act, ch. 191, 44 Stat. 1224 (1927) (codified in scattered sections of 12 U.S.C.), provided a belated legal foundation for these national bank affiliates. This Act, in the words of a supporter, “contain[ed] no grant of power at all to national banks to engage in the purchase and sale of investment securities, and merely recognize[d] the existing practice . . . .” 68 CONG. REC. 3580 (1927) (remarks of Sen. Pepper). It allowed banks to buy and sell “without recourse marketable obligations . . . in the form of bonds, notes and/or debentures, commonly known as investment securities . . . . ” McFadden Act, ch. 191, § 2(b), 44 Stat. 1224, 1226 (1927). The Act, which was mainly concerned with branch banking, see Perkins, supra, at 493-95, left many questions unanswered. It did not define the scope of the “existing practice,” or whether banks could perform these services directly without the use of affiliates.

Congress added the four sections at issue here in part to cut back on the latitude given banks by the McFadden Act. See notes 45-52 infra and accompanying text.

21. “Existing customers” are those who come to the bank for a service other than brokerage. The term does not have precise conceptual boundaries but is meant to distinguish those members of the general public who would be attracted to the bank by and use only the discount brokerage services. See New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091, 1097 (D.D.C. 1975), vacated as not ripe for decision sub nom. New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978) (accommodation requires that customer relations exist independently of service).

22. See New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091, 1097 (D.D.C. 1975), vacated as not ripe for decision sub nom. New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978); Security Pacific Application, supra note 7, at 86,256-57; Luse & Olson, supra note 12, at 22, col. 1. This theory is often read to prohibit banks from making a profit on the transaction, thus compelling them to price their brokerage services at cost. For an explanation of the origin of the at-cost limitation and analysis of its validity, see notes 32-33 infra.
section 24(7) as a narrow exception to the general prohibition: A bank can execute brokerage transactions only for "customers" who have a preexisting, nonbrokerage relationship with the bank. This theory, at one time advanced by the Comptroller of the Currency, has since been advocated by representatives of the securities industry and might effectively prevent banks from operating discount brokerage services.

The "agency" interpretation of these sections emphasizes that discount brokers do not sell their own securities; they sell their services. According to agency theory, section 24(7) permits a bank to sell its services, as a broker-agent, to anyone. The agency approach holds that section 24(7)'s limitation language, which allows a national bank to deal in securities and stock "solely upon the order, and for the account of, customers, and in no case for its own account," does not limit the bank's potential brokerage clients, but only bars a bank from dealing for its own account. The three other

23. The Comptroller stated in 1933 that bank agency transactions in securities were an "accommodation" service especially important to rural areas. See 1933 ANNUAL REPORT OF THE COMPTROLLER OF THE CURRENCY 11. In 1935, the Comptroller restated this interpretation in explaining minor changes in § 24(7). Hearings on H.R. 5357 Before the House Committee on Banking and Currency, 74th Cong., 1st Sess. 663 (1935) (statement of J.F.T. O'Connor, Comptroller of the Currency). Subsequent Comptrollers have abandoned this position. See note 32 infra.


25. At least a bank could not advertise the service, or offer it to anyone but its preexisting customers.

26. In discussing a more limited bank brokerage plan, the district court for the District of Columbia stated that "[these limited brokerage] banks merely sell a service to customers who have independently chosen a form of investment. Banks which offer to deduct automatically from a customer's account utility bills or mortgage payments are not selling electricity or mortgages; banks offering to deduct security purchases are not selling securities." New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091, 1099 (D.D.C. 1975), vacated as not ripe for decision sub nom. New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978). Another commentator describes the brokerage business as service oriented:

L. SHEPARD, supra note 6, at 3; see generally notes 2-7 supra and accompanying text. Unlike the automatic investment service plan at issue in Smith, however, recent bank discount brokerage announcements have stated that the banks will not merely deduct purchases from accounts, but will also make margin loans. See note 7 supra.

27. The notion that brokerage services are legal only if offered to customers, and that one can become a customer simply by having the service offered to him may seem circular. However, a "customer" in normal business practice is any person presently willing to purchase a service, and not only one who has had previous business dealings with the bank. See note 21 supra.

28. Both the accommodation and agency interpretations agree that § 24(7) prohibits banks from dealing for their own account. This prohibition is at first stated flatly, but subsequent provisos limit its application. See note 15 supra. The first proviso is that "the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe." 12 U.S.C. § 24(7) (1976). The
sections would still retain their vitality under this approach: Banks still could not publicly sell stock and securities as principals, nor could banks have ownership or management ties with firms that do sell as principals. The agency interpretation imputes an essential function to each section without straining the meaning of "customer" by modifying it with the implied term "preexisting."

One court has applied the agency interpretation to a more limited bank brokerage plan. In addition, current regulatory authorities

Comptroller's regulations appear in 12 C.F.R. § 1 (1982). These regulations permit banks to deal in, underwrite, purchase and sell without limitation for their own account certain government obligations, while other government agency securities may be subject to limitations on amount held, as well as possible prohibitions on dealing or underwriting. See 12 C.F.R. § 1 (1982); see also 12 U.S.C. § 24(7) (1976). This three-tier system is based on the nature of the security and is described briefly in Karmel, Glass-Steagall: Some Critical Reflections, 97 BANKING L.J. 631, 633-34 (1980).

29. Even under an agency interpretation § 378 would still retain its function by prohibiting firms that underwrite or deal for their own account from engaging in banking activities.

The Federal Reserve Board has given those sections a different interpretation. The Board noted that "public sale" in §§ 78 and 378 appeared in the middle of terms like "issue," "flotation," "underwriting" and "distribution." Under the rules of statutory construction, words listed in a group are often given a related meaning. See, e.g., Third Natl. Bank in Nashville v. Impac Ltd., 432 U.S. 312, 322 (1977). Thus, the Board reasons that this group of terms "generally refer[s] to the process by which new issues or large blocks of securities are distributed to the public, not to brokerage functions, which are primarily concerned with the transfer of securities at the request of a particular customer. The term 'public sale' used in association with this series of terms should be given a meaning similar to those terms . . . ." Federal Reserve Board, supra note 3, at 114 (footnote omitted). The Board also suggested that the failure of § 377 to include the term "brokerage" in its language belied an intention to ban profit-oriented agency businesses. Id. Through this interpretation, the Board found that Glass-Steagall did not preclude a bank holding company from acquiring a discount brokerage operation. See also note 36 infra.

One could argue that a "natural" interpretation of the other three sections would permit discount brokerage as the selling of securities. The textual argument may be open to a charge of semantic shuffling at this point, but Part II demonstrates that the policies of Glass-Steagall and an accurate analysis of discount brokerage ultimately support this interpretation. In other words, Part II establishes that within the framework of Glass-Steagall the initially debatable distinction between selling one's own securities and selling someone else's becomes dispositive.

30. Early Comptrollers effectively included this implied term. See note 32 infra. If the Glass-Steagall Congress had really intended this meaning, it would have modified "customer" with "preexisting" instead of emphasizing the prohibition on transactions for the bank's own account. See note 15 supra and accompanying text. This observation is especially significant because Congress inserted the word "customer" in 1933. The earlier regulation of bank activities, the McFadden Act, did not contain the term: Provided, That the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities, under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency . . . .

McFadden Act, ch. 191, sec. 2(b), 44 Stat. 1224, 1226 (1927) (current version at § 24(7) (1976)).

have accepted the legality of bank discount brokerage services even when those services involve the public solicitation of new clients.\footnote{32}

permits national banks to purchase and sell securities if (1) the bank acts as agent for a customer, (2) the transactions are without recourse, (3) the transactions are initiated solely upon the order of the customer, and (4) the transactions are for the account of the customer and not for the bank's account. See 404 F. Supp. at 1097. This reading of \$ 24(7) would also permit discount brokerage. See notes 2-7 \supra and accompanying text.

32. See Federal Reserve Board, \supra note 3, at 114-15; Security Pacific Application, \supra note 7 (Comptroller of Currency); S & L Brokerage Proposal, \supra note 8 (Federal Home Loan Bank Board); FDIC Policy Statement, \supra note 8.

The weight that should be given to this regulatory approval is not clear. While the Supreme Court has relied extensively on regulatory rulings in the banking area, see, e.g., Board of Governors v. Investment Co. Inst., 450 U.S. 140, 145 (1980) (particular Board determination entitled to the greatest deference") (footnote omitted); Investment Co. Inst. v. Camp, 401 U.S. 617, 626-27 (1971) (more deference due when regulator issues "deliberative" opinions than when an explanation does not accompany an interpretation), the regulatory history of bank brokerage services is somewhat convoluted.

The Comptroller originally used the term "accommodation" to describe the scope of permissible brokerage activities under \$ 24(7). See note 23 \supra. The Comptroller adopted this interpretation shortly after the passage of Glass-Steagall; in resolving ambiguous sections, the courts ordinarily give great weight to regulatory interpretations made contemporaneously with enactment. National Lead Co. v. United States, 252 U.S. 140, 145 (1920); cf. NLRB v. Bell Aerospace Co., 416 U.S. 267, 274-75 (1974) (legislative inaction subsequent to an agency ruling signals tacit legislative approval of the agency's interpretation of the statute). A later Comptroller noted, however, that "neither the word nor the idea of the 'accommodation' limitation appears in the statute or in any committee or floor comments." Bank AIS, \supra note 31, at 81,338. In 1935, the word "accommodation" worked its way into the history of \$ 24(7). The Comptroller, commenting on a small change to \$ 24(7) imposed by the Banking Act of 1935, ch. 614, 49 Stat. 684 (codified in scattered sections of 12 U.S.C. (1976)) stated that the revision "makes it clear that \$ 24(7) of the Banking Act of 1933 was not intended to prohibit national banks... from buying or selling stock for the account of their customers and as an accommodation thereto and not for their own account." \textit{Hearings on H.R. 5337 Before the House Committee on Banking and Currency, 74th Cong., 1st Sess.} 633 (1935) (Statement of J.F.T. O'Connor, Comptroller of the Currency) (emphasis added), \textit{reprinted in Bank AIS,} \supra note 31, at 81,358. Though Congress approved the revision, allowing banks to buy \textit{stocks} as well as securities on behalf of their customers, neither House nor Senate Report used the term accommodation. See \textit{H.R. Rep. No. 742, 74th Cong., 1st Sess.} 18 (1935); \textit{S. Rep. No. 1007, 74th Cong., 1st Sess.} 17 (1935).

The Comptroller did not actually explain what he meant by "accommodation" until 1936. Banks could only perform the "accommodation" service for existing customers, without any extension of credit, and only on a nonprofit basis. \textit{1 Bull. of the Comptroller of the Currency}, No. 2 at 2-3 (Oct. 21, 1936). In 1957, the Comptroller relaxed the nonprofit limitation, but retained the preexisting customer requirement. See Comptroller of the Currency, \textit{Digest of Opinions Relating to National Banks,} \textit{\$ 220A} (1957), \textit{quoted in Bank AIS,} \supra note 31, at 81,357. In 1961, the Comptroller replaced the \textit{Digest of Opinions with a Comptroller's Manual for National Banks.} This \textit{Manual} has never defined the scope of bank brokerage activities. See \textit{Bank AIS,} \supra note 31, at 81,357. Recent Comptrollers have rejected the accommodation theory completely, terming it "ultra-conservative" and a reflection of "the
More important, the Supreme Court assumed in *Board of Governors of the Federal Reserve System v. Agnew*\(^{33}\) that section 78, which prohibits common management between national banks and firms that engage in the "public sale . . . of stock, bonds, or other similar securities,"\(^{34}\) does not encompass brokerage activities.\(^{35}\) Though the Court in *Agnew* assumed rather than ruled on the scope of the "public sale" language, the case strongly implies that sections 78 and 377
great caution of banking regulations in the years immediately following the 1931-2 debacle."*Bank AIS, supra* note 31, at 81,358, 81,360; see *Security Pacific Application, supra* note 7, at 86,257.


33. 329 U.S. 441 (1947).

34. 12 U.S.C. § 78 (1976); see note 17 *supra*.

35. The Court considered whether a firm was "primarily engaged" in securities activities for purposes of 12 U.S.C. § 78. 329 U.S. at 446-49. If the Court had found that the firm engaged primarily in activities defined in § 78, then that section's common management prohibition would have prevented any of the firm's employees from serving as a director of a national bank. See note 17 *supra* and accompanying text.

In the fiscal year ending in February, 1944, the firm derived 32% of its gross income from underwriting and 47% from brokerage activities. 329 U.S. at 445. If the Court had included brokerage services along with dealing and underwriting, it would have held that the firm obtained over half of its income from activities prohibited by § 78. See note 17 *supra* and accompanying text. Yet the Court evidently did not conclude that brokerage activities fell within the scope of § 78. In fact, the Court indicated that the underwriting field encompassed the section's "public sale" language. 329 U.S. at 445 n.3; cf. note 29 *supra* (similar interpretation by the Federal Reserve Board). This analysis is consistent with the Court of Appeals opinion, in which Judge Prettyman noted that the Federal Reserve Board, in 1945, considered "issue, flotation, underwriting, public sale or distribution, at wholesale or retail or through syndicate participation of stocks, bonds or other similar securities" as meaning "underwriting." *See Agnew v. Board of Governors of the Federal Reserve System*, 153 F.2d 785, 787 n.3 (D.C. Cir. 1946), *rend. on other grounds*, 329 U.S. 441 (1947). The court further noted that "[u]nderwriting and brokerage, although both concerned with securities, are vastly different operations." 153 F.2d at 787. While the Supreme Court and the Court of Appeals thus excluded brokerage services from the "public sale" language of 12 U.S.C. § 78.
do not prohibit bank brokerage activities. More recent Supreme Court analysis supports this conclusion, although dicta in two cases can be read to support either the accommodation or the agency theory.

