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Remarks to

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The Glass-Steagall Act
and
The Securities and Exchange Commission

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Commissioner

The views expressed herein are those of Commissioner Treadway and do not necessarily represent those of the Commission, other Commissions, or the staff.

THE GLASS-STEAGALL ACT

AND

THE SECURITIES AND EXCHANGE COMMISSION

During the past year, the blurring of traditional boundaries between the banking and securities industries has resulted in the Commission's taking various positions on Glass-Steagall. Due to the Commission's somewhat unclear responsibility for Glass-Steagall matters, I think it is safe to say that the Commission's approach has been on an *ad hoc* basis. Indeed, the simple fact is that the Commission is not primarily responsible for interpreting and enforcing Glass-Steagall. Some argue forcefully that the only authority the Commission has to enforce Glass-Steagall is indirect, through disclosure. Therefore, if the uncertain, or novel Glass-Steagall issues are fully disclosed, proponents argue that the SEC has discharged its duties and should stay out the picture.

1. Bank Brokerage Activities

The recent expansion of securities brokerage activities by depository institutions is, I suppose, as good a starting point as any.

a. Perhaps the most publicized recent Commission action in this area is the favorable May 13, 1982 letter to the Federal Reserve Board on the proposal by BankAmerica Corporation to acquire Charles Schwab & Company, a discount broker.

b. Perhaps the next most publicized matter arose when the Federal Home Loan Bank Board approved the plan of a group of S&L's to form a jointly-owned registered broker-dealer subsidiary, Savings Association Investment Securities, Inc. ("SAIS"), to act in a agency capacity as an "introducing broker." On July 8, 1982, the Commission's staff issued a no-action letter on this matter after the FHLBB's General Counsel on May 6, 1982 issued a favorable Glass-Steagall opinion on the organization and operation of SAIS.

In addition to these two, where the Commission took affirmative actions, other developments have occurred without direct Commission ruling or involvement:

a. The acquisition by Washington Mutual Savings Bank, a large state-chartered thrift institution in