Apparent judicial acceptance of the agency interpretation assumes greater significance in light of several flaws inherent in the accommodation theory. First, as noted before, the theory requires that “customer” in section 24(7) be read as “preexisting customer.”

36. “[I]f brokerage were involved within the type of securities actively prohibited by [12 U.S.C. § 78], there would have been no issue to decide in Agnew.” Luse & Olson, supra note 12, at 23, col. 1.

37. In Investment Co. Inst. v. Camp, 401 U.S. 617 (1971), the Court analyzed the underlying concerns of Glass-Steagall as applied to bank entry into the mutual investment fund business. After a thorough discussion of the abuses leading to passage of the Act, the Court concluded:

These are all hazards that are not present when a bank undertakes to purchase stock for the account of its individual customers. . . . [This purchasing activity], unlike the operation of an investment fund, does not give rise to a promotion or salesman’s stake in a particular investment; . . . it does not entail a threat to public confidence in the bank itself; and it does not impair the bank’s ability to give disinterested service as a fiduciary or managing agent. In short, there is a plain difference between the sale of fiduciary services and the sale of investments.

401 U.S. at 638 (emphasis added) (footnote omitted). Similarly, the Court noted in Board of Governors v. Investment Co. Inst., 450 U.S. 46, 63 (1981) (ICI-II) that “[t]he management of a customer’s investment portfolio — even when the manager has the power to sell securities owned by the customer — is not the kind of selling activity that Congress contemplated when it enacted [§ 21 of the Glass-Steagall Act. 12 U.S.C. § 378 (1976)].” This language apparently supports very broad brokerage powers for banks that do not deal as principals.

In spite of its broad language and favorable holding, ICI-II also stated that § 378 “was intended to require securities firms such as underwriters or brokerage houses to sever their banking connections.” 450 U.S. at 63 (emphasis added). The Securities Industry Association has argued that this phrase limits bank brokerage activities, but the Federal Reserve Board dismissed the dicta as a “passing remark” upon which reliance was “misplaced.” Federal Reserve Board, supra note 3, at 116 n.54. The Board noted that ICI-II did not consider brokerage activity alone, and that most “brokerage houses” also perform other functions such as dealing or market making. Other statements in both Camp and ICI-II are superficially relevant, but they also suffer from inconsistency. Compare ICI-II, 450 U.S. at 55 (“[A] bank regularly buys and sells securities for its customers.”) and Camp, 401 U.S. at 624-25 (“No provision of the banking law suggests that it is improper for a national bank . . . to purchase stock for the account of its customers.”) with ICI-II, 450 U.S. at 70 (Glass-Steagall’s purpose was to separate “as completely as possible commercial from investment banking”) and Camp, 401 U.S. at 629-30 (Congress was concerned with banks’ “direct and indirect involvement in the trading and ownership of speculative securities.”) (footnote omitted).

In fact, one could easily rely on dicta from the relevant cases to conclude that Glass-Steagall does not bar bank discount brokerage operations. Agnew’s assumption that § 78’s “public sale” language does not encompass brokerage activities, see notes 33-36 supra and accompanying text, arguably applies to § 377’s “public sale” language as well. See also note 29 supra (Federal Reserve Board interpretation of “public sale”). Under this approach, only § 378 remains to limit the agency language of § 24(7). This last restriction arguably vanishes in a loosely worded footnote in ICI-II where the Court stated that “[§ 378] cannot be read to include within its prohibition separate organizations related by ownership with a bank . . . .” 450 U.S. at 58 n.24. Since § 378 would therefore not include a bank subsidiary, a subsidiary could engage in brokerage activity without any problem. However, reliance on these snatches of language does little to advance the analysis of the problem. This Note assumes that a superior justification for allowing discount brokerage services lies in an examination of the policies underlying the Glass-Steagall Act. See Part II infra.

38. See notes 21 & 30 supra and accompanying text.
Second, this implied modifier is an unworkable limitation because a bank can avoid it simply by requiring a prospective client to open up an account before using the bank's brokerage services. Third, the distinction drawn by the theory seems nonsensical because it would simply limit discount brokerage activities to those banks with many preexisting customers. No one could seriously argue that such a limitation would handicap the Bank of America.

In addition, the accommodation theory raises serious statutory and constitutional questions to the extent that it improperly limits public advertisement of discount brokerage services. The Supreme Court has already rejected, on statutory grounds, state restrictions on bank advertising because it could not accept the notion "that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business." The Court has also indicated its willingness to control regulation of commercial speech on constitutional

39. A requirement, for example, that a small savings or checking account be opened before establishing a brokerage relationship would be meaningless. A prohibition against opening an account just for the purpose of securing brokerage services would also be unenforceable, since the customer's intent could not be ascertained. Such prohibitions would be nothing more than restrictions on effective marketing of an admittedly authorized activity. Luse & Olson, supra note 12, at 22, col. 2. See also New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091, 1097 (D.D.C. 1975), vacated as not ripe for decision sub nom. New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978).

40. In 1980, for example, the Bank of America had 1.3 million VISA and Mastercharge cardholders, plus depositors. See Bank of America expands automated card program, 72 A.B.A. BANKING J. 110, 110 (Sept. 1980).

41. Franklin Natl. Bank v. New York, 347 U.S. 373, 377 (1954). The case presented the "narrow question whether federal statutes which authorize national banks to receive savings deposits conflict with New York legislation which prohibits them from using the word 'saving' or 'savings' in their advertising or business." 347 U.S. at 374. Section 24 of the Federal Reserve Act, as amended by the McFadden Act, ch. 191, § 16, 44 Stat. pt. 2 1224, 1232-33 (1927) (amended 1974, 88 Stat. 716, 725, codified as amended, 12 U.S.C. § 371 (1976)), permitted national banks "to receive time and savings deposits"; 12 U.S.C. § 24(7) grants national banks power "[t]o exercise ... all such incidental powers as shall be necessary to carry on the business of banking ... by receiving deposits ..." Neither of these statutes expressly authorizes advertising of any service, let alone the advertising of savings accounts or the use of the word "savings." Nevertheless, the Court found advertising necessary within the scope of § 24(7)'s incidental powers clause. The Court refused to construe the two Federal Acts as permitting only a passive acceptance of deposits thrust upon [national banks]. Modern competition for business finds advertising one of the most usual and useful of weapons. ... It would require some affirmative indication to justify an interpretation that would permit a national bank to engage in a business but gave no right to let the public know about it.

347 U.S. at 377-79. Thus the Court followed a two-step analysis: first it isolated the statutory authority for a function, then applied a strong presumption in favor of advertising that function. Here the presumption, though implied from the incidental powers clause of § 24(7), was strong enough to override conflicting state law under the Supremacy Clause.

Application of this two-part analysis suggests that banks can advertise their brokerage services. First, even the accommodation theory acknowledges that § 24(7) authorizes banks to conduct some brokerage transactions. Absent any "affirmative indication" to the contrary then, banks can advertise discount brokerage services.
grounds. Because bank advertising is difficult to limit, and because banks can easily avoid the "preexisting customer" requirement, the accommodation theory reduces to a single restriction: banks cannot make a profit on their discount brokerage business. This conclusion is not supported by Glass-Steagall's sparse legislative history, which indicates that banks can continue to offer profitable brokerage services just as they had before the Act.

Given the consistency of bank discount brokerage services with Agnew's interpretation of Glass-Steagall and the problems posed by the invocation of customer "accommodation," no interpretative reason favors the accommodation theory over an agency rationale. The courts should adopt the agency interpretation to the extent that it is consistent with the goals of Glass-Steagall.

II. BANK DISCOUNT BROKERAGE SERVICES AND THE POLICIES OF THE GLASS-STEAGALL ACT

This Part analyzes whether bank discount brokerage operations conflict with the purposes of the Glass-Steagall Act. If the agency interpretation is consistent with the goals of the statute, then Glass-Steagall poses no legal bar to banks offering discount brokerage services. Analysis of these goals demonstrates that Glass-Steagall does not, in fact, bar these services. The Act prevents abuses that bank agency brokerage transactions simply do not cause.

The broad goal of the statute was "to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression." The major feature of the Act, the


At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest.

447 U.S. at 566. The application of these steps to bank brokerage activities is straightforward. As the accommodation theory concedes, banks can conduct some brokerage activities. Thus, the speech would concern a "lawful activity." The inquiry concerning governmental interests is conducted in Part II of this Note. These alleged interests, the policies of the Glass-Steagall Act, are not implicated at all by bank discount brokerage services. In fact, no governmental unit is asserting these interests; the relevant regulatory agencies are willing to permit bank advertising of brokerage services. See note 32 supra and accompanying text.

43. See notes 22, 32 supra.

44. See note 49 infra.

45. Board of Governors of the Federal Reserve System v. Investment Co. Inst., 450 U.S. 46, 61 (1981). See also Clark & Saunders, supra note 18, at 723, 725 ("By 1933, nearly 9,000 U.S. banks had failed, largely due to the enormous stock markets losses which the banks had sustained from speculative investments."); Note, A Conduct-Oriented Approach to the Glass-Steagall Act, 91 YALE L.J. 102, 103 (1981); Comment, supra note 12, at 779.
creation of federal deposit insurance,46 aimed to achieve this goal by increasing depositor confidence in the banking system.47 Congress intended the provisions at issue here to protect depositors by divorcing commercial from investment banking, and in so doing, to avoid undue risks in commercial banking.48 Unfortunately, Congress never discussed the extent to which brokerage activities increase these risks. The legislative history details the particular activities — such as underwriting and dealing — that Congress clearly meant to separate from commercial banking, but it barely touches upon the scope of permissible brokerage operations.49 In Investment Co. Inst.

46. See Board of Governors of the Federal Reserve System v. Investment Co. Inst., 450 U.S. 46, 61 n.27 (1981); J. White, Banking Law 319 (1976) ("The Act's most controversial provisions, those creating the FDIC, overshadowed the provisions relevant to the [Camp] case.").

47. A leading banking lawyer has stated that "investment banking community insulation was an incidental side effect of legislation passed almost a half century ago that was mainly intended to protect bank depositors and restore public confidence in the commercial banking system. Of Glass-Steagall's 34 sections, only 5 deal with securities matters — and then only in relation to protecting domestic depositors of banks." Angermueller, Commercial vs. investment bankers: The Case For, 55 Harv. Bus. Rev., Sept.-Oct. 1977, at 132, 133-34.

48. See Board of Governors of the Federal Reserve System v. Investment Co. Inst., 450 U.S. 46, 61-62 (1981); Sametz, Background of the Controversy over Banks' Securities Activities — A Briefing, in Securities Activities of Commercial Banks 3-4 (A. Sametz ed. 1981) ("Clearly the purpose of the prohibitions concerning the structure of bank assets was to safeguard the 'soundness' of banks through the protection of the resources of the banking system . . ."); Senterfitt, supra note 12, at 18 ("Quite obviously, the concern uppermost in the mind of the Congress when it included [the four securities sections] in the [Glass-Steagall Act] was to stop the tidal wave of bank failures and to prevent such failures in the future.").

49. See Federal Reserve Board, supra note 3, at 115 (concluding that since harmful activities were "exhaustively catalogued," while brokerage activities were rarely discussed, the Act did not intend to prohibit bank brokerage services).

The only discussion of the crucial § 24(7) language occurs in several committee reports. The 1932 Senate Report states: "National banks are to be permitted to purchase and sell investment securities for their own customers to the same extent as heretofore . . . ." S. Rep. No. 585, 72d Cong., 1st Sess. 15 (1932) (emphasis added); see S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933) (similar language); H.R. Rep. No. 150, 73d Cong., 1st Sess. 3 (1933) (similar language); Luse & Olson, supra note 12, at 22, col. 1 (committee reports constitute only legislative history that comments on § 24(7)). Unfortunately, determining the scope of brokerage activities before 1933 is an almost impossible task. Several authorities point to a series of cases admitting extensive bank brokerage activities. See New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091, 1098 (D.D.C. 1975) (cases indicate more extensive brokerage activity than the accommodation theory would allow), vacated as not ripe for decision sub nom. New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978); Security Pacific Application, supra note 7, at 86,258. Only one case cited, however, did not involve a preexisting customer relationship with the bank. See Greenfield v. Clarence Sav. Bank of Clarence, 5 S.W.2d 708 (Mo. Ct. App. 1928) (client left $2,000 with the bank to purchase bonds through the bank). The remaining cases did not even focus on the legality of bank brokerage activities. See, e.g., Blakely v. Brinson, 286 U.S. 254 (1932); McNair v. Davis, 68 F.2d 935 (5th Cir.), cert. denied, 292 U.S. 647 (1934); Mark v. Westlin, 48 F.2d 609 (D. Minn. 1931); Dyer v. Broadway Natl. Bank, 252 N.Y. 430, 433, 169 N.E. 630, 635 (1930) (recognized that banks purchased stocks for customers). In any event, these cases certainly did not deal with deals on the scale of discount brokerage. Cf. New York Stock Exch., Inc. v. Smith, 404 F. Supp. 1091, 1098 (D.D.C. 1975) (cases do not reveal operations as extensive as the AIS plan at issue, though they do indicate an agency role for banks), vacated as not ripe for decision sub nom. New York Stock Exch., Inc. v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S 942 (1978). Given the uncertain scope of these cases, and the corresponding uncertainty in
v. Camp, however, the Supreme Court analyzed in detail the particular risks and abuses that Congress intended to eliminate in separating commercial from investment banking. The risks guarded against range from "financial dangers" to the "more subtle hazards" inherent in mixing the two lines of business. The extensive delineation of these hazards in Camp provides a comprehensive framework for evaluating the legality of bank discount brokerage operations.

A. Promotional Pressures of Investment Banking

Congress believed that the "aggressive and promotional character of the investment banking business" would create unfortunate "temptations" for commercial bankers. These temptations could take several forms. A bank selling particular securities would have a "salesman's interest" in promoting those securities, an interest incompatible with impartial evaluation of credit risks. Alternatively, the bank affiliate's interest in particular securities might distort credit decisions, causing the bank to make imprudent loans to "companies in whose stock or securities the affiliate had invested or otherwise become involved." Finally, a bank with promotional concerns

the legislative history, this Note will analyze the issue by examining the policies of Glass-Steagall. Because discount brokerage did not exist until 50 years after the passage of the Act, the vague legislative history is not a reliable indicator of congressional approval or disapproval of bank discount brokerage operations.

50. 401 U.S. 617 (1971). In this case, the Court struck down the Comptroller's approval of bank management of mutual investment funds.

51. See 401 U.S. at 630-34, 636-38.

52. 401 U.S. at 630.


54. 401 U.S. at 632 (footnote omitted).

55. 401 U.S. at 631.

56. 401 U.S. at 631; see Note, supra note 45, at 104-05.

57. 401 U.S. at 631; see also 75 Cong. Rec. 9912 (1932) (statement of Sen. Bulkley); Note, supra note 45, at 104-05.

The theoretical validity of this unsound loan proposition is not obvious. If an affiliate were holding worthless securities, a bank would face two options. First, it could let the issuing company flounder without an extension of credit. The bank's affiliate would suffer a loss, but the bank would presumably be insulated by separate incorporation. The loss to its affiliate would reflect on the bank only to the extent of the closeness of association in the public mind. The bank's second option would be to extend credit to the troubled company to avert the loss to its affiliate. This raises the immediate possibility that a bank would have to loan more than the value of the securities held by its affiliate in order to help the troubled company, or that the loan would be in addition to the securities, thereby increasing the total exposure of the bank-affiliate entity. Even in a more restricted case, where the bank loan would somehow pay off the affiliate's securities, the risk and loss would be transferred directly within the bank, which would thereby lose its limited liability and the public relations advantages of separate incorporation. That a bank would choose the second option over the first appears irrational. A further point is that the theory almost necessarily assumes that the loan will go bad. If
would face conflicts of interest; it might protect its own investments at a customer's expense.\footnote{Michigan Law Review [Vol. 81:1498}}

The concerns that motivated congressional enactment of Glass-Steagall are not relevant to a bank discount brokerage operation. All of them are related to "the investment banker's pecuniary stake in the success of particular investment opportunities"\footnote{Michigan Law Review [Vol. 81:1498}} and thus pertain only to the dealing and underwriting functions of investment banking. Discount brokers neither sell nor have a financial interest in particular securities. Thus, they have neither direct investments to protect nor a salesman's promotional interest in the securities.\footnote{Michigan Law Review [Vol. 81:1498}} At most, a bank might be tempted to make unsound loans to companies in which brokerage customers had invested.\footnote{Michigan Law Review [Vol. 81:1498}} However, a bank probably would not make risky loans solely to prevent losses to customers, especially where the bank brokerage service did not promote the stock.\footnote{Michigan Law Review [Vol. 81:1498}}

However, the discount brokerage business, and particularly bank discount brokerage, might produce two of the promotional pressures that motivated Congress to pass Glass-Steagall. First, while brokers feel no pressure to sell a specific investment, "[a]ny discount business... depends on generating a large volume of sales."\footnote{Michigan Law Review [Vol. 81:1498}} The cost the loan is not "unsound," but instead would help the troubled company on its way, then the second option would be preferable, but the supposed evil of the system would not exist.

\footnote{58. 401 U.S. at 633. One Senator stated: Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits. 75 CONG. REC. 9912 (1932) (statement of Sen. Bukley).}

\footnote{59. 401 U.S. at 634; see also 401 U.S. at 631.}

\footnote{60. See Federal Reserve Board, supra note 3, at 116. Discount brokerage services do not generate pressure to unload worthless securities on customers, nor would the bank have an opportunity to profit through a differential in selling and buying prices. The profit stems solely from the commissions on buying and selling. See text at notes 63-67 infra.}

\footnote{61. One might argue that a bank may make loans to corporations in which its brokerage customers had invested in order to boost the market value of the stock and thereby attract new customers. The potential for abuse arising from this conflict would seem to be minimal since it is highly unlikely that a bank would risk making unsound loans solely for the comparatively insignificant increment in revenues from new brokerage customers. Lüse & Olson, supra note 12, at 22, col. 3; note 57 supra.}

\footnote{62. Should banks limit their brokerage transactions to agency transactions, they would avoid promotional activity in the same way as do discount brokers. See notes 3-5 supra and accompanying text.}

\footnote{63. Behind the shakeout in discount brokering, supra note 3, at 47.}

Brokerage fees are usually determined as a percentage of the value of each transaction, (frequently with a minimum or maximum also), so quantity and amount would be positively correlated to the income. See S. JAFFE, BROKER-DEALERS AND SECURITIES MARKETS 306-25 (1977) (description of commissions with analysis of rules designed to curb this volume incentive).
of maintaining a large-scale discount brokerage business could add to the pressure. The need for volume might tempt banks to extend credit through margin loans in order to facilitate securities purchases. Although a bank's ability to make margin loans raises issues of competitive fairness and investor protection, such loans do not threaten the interests of depositors. Two separate regulatory authorities already police “margin” loans. Under authority of the securities laws, the Federal Reserve Board controls margin purchases of stock and securities. In addition, although the Comptroller of the Currency does not directly regulate bank loans, it closely examines the lending practices of banks. If the practices

64. See Angermueller, supra note 47, at 135 (“Commercial banks have discovered, as securities firms have learned before them, that the cost of maintaining a large-scale retail brokerage operation is heavy.”). See also Security Pacific Application, supra note 7, at 86,256 (subsidiary eventually intends to offer services at non-branch locations inside and outside California and may also seek membership on one or more national securities exchanges); Wriggling through the loopholes, supra note 2 (“Bank of America . . . will end up owning a membership on several stock exchanges through Schwab . . .”).

65. See Investment Co. Inst. v. Camp, 401 U.S. 617, 632 (1971); S. REP. No. 77, 73d Cong., 1st Sess., 9-10. This concern would be more acute for discount brokers than for traditional brokers because of the heightened need for volume in discount brokerage.

66. See notes 160-72 infra and accompanying text.

67. In fact, several commentators have asserted that concerns about unwise extension of credit are not significant at all. See Luse & Olson, supra note 12, at 22, col. 3 (“[I]t is unlikely that for the sake of commissions, banks would make unsound loans to individuals in order to induce them to purchase securities through the bank.”); Note, Bank-Sponsored Investment Services: Statutory Proscriptions, Jurisdictional Conflicts, and a Legislative Proposal, 27 U. FLA. L. REV. 776, 793 (1975) (a “modest service fee . . . is hardly the incentive to accept poor credit risks.”) Yet in some situations, this concern is not unrealistic. For example, in a rising stock market, banks may become overly optimistic and lose sight of the transitory value of their collateral. Loans that seemed solid might become questionable if the market turns. Cf. Ingrassia, Failure of Two Small Missouri Banks Typifies Troubles Behind Closings, Wall St. J., Mar. 24, 1983, at 3, col. 6 (“poor economic conditions make good loans turn bad”). In addition, banks might try promotional gimmicks, such as low-interest loans, to attract publicity and consumer interest at the start-up of a discount brokerage business. See, e.g., Salamon, Money Funds, Proliferating as Assets Fall, Wall St. J., March 11, 1983, at 21, col. 3 (banks paying high interest rates to lure new money market customers).


Banks are currently subject to virtually the same major limits as brokers. While the regulations for brokers are more detailed, many important regulations are the same for both banks and brokers. See, e.g., 12 C.F.R. §§ 220.8(a)(1) (1982) (maximum loan value of margin equity security in a general account is 50% of current market value); 220.8(e) (1982) retention requirement of margin security is 70% of current market value); and 220.8(f) (1982) (“[N]o put, call, or combination thereof shall have loan value.”). Two possibly significant differences in coverage are that the bank margin regulations apply only to stock loans, see 12 C.F.R. §§ 221.1(a)(1), 3(1) (1982), and have a “purpose” requirement. See 12 C.F.R. § 221.1(a)(1), 3(b) (1982). Presumably the differences reflect the fact that the banks engage in all sorts of loan-financing, while brokers do not. See note 162 infra. Ultimately, if the Federal Reserve becomes concerned with a rise in margin loans, it can tighten these limits as it has often done in the past. See 2 L. Loss, supra note 7, at 1244-48 (description of past changes in margin restrictions).

are questionable or risky, "examiners may be permanently stationed at the bank to supervise its day-to-day activities, or the Comptroller may require the more serious remedies of additional capital or a change in bank management." These bank examinations directly police the problem of unsound margin loans and protect depositors by assuring that unsound loans do not affect the solvency of banks. In short, existing regulatory mechanisms will probably discourage banks from unwisely extending credit to facilitate volume securities purchases. However, to the degree that those regulations fail to provide as much protection as securities law, and therefore give banks an unfair advantage over traditional brokers, banks should be required to incorporate separately their discount brokerage services. This requirement would bring the services within the ambit of the securities regulations.

The second concern specific to bank discount brokerage lies in the risk that promotional pressure will produce a conflict of interest by preventing the commercial banker from rendering disinterested investment advice. Although this problem again appears most forcefully where a bank has "a particular investment to sell," bank discount brokers might be more open to this charge than nonbank discount brokers. Banks are currently permitted to buy and sell some types of securities as principals, and their trust departments

70. Note, The Legality of Bank-Sponsored Investment Services, 84 YALE L.J. 1477, 1498 (1975) (footnote omitted); cf. 12 U.S.C. § 1818 (1976); 12 C.F.R. Part 19 (1982) (discussing various remedies, including termination of bank's insured status; cease and desist orders for unsafe practices; and removal of officers). Where the Comptroller has found problems, he has not hesitated to arrange involuntary mergers with other banks. See, e.g., Ingrassia, supra note 67 (regulators classified loans as problems, required additional capital for the banks, and eventually declared the banks insolvent).

71. See Lybecker, Regulation of Trust Department Investment Activities, 82 YALE L.J. 977, 978 (1973) (examinations "assure bank depositors of the bank's continuing solvency"); Note, supra note 70, at 1498.

72. See notes 160-95 infra and accompanying text.


74. Camp, 401 U.S. at 636. The Court stated:
A bank that operates an investment fund has a particular investment to sell. It is not a matter of indifference to the bank whether the customer buys an interest in the fund or makes some other investment. If its customers cannot be persuaded to invest in the bank's investment fund, the bank will lose their investment business and the fee which that business would have brought in.

401 U.S. at 636. In discount brokerage, a bank would have no particular investment to sell and would be indifferent as to which security a customer selects. As long as the customer makes some purchase or sale transaction, the bank will make its commission.

The Court noted two types of conflicts. The first is "between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice," 401 U.S. at 633. The second is where "security affiliates . . . unload excessive holdings through the trust department of the sponsor bank." 401 U.S. at 633 (footnote omitted). Neither of these conflicts would exist where the broker neither promotes nor owns any stock.

75. See 12 U.S.C. § 24(7) (primarily government securities); see note 15 supra.
regularly buy and sell most kinds of securities. Adding a discount brokerage operation would arguably give a bank further opportunities to manipulate transactions. These potential conflicts, however, are already regulated. Trust departments are held to high standards of accountability. Similarly, the anti-fraud provisions of the securities laws, the common law, and bank regulations all police the manipulation of bank brokerage and dealing transactions. Given that these safeguards protect against the potential for manipulation between trust accounts and bank-owned securities, they are ade-

76. See Hunsicker, Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions, 50 S. CAL. L. REV. 611, 613 (1977) ("Bank trust departments currently handle approximately $400 billion of other people's money and are by far the dominant class of institutional investors in an economy increasingly dominated by institutional investors." (footnotes omitted)).

77. The potential for manipulation would lie in the pricing of transactions. If, for example, a brokerage customer places a "market order," an order to buy or sell at the best price available, see K. Garbade, Securities Markets 447 (1982), the bank might sell one of its own securities at a higher-than-market price, or buy the customer's security at a lower-than-market price. If the customer placed a "limit order," specifying the price he would buy or sell at, see id., no such opportunity would exist. The potential for manipulation between trust accounts and brokerage clients seems less severe. The bank might, by systematically favoring trust accounts, get higher management fees while still receiving brokerage commissions. Since more money is involved in trust funds, see note 76 supra, and the bank's reputation and rewards are more directly related to trust performance, banks would have an incentive to favor trusts in transactions. See generally Herman, Commercial Bank Trust Departments, in Abuse on Wall Street 23, 80-92 (Twentieth Century Fund Report 1980). However, the relatively sophisticated investor who uses a discount brokerage service, see Federal Reserve Board, supra note 3, at 113, would probably recognize a consistent discrepancy in price.

78. As a fiduciary, the trustee is subject to the 'prudent-man rule' in the administration of the trust. This rule requires that the trustee make such investments as a prudent man would make with his own property, having primarily the view of preservation of the estate and the production of a reasonable amount of income. Some courts have held that a bank trust department is under an even higher standard of skill and prudence than other trustees since banks have or at least hold themselves out as having greater skill in investments than a layman has.

J. WHITE, supra note 46, at 512; see generally 12 U.S.C. §§ 92a(c)-(h) & 481 (1976); 12 C.F.R. § 9 (1982).

Current regulations apparently prevent a bank from selling trust account securities at prices favorable to brokerage customers. Cf. 12 C.F.R. § 9.12(d) (1982) (bank may sell assets from one fiduciary account to another if the transaction is fair to both accounts).


80. See generally Mayer, Broker-Dealer Firms, in Abuse on Wall Street (Twentieth Century Fund Report 1980) (examining "the scope of the broker-dealer's fiduciary obligations").

81. 12 C.F.R. § 12.6(b) (1982) requires banks to allocate securities and prices equitably when orders are received at the same time, and 12 C.F.R. § 12.6(c) (1982) permits cross-selling among accounts only where permissible under local law and "on a fair and equitable basis." This regulation was promulgated under the Comptroller's authority to regulate bank securities activities. See 12 U.S.C. § 24(7) (1976).

82. A bank manipulating market orders from brokerage customers would certainly be in violation of bank regulations, see note 81 supra, and would not be executing the transaction at "the best price available."

83. See Investment Co. Inst. v. Camp, 401 U.S. 617, 633 (1971), where the Court observed that Congress had before it evidence that security affiliates might be driven to unload excessive holdings through the trust department of the sponsor bank. Some witnesses at the hear-
quate to prevent the more limited problem present when banks engage in brokerage activities. 84

B. Public Confidence in the Banking System

Another concern of Glass-Steagall is that the actual or perceived association of banks with risky securities markets would cause a loss of confidence in the banking system. 85 Banks could not involve themselves with “selling particular stocks and securities” without their “[prudent] reputation being undercut by the risks necessarily incident to the investment banking business.” 86 Specifically, a bank believing that a troubled securities affiliate could impair public confidence in the bank might feel compelled “to shore up the affiliate through unsound loans or other aid.” 87 Alternatively, customers dissatisfied with their purchases 88 or with the execution and price of an

84. As several commentators have noted, potential conflicts of interest are always present when an agent acts for more than one principal. See Banks AIS, supra note 31, at 81,362; Luse & Olson, supra note 12, at 22, col. 4; Note; supra note 70, at 1493-94. Thus, the mere possibility of conflict should not always lead to prohibition. Indeed, in the securities industry, a broker-dealer acting as both agent and principal necessarily faces conflicts. After a thorough study of the situation the Securities and Exchange Commission recommended regulation of broker-dealers rather than a blanket prohibition of the dual function. SEC, REPORT ON THE FEASIBILITY AND ADVISABILITY OF THE COMPLETE SEGREGATION OF THE FUNCTIONS OF DEALER AND BROKER 109-14 (1936); cf. 17 C.F.R. §§ 240.15b10-3, 240.15c1-7 (1982) (suitability and anti-churning rules). Similarly, regulation will adequately control potential abuse of discount brokerage services.


86. Investment Co. Inst. v. Camp, 401 U.S. at 632 (footnote omitted). Note the court’s reference to sale of “particular stocks and securities” (emphasis added), a feature not present in bank discount brokerage services. See also Clark & Saunders, supra note 16, at 834.

87. Investment Co. Inst. v. Camp, 401 U.S. at 631. By definition, the argument would only apply in a holding company or other affiliate context, and the major affiliate proposals to date contemplate national operations. See BankAmerica Application, supra note 2, at 85,962; Security Pacific Application, supra note 7, at 86,255. One wonders whether the far-flung brokerage operations would be so closely associated as to impair confidence in the bank should the affiliate fare badly. This question is ultimately an empirical matter, which has so far been subject to more conjecture than study. A further weakness of the argument in the holding company context is that regulations could be designed to prevent most of the public association between the two entities, cf. 12 C.F.R. § 225.125 (1982) (bank holding company may not have name similar to or share offices with an investment company that the holding company advises), although such regulations might mitigate the expected convenience of a one-stop financial center.

88. [A]lthough such a [trading] loss would possibly not result in any substantial impairment of the resources of the banking institution owning that affiliate . . . there can be no doubt that the whole transaction tends to discredit the bank and impair the confidence of its depositors.

75 CONG. REC. 9912 (1932) (statement of Sen. Bulkley.) Note the definitional trap that this argument sets for bankers. If they do not make loans to assist companies whose securities their customers have purchased from the banks’ affiliates, then the customers will blame the banks
order,99 might have less confidence in the bank.

In fact, the fear that bank discount brokerage services might damage the staid image of banking is unfounded. Discount brokerage services place relatively little bank capital at risk90 and present no speculative traps that would reflect on the banks' management ability.91 Given that depositors are insured,92 the slight increase in banks' exposure to loss should not affect public opinion on the riskiness of banking. Just as the hazards of the housing industry do not reflect upon a bank when it offers automatically to deduct mortgage payments, the risks of the stock market should not impair a bank's reputation when it offers brokerage services to customers.93 In both cases, customers should realize that the bank is merely performing a low-cost clerical transaction.

Concerns about consumer dissatisfaction with discount brokerage services also do not withstand analysis. The risk that bank loans to affiliates will undermine public confidence is minimal because for their losses. If they do make such loans, then they will suffer direct losses and public confidence in them will diminish. The argument fails to admit that customers may not blame banks for the customers' own losses; that loans may be beneficial and sound; or that customers who lose a deal may increase their confidence in banks.

90. See Spencer, Rationale of Current Regulatory Approaches to Banks' Securities Activities, in SECURITIES ACTIVITIES OF COMMERCIAL BANKS 35, 40 (A. Sametz ed. 1981) ("Bank brokerage activities such as . . . customer transaction services tie up very little bank capital because the banks act as agents rather than as principals in the activity."); cf. Osborn, What happens after Glass-Steagall? 16 INSTITUTIONAL INVESTOR, Feb. 1982, at 67, 68 (banks' capital is very large relative to traditional broker-dealer firms).

To a large extent, banks now provide the capital for much of the nation's securities business. "[S]ecurities firms borrow between $5 and $6 billion from banks" every day, Osborn, supra, at 70, and as of August, 1982, commercial banks in the U.S. held $237.1 billion of non-Treasury securities and had $21.4 billion outstanding in security loans (seasonally adjusted figures). See 68 FED. RESERVE BULL. A15 (Oct. 1982). Dissemination of accurate information about current bank involvement in securities, and the marginal increase in involvement that could result from discount brokerage services, would probably dispel any incipient public confidence problem.

91. See Clark & Saunders, supra note 16, at 834.

92. Deposit accounts are insured by a federal agency. See generally 12 U.S.C. §§ 371a, 371b, & 1811-32 (1976). In the past, fixed interest rates have been a further stabilizing force. In 1980, however, Congress transferred the power to set rates, see 12 U.S.C. §§ 371b, 1456(a), & 1828(g), to a newly formed Depository Institutions Deregulatory Committee. The Committee was directed "to provide for the orderly phase-out and the ultimate elimination [by March 31, 1986] of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts . . . ." Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 204(a), 94 Stat. 132, 143; see generally 12 U.S.C. §§ 3501-09 (Supp. V 1981).

both Glass-Steagall94 and the Bank Holding Company Act95 extensively regulate such loans.96

Furthermore, discount brokerage poses no threat to customer satisfaction because where brokers do not promote stocks or render advice, losses to the customer do not reflect on the bank at all.97 Even if bank discount brokerage operations did produce customer dissatisfaction with the specific services provided, they would not threaten


In addition to these direct safeguards, bank regulators have extensive authority to examine affiliates to ensure that their activities do not, by act or implication, threaten the solvency of the bank. See, e.g., 12 U.S.C. §§ 161(c), 481, 1817(a), 1844(c) (1976); 12 C.F.R. § 7.7376(d) (1983).

96. The possibility of unsound loans is a problem common to all affiliates — an affiliate in any line of business may fare badly. The argument seems to have arisen in the context of bank securities activities because securities affiliates fared badly prior to 1933; thus, experience implies that a full-scale securities business is particularly risky. Even without statutory regulation of bank loans to affiliates, discount brokerage affiliates are not as risky. First, the securities business generally is better regulated than in the 1920s. See notes 149-52, 156, 159-61 infra and accompanying text. Second, the major element of risk — investment of the affiliate's capital directly in securities — is absent from discount brokerage operations.

The fear that the public will lose confidence in banks has not stopped the recent trend toward holding company and affiliate organization. Indeed, the Treasury Department has recently proposed to require in some cases bank securities activities be conducted by a non-bank affiliate. See text at notes 173-95 infra. See generally Securities Activities of Depository Institutions: Hearings on S. 1720 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 97th Cong., 2d Sess. 4-10 & 15-17 (1982) (statement of Donald Regan, Secretary of the Treasury).

97. See Federal Reserve Board, supra note 3, at 116; Clark & Saunders, supra note 16, at 832. The fact that banks would not promote any particular security is a sufficient answer to the observation that Congress intended Glass-Steagall to overcome fears “that the promotional needs of investment banking might lead commercial banks to lend their reputation for prudence to the enterprise of selling particular stocks and securities, and that this could not be done without the reputation being undercut by the risks necessarily incident to the investment banking business.” Investment Co. Inst. v. Camp, 401 U.S. 617, 632 (1971) (emphasis added); see also notes 86-89 supra.

The argument that banks will make unsound loans to affiliates, see note 87 supra and accompanying text, assumes that public perception of guilt by association would force the bank to prop up the struggling affiliate. But in the case of discount brokerage services, the association is between the bank and an unrelated company in which a customer has invested. Where the customer does not rely on the discount broker in choosing the stock, the association is extremely tenuous.

In some areas, the association argument has some weight. According to the regulations on bank holding company (BHC) investment adviser activities, the BHC cannot advise “an investment company which has a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks.” 12 C.F.R. § 225.125(f) (1982). The regulations state the concern more explicitly with regard to offices: “[A BHC] should not act as investment advisor to a mutual fund which has offices in any building which is likely to be identified in the public’s mind with the bank holding company.” 12 C.F.R. § 225.125(h) (1982). The goal of these regulations apparently is to make the mutual fund appear unrelated to the bank, while in the case of a company whose stock is sold by a bank discount broker, the appearance flows naturally from the fact of unrelatedness.
the stability of the banking system.\textsuperscript{98} Customers upset over the price or efficiency of a transaction need only switch to another broker — bank-owned or otherwise.\textsuperscript{99} If their disenchantment is so great that they also wish to withdraw their deposits from the bank,\textsuperscript{100} they are likely only to switch to another bank.\textsuperscript{101} Glass-Steagall should not be construed to protect the possible poor reputation of a few inefficient banks when the integrity of the banking system itself is not threatened.\textsuperscript{102}

C. Diversion of Resources

Bank discount brokerage services might cause a bank "[to] divert talent and resources from its commercial banking operation[s]\textsuperscript{103} to

\textsuperscript{98} The notion that dissatisfaction with particular services would undermine the banking system simply proves too much; perhaps banks should not act at all, lest they act poorly and offend some customer upon whose goodwill they depend. Waiting in teller lines may be the most frequently criticized aspect of banking, but no one suggests that banks should abolish teller services. Banks sometimes make bad loans, and spectacular incidents like the failure of Penn Central, Franklin National Bank, and Penn Square may impair public confidence in the banking system, but no one has seriously suggested that banks should stop making commercial loans. If the service is necessary and/or beneficial, the remedy for occasional problems is to improve the system, rather than abolish it.

\textsuperscript{99} The anti-fraud provisions of the securities acts have been interpreted to incorporate the trade custom that all transactions will be consummated promptly unless otherwise agreed. \textit{See} E. Weiss, \textit{supra} note 2, at 181. Though banks are generally exempt from the securities laws, \textit{see} note 141 \textit{infra}, they are subject to the anti-fraud provisions. \textit{See} text at note 79 \textit{supra}. Thus, the "prompt execution" doctrine would apply to bank discount brokers, and regulations currently exist to facilitate such a rule. \textit{See} 12 C.F.R. § 12.3(c) (1983) (banks required to keep time records for customer securities transactions). In the unlikely event that banks are not required to execute orders promptly and that all banks execute orders slowly, a dissatisfied customer could at least switch to a nonbank broker, who would be held to a duty of prompt execution.

\textsuperscript{100} This argument assumes that the customer has some nonbrokerage relationship with the bank, but if the conclusion of this Note is adopted, that would not necessarily be the case.

\textsuperscript{101} Banks still have a virtual monopoly on transaction balances, so there are few other places that a disgruntled customer could go with his money. For example, in October of 1980, M-1A (demand deposits in commercial banks plus cash) totaled $386.7 billion, and that figure only increased by $24.1 billion when NOW accounts at banks, thrifts, and credit unions were added (seasonally adjusted figures). \textit{See} 66 FED. RESERVE BULL. A13 (Dec. 1980). Even if the funds were placed in a cash management account or money market fund, they would not be wholly withdrawn from the financial markets. Again, this question is subject to empirical proof, but most individuals probably would not withdraw their deposits from a bank and hide them under a mattress merely because the bank was slow in executing a securities transaction.

\textsuperscript{102} Naturally, the banking laws should not encourage any practices that would significantly increase the risk of failure, even for only a handful of banks. But our economic system is generally founded on a desire to reward the efficient over the inefficient, and this reward, not an increase in risks, is the likely result of the customer dissatisfaction argument in the bank discount brokerage context.

\textsuperscript{103} Investment Co. Inst. v. Camp, 401 U.S. 617, 638 (1971); \textit{see} Clark & Saunders, \textit{supra} note 16, at 828, 835. The Court in \textit{Camp} expressed this concern in the context of promotion of an open-ended mutual fund, but the point applies as well to discount brokerage services. A bank might share computer facilities or managerial effort with its brokerage operation. \textit{See} Weinstein, \textit{Banks Get Into Brokerage Business—Chemical Bank Tests the Water}, 116 TR. & EST. 31 (1977); StL Brokerage Proposal, \textit{supra} note 8 at 61,022-23.

An analogous problem is the "obvious danger that a bank might invest its own assets in
securities activities. The upper management of a bank would be occupied by brokerage concerns where it had not been in the past. New offices might be opened, staff added, and advertising campaigns launched. This argument, however, assumes that the pool of skilled banking talent is limited and does not explain why banks would not hire from among experienced brokerage personnel instead of diverting bank management.\(^{104}\) If the new operation is profitable, the bank is strengthened by the slight diversion of resources incurred in the start-up.\(^{105}\) If the brokerage business is not profitable, a bank presumably will not suffer losses indefinitely but will terminate the operation.\(^{106}\) Any needed diversion of bank resources to discount brokerage services would have a limited duration and would not threaten the bank's solvency.

\(^{104}\) Some smaller savings and loan associations have proposed to hire experienced brokerage personnel for their discount brokerage operations. \(\text{See Federal Home Loan Bank Board General Counsel, Stock Brokerage Activities for Existing, Acquired or Newly Established Service Corporations, [Current] FED. BANKING L. REP. (CCH) \textsection 83,013, at 61,031-32 (March 3, 1983) [hereinafter cited as FHLBB General Counsel]. Where banks acquire an existing discount brokerage firm, they are, of course, hiring out of the existing pool. Several banks have used this approach, see Federal Reserve Board, supra note 3, at 105; Carrington, supra note 1.\)

\(^{105}\) In approving an application for a bank discount brokerage operation, the Federal Reserve Board noted that "[d]espite fluctuations in earnings, discount brokers in general, and [the broker being acquired] in particular, have been profitable . . . . [The discount broker] is not a speculative enterprise . . . ." \(\text{Federal Reserve Board, supra note 3, at 113. The growth in commissions and market share of discount brokers, see Carrington, supra note 1, also indicates that discount brokers seem to be doing well.}\)

\(^{106}\) Banks in the recent past have not hesitated to terminate unprofitable brokerage operations. Approximately thirty major banks offered automatic investment services in the mid-1970s, but "no one made any money at it . . . ." \(\text{Weinstein, supra note 103, at 32 (quoting Roger Kline, a consultant with an investment firm). By 1976, only 18 banks still offered the service, and some of these later ended their involvement. See Spicer, Regulation of Bank Securities Activities: The Effects of the SEC Bank Study, 95 BANKING L. J. 616, 618 (1978). Similarly, when Chemical Bank's more expansive brokerage service in the late-1970s failed to turn a profit, the Bank ended it within a year. See Clark & Saunders, supra note 16, at 829-30.}\)
D. Centralization of Banking Functions

Although Congress did not intend the Act to do so, Glass-Stegall currently serves to decentralize capital formation and investment decisionmaking. The securities industry has argued that discount brokerage services undermine this function because banks would have an unfair competitive advantage over the brokers.

First, according to this argument, banks could scan their deposit records to solicit prospective brokerage customers. But even if banks used their depositor lists to attract customers, they might not obtain new investors because established brokerage firms thoroughly cover existing sources of capital. In fact, brokers would have an advantage in the resulting marketing battle, because they would have access to relevant information concerning customers’ past brokerage transactions. Moreover, brokers would have an opportunity to win new customers away from the banks. By resisting these changes, the securities industry apparently fears not only unfair competition, but any competition at all.

Second, full service brokers argue that bank discount brokerage services would profit unfairly from access to cheaper funds. Such access results from a bank’s structural position as a depository institution. Federal deposit insurance and interest rate ceilings also assure the availability of low-cost funds by making consumer bank accounts riskless and relatively inexpensive. These apparent advantages do not, however, permit banks to profit unfairly. Banks bear part of the cost of assuring available funds by paying deposit insurance, and securities firms receive similar protection from the Securities Investor Protection Corporation. In addition, interest rate ceilings are now being phased out and will be eliminated in 1986. Ultimately, the asserted advantages of access to low-cost funds do not seem to carry over into bank profitability and ability to

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109. See Taylor, supra note 107, at 141.
110. Cf. Carrington, supra note 1 (brokers, already cutting rates because of discount competition, think discounters will become more important if banks enter the market).
111. See Federal Reserve Board, supra note 3, at 111-12.
112. See Securities Indus. Assn., supra note 108, at 777-80; see also Osborn, supra note 90, at 70 (broker loans from banks are higher than bank cost of funds).
115. See generally 15 U.S.C. §§ 78aa-78lll (1976); Angermueller, supra note 47, at 137; Note, supra note 70, at 1499-1500.
116. See note 92 supra.
attract capital.\textsuperscript{117} Claims about cross-subsidization and voluntary tying\textsuperscript{118} are similarly unpersuasive. These arguments amount to nothing more than a concern that consumers will handle all of their financial transactions in one place, a bank. Both claims assume conditions of product scarcity or market dominance that do not exist in the banking business.\textsuperscript{119} The voluntary tying argument assumes that consumers will patronize bank brokers in the hope of getting credit from the bank.\textsuperscript{120} However, the possibility of tying is remote because credit is not scarce.\textsuperscript{121} Similarly, cross-subsidization only occurs where a company with one product line "has sufficient market dominance [in another product line] to be able to eliminate competitors by sustained below-cost pricing."\textsuperscript{122} Considering that discount brokers have an 8.4\% share of retail brokerage commissions,\textsuperscript{123} that discount brokerage as a business has low barriers to entry,\textsuperscript{124} and that more companies, including relatively small corporations, are in fact entering the business,\textsuperscript{125} market dominance in discount brokerage is an unlikely prospect. Thus, the only probable result of a bank's attempt to subsidize discount brokerage is a loss for the operation.\textsuperscript{126}

The securities industry also complains that tax advantages enjoyed by banks make competition unfair.\textsuperscript{127} However, these tax advantages concern other bank securities activities, such as municipal securities dealing.\textsuperscript{128} If the discount brokerage service itself is not

\textsuperscript{117} See, e.g., Osborn, supra note 90, at 69 (large banks earned 13\% return on equity for the year ending September, 1981, while "Wall Street Houses" averaged 22\% during the same period); Federal Reserve Board, supra note 3, at 111 ("[T]he rate paid by [BankAmerica Corp.] on its commercial paper during May through July 1982 were generally the same or higher than rates on commercial paper paid by corporations of similar size and credit ratings.").

\textsuperscript{118} See Federal Reserve Board, supra note 3, at 112; Securities Indus. Assn., supra note 108, at 782-83; Note, supra note 14, at 108-09.

\textsuperscript{119} Federal Reserve Board, supra note 3, at 112.

\textsuperscript{120} Note, supra note 45, at 108-09.

\textsuperscript{121} Federal Reserve Board, supra note 3, at 112; Angermueller, supra note 47, at 134 (those who seek capital "cross freely from turf to turf looking for the best available and most economic service."); id. at 136 (corporations switch from bank to bank, are not "captive clients").

\textsuperscript{122} Federal Reserve Board, supra note 3, at 112.

\textsuperscript{123} See note 1 supra.

\textsuperscript{124} See Federal Reserve Board, supra note 3, at 112.

\textsuperscript{125} See FHLBB General Counsel, supra note 104 (five savings and loan associations and a federal savings bank each setting up a discount brokerage operation).

\textsuperscript{126} The paradigm case for both cross-subsidization and voluntary tying would occur where a huge banking firm acquires a large discount broker, as BankAmerica has done. However, in a careful analysis, the Federal Reserve Board found these concerns unjustified. Federal Reserve Board, supra note 3, at 112. If, in this situation, credit is not a scarce product and the prospects for market dominance in retail brokerage are slim, the probability that the tying and cross-subsidization will ever materialize is low.


\textsuperscript{128} Id.; Federal Reserve Board, supra note 3, at 112.
subsidized, these limited tax advantages will not affect the competition between bank discount brokers and others for the retail brokerage business.

The securities industry contends that the advantages that banks allegedly possess in offering discount brokerage services will exacerbate the existing concentration of financial power in the hands of bankers, thus undermining the decentralization effect of Glass-Steagall. This argument assumes that major banks will dominate, or at least succeed in, the discount brokerage business. Even if banks did dominate, their influence would not produce a centralization of financial decisionmaking that amounted to "control of the allocation of business capital in our economy." Discount brokerage by definition involves no decisionmaking by the broker, so banks would have no more power to control the allocation of financial support than they did before. While bank entry into other securities activities, such as underwriting or private placements, might give banks greater control over the sources of capital, their performance of a clerical brokerage function will not. Because banks actually control a lower share of financial assets than they did thirty years ago, and because antitrust laws already guard against undue concentration of power, bank discount brokerage services will not injure the decentralization function of Glass-Steagall. In fact, to the extent that bank discount brokerage services attract new investors, financial decisionmaking will become more decentralized.

Because the agency interpretation of section 24(7) does not share the interpretative burdens of accommodation theory, and because agency theory in the discount brokerage context does not implicate statutory concerns, the Glass-Steagall Act does not prohibit bank discount brokerage services. The legality of these services should not be surprising. Even the securities industry concedes that the Act

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129. See Evans, Regulation of Bank Securities Activities, 91 Banking L.J. 611, 612 (1974); Karmel, supra note 28, at 633, 640-41; Taylor, supra note 107, at 141-44. But see Smith, Interstate Banking Restrictions Outweigh Public Benefit, 101 Tr. & Est. 26, 28 (1982) (United States Attorney General commenting that in banking, "[n]either market concentration nor aggregate concentration is a serious prospect.").

130. See note 107 supra and accompanying text.

131. Concentration could permit "the large commercial banks . . . to determine which enterprises are to grow and which are not, and investment decisions might tend to concentrate on a particular group of industries at expense of all others." Id. (footnotes omitted); see generally id. at 786-88; Taylor, supra note 107, at 143.

132. See text at notes 2-7 supra.


135. In light of the extensive bank and securities regulation built up since the passage of Glass-Steagall, several bankers have argued that Glass-Steagall's concerns will rarely impli-
allows banks to conduct some brokerage activities.\textsuperscript{136} Congress presumably thought these activities compatible with commercial banking. Discount brokerage operations, if anything, should be more compatible with prudent banking than any other type of brokerage activity. By not offering any investment advice,\textsuperscript{137} these operations


\textsuperscript{136} See note 24 \textit{supra} and accompanying text.

\textsuperscript{137} This Note has assumed that banks providing discount brokerage services will not offer any investment advice. Most of the approved plans have not stated that services will include investment advice. \textit{See} Federal Reserve Board, \textit{supra} note 3, at 106 (expressly states there will be no investment advice); Security Pacific Application, \textit{supra} note 7, at 86,256 (investment advice not listed service). \textit{But see} FHLBB General Counsel, \textit{supra} note 104 (approving applications for stock brokerage and investment advisory services). The Federal Reserve Board's Notice of Proposed Rulemaking also assumed that banks would not give investment advice. \textit{See Rulemaking Proposal, supra} note 10, at 7747.

Nevertheless, even the additional service of investment advice might not tip the legal scales against bank discount brokerage services. First, the Supreme Court has always assumed that banks can offer such advice. \textit{See}, e.g., Investment Co. Inst. v. Camp, 401 U.S. 617, 624-25 (1971). Moreover, the Court has held that banks can not only advise but can also manage closed-end investment funds. The Court stated that “[t]he management of a customer’s investment portfolio — even when the manager has the power to sell the securities owned by the customer — is not the kind of selling activity that Congress contemplated when it enacted [§ 378].” Board of Governors of Federal Reserve System v. Investment Co. Inst. 450 U.S. 46, 63 (1981).

If Glass-Steagall does not forbid management discretion, it probably does not prohibit investment advice coupled with agency services.

Allowing banks to advise their discount brokerage customers does not violate Glass-Steagall’s policies. Provision of advice would not increase promotional pressures. Moreover, because banks have traditionally given advice, offering investment counseling along with discount brokerage would not cause an undue diversion of banking resources.

Investment advice might, however, implicate the public confidence concern. If customers blame the bank’s advice for losses suffered, if such losses outnumber gains, if the dissatisfaction is great, and if customers transfer their dissatisfaction from the brokerage operation to the depository activities of a bank, then the solvency of individual banks might be threatened—assuming, of course, that many depositors had invested in securities in the first place. This argument assumes that the bank’s lack of expertise in securities advice would reflect on its overall management ability. Yet the Supreme Court has recognized the limited force of this domino-theory argument. Even where the bank was the organizer and manager of an open-end investment fund, the Court stated:

\begin{quote}
If the fund investment should turn out badly there would be a danger that the bank would lose the good will of those customers who had invested in the fund. \textit{It might be unlikely that disenchantment would go so far as to threaten the solvency of the bank.} But because banks are dependent on the confidence of their customers, the risk would not be unreal.
\end{quote}

\textit{Camp}, 401 U.S. at 638 (emphasis added). Where a bank only offers advice to individual customers, but does not manage a fund, the threat to bank solvency seems even more “unlikely.”

A bank’s offer of investment advice might also raise a conflict of interest problem. The Supreme Court has noted “the obligation of the commercial banker to offer disinterested investment advice.” \textit{Camp}, 401 U.S. at 633. However, this concern is most acute where a bank acts as a principal. Where the bank gives advice and acts only as a broker, no conflict of interest arises.

Two non-Glass-Steagall concerns may apply when a bank offers discount brokerage services and investment advice. Neither of these concerns are unique to this area, however, and existing regulations can easily handle both. Banks might advise brokerage customers on the basis of inside information acquired through loan applications. However, similar opportunities already exist for favoring trust accounts, and the problem of inside information is hardly confined to banks. The securities laws and regulations provide the most appropriate means to control this problem. \textit{See generally}, S. \textit{Jaffe}, \textit{Broker-Dealers and Securities Markets} 148-53 (1977). A bank/broker might also have an opportunity to earn excessive commissions
eliminate Congress's promotional pressure and public confidence concerns. The nature of discount brokerage services also precludes development of a more modern Glass-Steagall problem, centralization of banking functions. Thus, the agency activities inherent in bank discount brokerage services are permissible because they are consistent with the goals of the Glass-Steagall Act.

III. THE REGULATION OF BANK DISCOUNT BROKERAGE OPERATIONS

Although Glass-Steagall permits banks as well as bank holding companies to engage in discount brokerage, a further problem has
troubled commentators. Both banks and the securities industry agree that those engaged in equivalent activities should be subject to equivalent regulation. They disagree, however, on whether banks engaged in brokerage activities are regulated as strictly as nonbank brokers. The claim of unequal regulation arises because the securities laws exempt banks from the definition of "broker." As a result, banks are not subject to the regulatory scheme promulgated and enforced by the Securities and Exchange Commission (SEC). This exemption might lead both to inadequate protection for bank brokerage customers, and to an unfair competitive advantage for public benefits include free competition, see, e.g., Federal Reserve Board, supra note 3, at 109-10; Clark & Saunders, supra note 16, at 818, more capital for modernization and expansion, see generally Angermueller, supra note 47; Senterfitt, supra note 12, and greater purchaser access to securities. See note 172 infra. Perhaps the best indication of the benefits, however, is the reaction of traditional securities firms. The industry fears that with banks entering the field, "discount brokers, a previously little-known and thinly capitalized segment of the [retail brokerage] business, will gain marketing strength." Carrington, supra note 1, at col. 1. Discounters have already forced "full-service brokers to quietly chop their fees to keep customers from defecting . . . ." Id. at col. 2. The securities industry, however, emphasizes the possible adverse effects of bank discount brokerage services. Basically, securities firms fear that discount brokerage will give banks an unfair competitive advantage that will result in overcentralization of financial resources. See Part II-D supra. However, these "adverse effects" do not implicate Glass-Steagall concerns, see Part II-D supra, and certainly do not outweigh the competitive benefits produced by bank discount brokerage operations. As a result, bank holding companies can perform these services under 12 U.S.C. § 1843 (1976). After a detailed analysis, the Federal Reserve Board reached the same conclusion. See Federal Reserve Board, supra note 3.

139. See, e.g., Angermueller, supra note 47, at 137; Senterfitt, supra note 12, at 21-22; Securities Indus. Assn., supra note 108, at 781; see also Securities Activities of Depository Institutions: Hearings on S.1720 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 97th Cong., 2d Sess. 11-12 (statement of Donald T. Regan, Secretary of the Treasury) [hereinafter cited as 1982 Hearings].

140. Compare Bank AJS, supra note 31, at 81,362-63 (Comptroller of the Currency arguing that "banks are subject to their own body of law and regulation, different but certainly no less strict than broker regulation"), with Evans, Regulation of Bank Securities Activities, 91 BANKING L.J. 611, 616-19 (1974) (then SEC Commissioner Evans); Securities Indus. Assn., supra note 108, at 781; Taylor, supra note 107, at 139-40 (1977).

Securities spokespersons are not the only ones complaining about unfair regulatory burdens, however. Bankers have observed that "we are still far more heavily regulated than our nonbanking competitors — such as full-line securities dealers . . . . The imbalance has its roots in the Glass-Steagall and Bank Holding Company Acts . . . ." See BankAmERICA CORP., 1981 ANNUAL REPORT 4 (1982). Because Glass-Steagall only lists powers and prohibitions, this complaint presumably involves the scope of permissible activities, rather than compliance costs.


143. See Evans, supra note 129, at 614 (SEC Commissioner addressing the lack of investor protection); Securities Indus. Assn., supra note 108, at 790 ("Among the standards and safeguards . . . . inapplicable to banks and this unavailable to their brokerage customers, are those
banks.\textsuperscript{144} Although banks are now subject to a rigorous regulatory structure,\textsuperscript{145} disparities in regulation do exist. Bank regulation aims to protect depositors and the stability of the banking system,\textsuperscript{146} functions served principally by the assurance of bank solvency.\textsuperscript{147} To avoid depositor runs on potentially troubled banks, the banking authorities enforce the regulations in a spirit of familial secrecy.\textsuperscript{148} In contrast, the broker regulation protects investors by controlling business relating to suitability, prompt execution, disclosure of adverse information, and insurance under the Securities Investor Protection Act.

\textsuperscript{144} See Securities Indus. Assn., \textit{supra} note 108, at 777-79; Taylor, \textit{supra} note 107, at 139-40; see generally Evans, \textit{supra} note 140. \textit{But see BANKAMERICA CORP., supra} note 140 (BankAmerica complaining of unfair regulatory burden on banks).


The Comptroller and at least one commentator have argued that the regulatory coverage of banks and brokers is equivalent in the areas of record examination and protection of depositors from loss in case of insolvency. \textit{See Bank AIS, supra} note 31, at 81,362-63; Note, \textit{supra} note 70, at 1497-1500. The SEC has also concluded that banking regulation adequately protects against customer loss of securities through theft or insolvency. \textit{See} Spencer, \textit{supra} note 106, at 624.

Some securities law protections will also apply to bank brokerage customers. The anti-fraud provisions will simply apply to banks. \textit{See} note 79 \textit{supra} and accompanying text. Moreover, banks will presumably be subject to the same common law restrictions as brokers. \textit{See} note 80 \textit{supra} and accompanying text. And to the extent that disclosure by the issuer of the stock best protects investors, \textit{see} 15 U.S.C. §§ 78l, 78m (1976); Evans, \textit{supra} note 129, at 612-13, 618, bank discount brokerage customers will receive the full benefit of this disclosure.

\textsuperscript{146} \textit{See}, e.g., Evans, \textit{supra} note 129, at 617-18. Congress enacted Glass-Steagall in order to serve these goals. \textit{See} A.G. Becker, Inc. v. Board of Governors of the Federal Reserve System, 693 F.2d 136, 146-47 (D.C. Cir. 1982) ("Congress enacted the Glass-Steagall Act primarily to protect bank depositors. . . . [I]t aims at protecting the integrity of banks and the financial resources of depositors rather than investors.") (emphasis in original); notes 45-52 \textit{supra} and accompanying text.

\textsuperscript{147} The bank examination statutes and regulations focus on the solvency of the bank. \textit{See} 12 U.S.C. §§ 161(a) (1976) (report of resources and liabilities to the Comptroller); 12 U.S.C. § 161(c) (1976) (reports of affiliates must disclose the effect of the affiliate upon the affairs of the bank); 12 U.S.C. § 1818(a) (1976) (termination of bank's insured status if unsound practices or violations exist); 12 C.F.R. § 19.20 (1982) (temporary cease-and-desist order when bank practices are "likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or [are] likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors"); \textit{see also} Lybecker, \textit{supra} note 71, at 978; Spencer, \textit{supra} note 106, at 624.

\textsuperscript{148} \textit{See}, e.g., Evans, \textit{supra} note 129, at 617-18 ("bank requirements and standards are enforced in a 'discrete' way"); Securities Indus. Assn., \textit{supra} note 108, at 790 (noting the "understandable reluctance of [bank] regulators to un settle the often delicate public confidence upon which the banking system depends"); Schoenbaum, \textit{Bank Securities Activities and the Need to Separate Trust Departments from Large Commerical Banks}, 10 U. MICH. J. L. REF. 1, 13-14 (1976) (bank regulators distrust disclosure). Schoenbaum goes further than others, claiming a "race of laxity" between the different [bank] regulatory agencies. \textit{Id.} at 1-2. Congress has also recognized the need for confidential enforcement of the banking laws. The Freedom of Information Act does not apply to "examination, operating or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. § 522(b)(8) (1976).
ness practices. To deter unethical practices, the SEC enforces the law in a public and adversarial manner. Although not dispositive, the contrast in goals and approaches suggests that the bank regulatory structure provides less protection to securities investors.

In several areas, this difference between philosophies is matched by differences in regulatory impact and coverage. The first discrepancy is in the required training of securities personnel. The SEC enforces extensive requirements with respect to the training, competency, and supervision of employees. One firm estimated that in 1981 it spent over one million dollars in training and examination costs. When the SEC pointed out this discrepancy in a 1977 study, bank regulators "specifically declined to adopt any such requirements, maintaining that general bank examination procedures are adequate." Existing bank regulations are probably sufficient if

149. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 198 (1976) ("[T]he overall Congressional purpose in the 1933 and 1934 Acts was to protect investors against false and deceptive practices that might injure them") (citation omitted); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 11-12 (1971); J.I. Case Co. v. Borak, 377 U.S. 426, 432-33 (1964); see also Herman & MacLean v. Huddleston, 51 U.S.L.W. 4099, 4103 (1983) ("Defrauded investors are among the very individuals Congress sought to protect in the securities laws."). In contrasting this emphasis to bank regulation, one commentator noted: "[O]ne continuing disparity that only Congress can remedy is to place on bank regulatory agencies investor protection mandates in addition to their responsibilities to bank depositors." Karmel, supra note 28, at 635; see also 1982 Hearings, supra note 139, at 35 (statement of John S.R. Shad, SEC Chairman) ("The missions and the regulatory philosophies of the banking authorities and the SEC are different.").

150. See Evans, supra note 129, at 618 (when the SEC discovers a violation, it "takes enforcement action which is disclosed to the public"); see also Angermueller, supra note 47, at 133 ("The commercial banks' regulatory environment has been more supportive and less hostile than the scrutiny and rules under which investment banks operate."); Note, supra note 70, at 1499 (bank "enforcement proceedings are not as well publicized as those of the SEC, which announces disciplinary actions relating even to minor infractions"); 1982 Hearings, supra note 139, at 35 (statement of John S.R. Shad, SEC Chairman).


152. 1982 Hearings, supra note 139, at 156 (statement of Sam Scott Miller):

Training of salesmen is another area of regulatory disparity. As I previously noted, all Paine Webber employees involved in the marketing and sale of securities, including our money market fund, must pass rigorous NASD and stock exchange examinations as a prerequisite to registration. Most of Paine Webber's salesmen are graduates of our own training school. A principal purpose of the school is to provide trainees the information they need to pass the examination. Paine Webber spent well over $1,000,000 last year to maintain this training facility and to administer broker examinations. There are no specific training or examination requirements for bank personnel who currently engage in securities or trust department activities.

153. 1982 Hearings, supra note 139, at 32 (statement of John S.R. Shad, SEC Chairman). The SEC study found disparities between bank and brokerage regulation in the areas of record-keeping, personnel competency, and confirmation requirements. See Spencer, supra note 106, at 625. Bank regulations adopted in 1979, however, now cover record keeping and
a bank’s discount brokerage business primarily involves simple clerical services.\textsuperscript{154} If, on the other hand, the discount brokerage operation offers investment advice,\textsuperscript{155} then traditional firms offering similar services will face a competitively disadvantageous training requirement, while investors using the bank’s services may receive less reliable advice.

The second difference between banks and securities firms concerns regulatory constraints on advertising. The stock exchanges, under the supervision of the SEC, restrict broker advertising that is unfair or misleading.\textsuperscript{156} Banks are not subject to similar regulations.\textsuperscript{157} Although bank examiners do review advertising “to determine whether it contains any violations of the banking laws (for example, payment of excessive interest rates), examiners are not generally charged with looking for unfair or misleading advertising relating to the performance of brokerage services.”\textsuperscript{158} Even if they were so charged, examiners untrained in securities law could not effectively scrutinize similarly untrained bank personnel.\textsuperscript{159}

A final concern is the clear disparity in margin loan regulation of confirmation requirements for bank securities transaction. See 12 C.F.R. §§ 12.1-12.7 (1982) (national banks); 12 C.F.R. § 208.8(k) (1982) (state banks that are members of the Federal Reserve System). Chairman Shad remains unimpressed: “[T]hese rules tend to be considerably less specific than those of the SEC, in many cases relying on reference to ‘sound banking practices’ rather than the more specific regulations applicable to securities firms.” \textit{1982 Hearings, supra} note 139, at 32.

154. See notes 1-7 supra and accompanying text. The SEC regulations apply to broker-dealers, who are salesmen and offer investment advice. As far as investor protection is concerned, bank employees will not need equally extensive training to perform comparatively simple clerical tasks. In addition, bank record keeping requirements should protect investors from incompetent clerks. See note 153 supra. By the same token, unfairness objections do not apply here, because different functions justify different regulation: banks offering clerical discount brokerage services do not need to train their employees as thoroughly as sales-oriented securities firms.

155. See notes 7, 137 supra.


158. \textit{1982 Hearings, supra} note 139, at 32 (statement of John S.R. Shad, SEC Chairman).

159. The stock exchange rules generally are prophylactic; advertising material must be approved in advance by trained employees. See, e.g., 2 \textit{NYSE GUIDE} (CCH) ¶ 2472 (Rule 472) (1978). Bank examinations, in contrast, are after-the-fact. Examiners might discover unfair advertising but could not prevent its damage already done. Additionally, although bank brokerage services are subject to anti-fraud provisions, see text at note 79 supra, a range of harmful conduct falls short of the requisite showing of material misrepresentation. In contrast, stock exchanges are “concerned with the manner — or form — in which information and opinions are presented.” \textit{Id.}, at ¶ 2474A.10. Testimonials, for example, cannot “be indicative of future performance or success,” and they must disclose whether any sums were paid for the testimonial. \textit{Id.} at ¶ 2474A.10(4).
bank and nonbank brokers. The Securities Exchange Act of 1934 \(^{160}\) authorizes margin regulations for banks and brokers under different subsections. \(^{161}\) This difference in statutory authority has two consequences. First, banks are subject to margin restrictions on loans for the purchase of stock, but not on loans for the purchase of nonequity securities. \(^{162}\) Second, the discrepancy in authority permits different margin restrictions between banks and brokers even for stock purchase loans. \(^{163}\) Though the stock loan restrictions are currently equivalent, \(^{164}\) bank discount brokers are still governed by a less detailed set of regulations than other discount brokers. \(^{165}\)

Unfortunately, this difference in regulation of margin loans is not justified when banks act as discount brokers. Congress apparently assumed that banks would process margin loans no differently than other loans, and that they would require an extensive application and credit check before advancing any margin credit. \(^{166}\) In contrast,


\(^{161}\) See 15 U.S.C. §§ 78g(a), (c), (d) (1976).

\(^{162}\) Compare 15 U.S.C. § 78g(d)(D) (1976) (authority to regulate bank margin loans does not apply to any "security other than an equity security") with 15 U.S.C. § 78g(o)(1) (1976) (authority to regulate brokerage margin loans made for the purchase or maintenance of "any security"). See generally 12 C.F.R. §§ 220, 221 (1982) (different regulations for loans by brokers and loans by banks); H.R. REP. No. 1383, 73d Cong., 2d Sess. 8 (1934), reprinted in 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, at item 18 (1973) (compiled by J. ELLENBERGER & E. MAHAR) [hereinafter cited as LEGISLATIVE HISTORY] ("Banks are subject to margin limitations only on loans on registered equity securities in cases where the loan is sought for the purpose of purchasing or carrying securities."); note 68 supra. One could argue that this exemption for nonequity (debt) securities recognizes the banks' traditional role of "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt." 12 U.S.C. § 24(7) (1976). Because this function is central to banking, securities regulation arguably should not control it. The distinction between "purpose" loans, which are made for the purpose of purchasing stock, and non-purpose loans especially reflects regulatory recognition of this difference in occupation. See 12 C.F.R. § 221 (1982) (Reg U may impose margin limit on broker but not on banks when loan is secured with stocks); see generally 2 L. Loss, supra note 7, at 1261-62. However, this observation does more to explain the origin of the debt securities exemption than it does to justify extension of that exemption to high volume, discount brokerage services.

\(^{163}\) See 15 U.S.C. §§ 78g(a), (c), (d) (1976); H.R. REP. No. 1383, 73d Cong., 2d Sess. 8, reprinted in LEGISLATIVE HISTORY, supra note 162, at item 18 ("The [Federal Reserve] Board is not required to fix the same margins for banks as for brokers . . . .").

\(^{164}\) See note 68 supra and accompanying text.

\(^{165}\) See 12 C.F.R. §§ 220, 221 (1982); note 68 supra. Some of the differences in margin regulations might exist because banks are in the business of making loans, whereas brokers are not. See notes 68, 162 supra.

\(^{166}\) See, e.g., Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 52-53 (hereinafter cited as Stock Exchange Regulation Hearings) (statement of Woodlief Thomas) ("[B]anks are a little more particular about whom they make loans to than a brokerage house. A bank will ordinarily make some credit investigation and find out about the credit standing of the individual."); id. at 274 (statement of W.D. Gradison, President, Cincinnati Stock Exchange) ("Banks also recognize the moral and financial character of the borrower in determining collateral values; thus a person of good moral character and high purpose can usually borrow more on his securities than a speculator or one whose record does not entitle him to credit."); id. at 687 (statement of Thomas Garner Corcoran, one of the drafters of the bill) ("[B]anks . . . require a
Congress expected brokers to process margin loans routinely, with approval based primarily on the collateral value of the underlying securities. Where banks act as brokers, a role the 1934 Congress misunderstood, this assumption about bank margin loans is not necessarily true, and it is even less likely to be true where banks act as discount brokers. Both bank and nonbank discount brokers rely on the speed and volume of transactions to make a profit. Neither fosters extensive client-brokerage relationships. Both seem likely to lend on the basis of the collateral value alone.

When banks act as discount brokers, then, the difference in regulatory coverage is not justified by Congress’s original purpose and is inherently unfair to nonbank discount brokers. To the extent that more extensive securities regulations help protect investors, bank borrower to make an adequate proof of credit standing to get a loan on securities (see note 49 supra, at least one witness in the 1934 securities hearings testified that under Glass-Steagall banks would no longer be able to “go in the business, like a broker, of dealing in securities.” stock exchange regulation hearings, supra note 166, at 86 (statement of Thomas Garner Corcoran); see also securities indus. assn., supra note 108, at 269. Because this witness apparently knew of the accommodation theory, and because other witnesses testified that banks could act as agents, see, e.g., stock exchange regulation hearings, supra note 166, at 154 (statement of Richard Whitney, President of the New York Stock Exchange) (“[B]anks . . . customarily act as agent for their customers in buying and selling securities . . . .”), the role that Congress thought banks would play in the securities industry is unclear.

167. See id. at 52 (statement of Woodlief Thomas) (“[I]t has been relatively simple to open up an account with a broker . . . .” The borrower did not need a credit reference or evidence of his ability to meet future obligations); id. at 67 (statement of E.A. Goldenweiser, Director of Research and Statistics, Federal Reserve Board) (“Anyone can borrow money from brokers for the purpose of carrying stocks . . . .”); id. at 688 (statement of Thomas Garner Corcoran) (“[B]rokers . . . almost push credit down the customer’s throat to give themselves bigger turnover and commissions.”).

168. Though the legislative history of Glass-Steagall explicitly allowed some role for bank brokerage activities, see note 49 supra, at least one witness in the 1934 securities hearings testified that under Glass-Steagall banks would no longer be able to “go in the business, like a broker, of dealing in securities.” stock exchange regulation hearings, supra note 166, at 86 (statement of Thomas Garner Corcoran); see also securities indus. assn., supra note 108, at 269. Because this witness apparently knew of the accommodation theory, and because other witnesses testified that banks could act as agents, see, e.g., stock exchange regulation hearings, supra note 166, at 154 (statement of Richard Whitney, President of the New York Stock Exchange) (“[B]anks . . . customarily act as agent for their customers in buying and selling securities . . . .”), the role that Congress thought banks would play in the securities industry is unclear.

169. See notes 7, 63 & 65 supra and accompanying text.

170. See notes 2-4 & 7 supra and accompanying text. BankAmerica’s discount brokerage operation, for example, relies on automation and low prices rather than on cultivated client relationships. See federal reserve board, supra note 3, at 106, 109.

171. Witnesses in the 1982 Hearings repeatedly stressed the unfairness of competitors operating under different regulatory regimes. See, e.g., 1982 hearings, supra note 159, at 4 (statement of Donald T. Regan, Secretary of the Treasury); id. at 87 (statement of Professor Robert Charles Clark).

172. In enacting the section on margin loan restrictions, for example, Congress had three goals in mind. Of most relevance here, Congress wanted to protect inexperienced investors from excessive margin purchases. See, e.g., stock exchange regulation hearings, supra note 166, at 67 (statement of E.A. Goldenweiser) (“[M]any of the people who are buying stocks on margin are not even aware . . . that they are at the same time borrowing money . . . .”); id. at 72-73 (statement of E.A. Goldenweiser); S. Rep. No. 1455, 73d Cong. 2d Sess. 11 (1934), reprinted in 5 legislative history, supra note 162, at item 21 (the margin “provisions are intended to protect the margin purchaser by making it impossible for him to buy securities on too thin a margin”); S. Rep. No. 792, 73d Cong., 2d Sess. 6-7 (1934), reprinted in 5 legisla-
brokerage customers do not receive this protection. And the original rationale for the discrepancy, the difference in bank and broker business practices, no longer applies to discount brokerage.

To remedy the disparity in regulation and to adhere to the legislative rationale, the banking authorities should impose a prudential precondition: every bank wishing to engage in discount brokerage must incorporate the service separately from the bank. This requirement would eliminate regulatory disparity because the relevant statutory exemptions cover only banks as such. Holding company

Protection of naive investors is more important with discount brokerage services than with other securities activities. Bankers, in extolling the advantages of bank-affiliated discounted brokers, stress that these services will increase small investor participation in the capital markets. See, e.g., Angermueller, supra note 47, at 135 (banks can tap the reservoir of "household capital" because they have 44,000 offices, compared to 3600 retail offices for securities firms); Clark & Saunders, supra note 16, at 818. Presumably these small investors are those most in need of protection from commission-hungry brokers.

Congress also restricted margin lending in order to prevent diversion of credit resources into stock market speculation, see 15 U.S.C. §§ 78b(3)(a), 78g(a), (b), (d) (1976); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934), reprinted in 5 Legislative History, supra note 162, at item 17 (easy margin lending practices "encourage the purchase of securities by persons with insufficient resources to protect their accounts in the event of a decline"); H.R. Rep. No. 792, 73d Cong., 2d Sess. 3, 7 (1934), and to prevent undue stock market fluctuations. See 2 L. Loss, supra note 7, at 1242-43. Where banks freely lend money on the basis of collateral value alone, these purposes are also frustrated. If the price of a stock declines sharply, for example, the collateral value declines sharply. The bank might feel compelled to call the loan; this would in turn force the investor (and others in the same position) to sell stock, further depressing its price.

This is not to say that every provision of the securities regulations protects investors. In fact, some of those complaining about unfair advantage of banks also complain about the absurdity of some of the securities regulations. See, e.g., 1982 Hearings, supra note 139, at 156-57 (statement of Sam Scott Miller).

173. Regulators have often imposed conditions on banks entering certain fields. See, e.g., Rulemaking Proposal, supra note 10, at 7746-47 (banks operating as discount brokers would act solely as agents, without any underwriting activities or provision of investment advice, and margin lending by nonbank subsidiaries would be conducted pursuant to Regulation T); 12 C.F.R. § 225.4 (Regulation Y) (listing of activities, and restrictions on those activities, that bank holding companies can engage in without special permission); Security Pacific Application, supra note 7, at 86,259-61 (bank forming discount brokerage subsidiary must process all margin loans at bank branch offices). The Supreme Court has relied extensively on these preconditions in evaluating the legality of particular activities. See Board of Governors of Federal Reserve System v. Investment Co. Inst., 450 U.S. 46, 52, 56-57, 62, 67 (1981).

174. The Securities Exchange Act of 1934 simply excludes a bank from the definition of "broker" and then defines "bank" narrowly. "Broker" "means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. § 78(a)(4) (1976). "Bank" is defined as:

(A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution, whether incorporated or not, doing business under the laws of any State of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this chapter, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.
affiliates and bank subsidiaries are within the definition of broker,¹⁷⁵ and thus would be required to register with the SEC.¹⁷⁶

Separately incorporated, discount brokerage operations would be subject to normal SEC regulation and would follow the broker margin rules. Nor is separate incorporation overly burdensome to banks. Every reported bank discount brokerage proposal has stated that the brokerage will be separately incorporated.¹⁷⁷ For reasons of increased fairness and low-cost investor protection, both the Treasury Department and the SEC have advocated mandatory separate incorporation for other bank securities activities.¹⁷⁸

The Treasury and SEC proposal, however, differs in several ma-


¹⁷⁵. Because they are not within the definition of “bank,” see note 174 supra, they are not excluded from the definition of broker.

¹⁷⁶. The SEC at one point contemplated deleting the entire bank exemption from the definition of broker. See Spencer, supra note 106, at 626. It did not recommend this action, however, because it “would result in duplicative and unduly burdensome regulation in some respects.” Id. The SEC noted that for the most part, recent bank incursions into securities, while “highly visible, were only formalizations of activities conducted by banks over the years.” Id. at 616. The SEC found, for example, that over 4,000 banks perform some type of customer brokerage service, a number that has remained fairly constant in recent years. Id. at 619.

The registration requirement, however, would not apply to those banks engaging in occasional securities transactions. It would only apply to banks that set up a high-volume discount brokerage service. Furthermore, the SEC apparently never considered the routine extension of margin credit in the context of bank discount brokerage operations. See id. at 617 n.4 (description of bank brokerage activities studied). In an Automatic Investment Service, for example, the bank extends no credit whatsoever, but executes the transaction after deducting the appropriate amount from the customer’s checking account. See id.; Bank AIS, supra note 31, at 81,354. Similarly, bank plans for stock purchase plans and the dividend reinvestment plans studied by the Commission involved automatic deductions rather than extension of credit. See Spencer, supra note 106, at 617 n.4. See generally Note, supra note 70, at 1478-80 (description of bank brokerage activities in the mid-seventies). Even in his 1982 testimony SEC Chairman Shad only discussed brokerage activities that did not involve margin lending. See 1982 Hearings, supra note 139, at 31-32 (statement of John S.R. Shad, SEC Chairman). The First regulatory approval of bank discount brokerage operations did not occur until later in the year. See S & L Brokerage Proposal, supra note 11.

¹⁷⁷. See BankAmerica Application, supra note 2, at 85,961 (bank holding company affiliate); FHLBB General Counsel, supra note 104, at 61,031-32 (several proposals for securities subsidiary, joint ventures with discount brokerage firms, and investments in discount brokerage firms); Security Pacific Application, supra note 7, at 86,255 (bank subsidiary); S & L Brokerage Proposal, supra note 8, at 61,022 (corporation owned by several savings and loan associations). All of the brokerage corporations are registered as brokers with the SEC. See, e.g., Federal Reserve Board, supra note 3, at 106 (BankAmerica’s operation); FHLBB General Counsel, supra note 104, at 61,030 n.3.

¹⁷⁸. See 1982 Hearings, supra note 139, at 6, 9, 11, 17 (statement of Donald T. Regan, Secretary of the Treasury) (needed to preserve competitive equality and upgrade investor protection); id at 25 (statement of John S. R. Shad, SEC Chairman). The proposal did not address discount brokerage subsidiaries but was limited to banks that wanted to underwrite municipal revenue bonds or act as advisors to mutual funds. Id. at 5, 6.
terial respects from the recommendation of this Note. First, it would limit the power of banking regulators to oversee the operations of securities affiliates. Presumably the rationale of this approach is to prevent duplicative, burdensome regulation. But this concern seems unjustified given that all bank discount brokerage operations have so far willingly submitted to the overlapping jurisdiction of the SEC and the bank agencies. Because banking authorities often need to examine affiliates closely to protect bank depositors, and because bank examiners can exercise their authority with some flexibility, prudence requires that the normal bank regulations on affiliates should remain intact.

179. See 1982 Hearings, supra note 139, at 5-6 (statement of Donald T. Regan, Secretary of the Treasury); id. at 53 (statement of J. Charles Partee, Member, Board of Governors of the Federal Reserve System). According to Mr. Partee, the proposal would permit the Federal Reserve to examine the affiliates only on “a prior finding that the financial condition of the affiliate is likely to have a materially adverse effect on the safety and soundness of the bank.” Id. at 55. In short, the Board could only examine a subsidiary for soundness where the unsoundness of the subsidiary is apparent. This measure is less likely to prevent financial deterioration than it is to arrest it.

180. SEC Chairman Shad puts great stress on regulation by function — “the principle that similar functions should be regulated by the same agency.” 1982 Hearings, supra note 139, at 32. He sees three advantages to this approach. First, each agency regulates where it has the most expertise. Second, each “function” is regulated consistently. Third, functional regulation “minimizes regulatory conflict, duplication, and overlap.” Id. at 35. These three virtues are not necessarily consistent. Only the third, for example, mandates a complete and rigid division of regulatory jurisdiction. The first principle — dividing jurisdiction by expertise — might in fact mandate regulatory overlap. The SEC, for example, has developed an expertise in the regulation of brokerage operations. However, it has no expertise in evaluating how the activities of an affiliate can impair depositor confidence in a bank. See note 182 infra and accompanying text. Only the banking authorities have developed this proficiency. Thus, if expertise were the sole criterion for allocating regulatory jurisdiction, both the SEC and the banking authorities would regulate brokerage affiliates of banks.

181. All have registered with the SEC as brokers, see note 177 supra, but they are still subject to bank regulation.

182. The Federal Reserve Board objected strongly to limiting its oversight of affiliates because of the need to protect depositors. See 1982 Hearings, supra note 139, at 43 (statement of J. Charles Partee, Member, Board of Governors of the Federal Reserve System) (Board would not object to separate incorporation “if we were to retain the authority to go in and to look at those activities and see the extent to which they are affecting the status of the whole banking organization.”).

The Board is worried about the effect of a struggling affiliate on the public’s perception of the bank. Id. at 43, 53-55, 57, 60-62, 65-66. Normally, “the public’s confidence in a bank is generally linked with the financial strength of any important nonbank affiliate.” Id. at 55. Because “the public often is aware that the bank and its nonbank affiliates are under common management and control, and are operated largely as a single entity . . . the public is apt to assume that when an important nonbank affiliate is experiencing financial difficulty, the bank may also be having problems . . . .” Id. at 68. In the past decade, adverse public reaction to problems of affiliates has driven two banks out of business. Id. at 65-66. Thus, to protect depositors fully, bank regulators need the authority to examine affiliates.

183. See 12 U.S.C. § 486 (1976) (Comptroller or Board can waive reports from affiliate if reports are unnecessary); 12 U.S.C. § 1844(c) (1976) (Board can use reports of other bank agencies instead of requiring its own). The Board has stated it would use any SEC-generated information in the oversight of bank securities affiliates. See 1982 Hearings, supra note 139, at 55 (statement of J. Charles Partee, Member, Board of Governors of the Federal Reserve System). Such cooperation could ease any burden caused by overlapping jurisdiction.
Second, the Treasury and SEC proposal requires that the separate securities corporation be a bank holding company affiliate rather than a direct bank subsidiary. By imposing this corporate structure, banking operations could be further insulated from any risk incident to the securities activity. With discount brokerage, however, risk is not really an issue because relatively little capital investment is involved. To the extent that discount brokerage poses a danger to the parent bank, the normal bank examination procedure, with its emphasis on solvency and protection of depositors, responds to the problem more directly. The other restrictions set forth in the Treasury and SEC proposal are similarly irrelevant to discount brokerage.

184. See 1982 Hearings, supra note 139, at 5-6 (statement of Donald T. Regan, Secretary of the Treasury). As a concession to small banks made because of the costs of reorganizing into a bank holding company, banks with less than $100 million in assets would be able to set up direct securities subsidiaries. Id. at 6.

Though this Note would not require a bank holding company structure, banks wishing to operate a discount brokerage might find such a structure desirable. If the Comptroller's application of the McFadden Act to discount brokerage is correct, see note 190 infra, direct brokerage subsidiaries are subject to fairly stringent margin lending restrictions.

185. See 1982 Hearings, supra note 139, at 17 (statement of Donald T. Regan, Secretary of the Treasury); id. at 97-98 (statement of Professor Robert Charles Clark). The logic apparently is that losses of a subsidiary directly injure the parent bank; losses of a bank holding company affiliate directly injure the parent holding company but only indirectly reflect upon the bank affiliate. Public reaction to losses of an affiliate, however, does not seem to depend on the intricacies of corporate form. The public considers problems of an affiliate as problems of the bank. See note 182 supra. Thus, the threat of a panic by depositors does not seem to vary with the corporate form.

186. The rationale for separate incorporation for discount brokerage services is not insulation from risk, but equivalence of regulation and protection of bank brokerage clients. See note 178 supra and accompanying text.

187. See notes 90-92 supra and accompanying text.

188. In its desire to eliminate overlapping regulation, the Treasury proposal limited the most important guard against risks to the bank — bank agency oversight of nonbank affiliates. See notes 179-83 supra and accompanying text. If allocation of regulatory jurisdiction by expertise is the goal, the banking authorities certainly have the most expertise in protecting bank depositors from the risks of nonbank affiliates. See note 180 supra.

189. The Treasury and SEC proposal imposed two other requirements on bank securities subsidiaries. First, relations between the bank and the subsidiary would be tightly regulated. Banks, for example, could not offer interest-free or low-interest loans to the subsidiary. These regulations would prevent certain bank advantages, such as access to low-cost funds, from spilling over and subsidizing nonbank activities. See 1982 Hearings, supra note 139, at 6, 8 (statement of Donald T. Regan, Secretary of the Treasury).

These bank “subsidies” might affect competition for government revenue bonds and mutual funds — the bank securities activities discussed during the hearings—but such subsidies are unlikely to affect competition in the discount brokerage industry. This position is, in effect, the “cross-subsidization” argument already rejected by the Federal Reserve Board. See notes 122-26 supra and accompanying text. Low barriers to entry, actual entry by relatively small firms, and the present 91.6% market share of full-service brokers, see note 123 supra and accompanying text, make it unlikely that bank subsidization of affiliates would cause a few bank affiliates to dominate discount brokerage in particular or retail brokerage in general.

The second restriction in the proposal was that if banks engaged in the new activities — underwriting government revenue bonds and advising mutual funds — they not only must incorporate these activities separately, but must also transfer their other securities activities to the new entity. See 1982 Hearings, supra note 139, at 5-6 (statement of Donald T. Regan,
The Federal Reserve Board has expressed two reservations about a separate incorporation requirement, and its proposed rule on bank holding company discount brokerage operations does not contain such a provision. First, the Board proposed to retain supervisory power over brokerage affiliates; as discussed above, this Note's proposal would not limit this power. Second, the Board felt that separate incorporation might burden smaller banks. Yet of the small institutions proposing discount brokerage services, chiefly savings and loan associations, every one stated that the service would be separately incorporated. The reason for this approach is simple: discount brokerage requires a large customer base. These institutions, too small to run such an extensive operation themselves,

190. See Rulemaking Proposal, supra note 10, at 7747. The only requirement for separate incorporation is that any margin lending done pursuant to Regulation T, 12 C.F.R. Part 220 (1982) (margin credit regulations for brokers), must be "conducted by nonbank subsidiaries of bank holding companies .... " Id. The proposal did not clearly indicate whether banks could continue directly to offer margin credit under Regulation U, 12 C.F.R. Part 221 (1982).

The Comptroller has taken the opposite approach to margin credit. He ruled that "all essential branch banking functions performed in connection with [the discount brokerage operations] be performed at chartered [authorized branch] offices." Security Pacific Application, supra note 7, at 86,261. The Comptroller considered the extension of margin credit, even by a separately incorporated discount brokerage service, as a branch function for the purposes of the McFadden Act. Id.; see 12 U.S.C. § 36(f) (1976) (regulation of branch banking activities). Nonbranch discount brokerage offices could advise clients on loans, but all loan applications would need to be processed and approved at regular bank branch offices. Security Pacific Application, supra note 7, at 86,259-60. This is a restrictive interpretation where the brokerage subsidiary is registered with the SEC as a broker, id. at 86,256, and so should have the freedom to extend margin loans as a broker.

While both these restrictions reflect, in opposite directions, the congressional assumptions about margin loans, see notes 166-67 supra and accompanying text, neither responds to the problems of unequal regulation and unequal investor protection. See text at notes 151-65, 172 supra. This Note's recommendation of mandatory separate incorporation with concomitant SEC registration is a more comprehensive approach to meshing the separate systems of regulation. To the extent that bank agency proposals ignore such concerns as investor protection, they fail to fulfill Congress's plan to protect brokerage customers.

191. See note 182 supra.

192. See 1982 Hearings, supra note 139, at 45, 52-55, 64 (statement of J. Charles Partee, Member, Board of Governors of the Federal Reserve System).

193. FHLBB General Counsel, supra note 104; S & L Brokerage Proposal, supra note 8.

194. See note 63 supra and accompanying text. In contrast, activities allowed under the Treasury proposal did not require extensive resources. The Treasury Department would have allowed banks to underwrite government revenue bonds and advise mutual fund companies. See note 178 supra. Smaller banks might only bid on a few bonds in a year; separate incorporation and capitalization might drive them out of the municipal bond business. See 1982 Hearings, supra note 139, at 45, 52, 64 (statement of J. Charles Partee, Member, Board of Governors of the Federal Reserve System). The Treasury and SEC requirement would thus be unfair to these banks, and would actually reduce competition among municipal bond underwriters.
band together in joint ventures or servicing arrangements.\textsuperscript{195} They can only operate a discount brokerage through a pooling of resources that necessarily requires separate entity status. The Board's solicitude for small banks is misplaced here. Given the advantages of separate incorporation, and the lack of serious drawbacks, bank regulators should require it of all bank discount brokerage operations.

\textbf{CONCLUSION}

Two interpretations can reconcile the apparent conflict among the provisions of the Glass-Steagall Act. The agency interpretation, which permits bank discount brokerage services, has the advantages of Supreme Court precedent and internal consistency. Further examination of the purposes of Glass-Steagall indicates that discount brokerage is not within the proscribed category of investment banking. The arguments against discount brokerage fall away upon recognition of the nature of the business. It is a service business lacking the speculative direct investment element characteristic of dealing or underwriting. The implementation of discount brokerage services, however, raises several problems of fairness and protection of investors. To remedy these problems, the regulatory authorities should require separate incorporation of the discount brokerage operation.

\textsuperscript{195} In the most recent batch of proposals, for example, only three contemplated operations wholly owned by small institutions. Three others involved an equity investment in a newly formed discount brokerage firm, a joint venture with an existing discount brokerage firm, and a service arrangement with a newly formed brokerage firm. \textit{See} FHLBB General Counsel, \textit{supra} note 104, at 61,031-32.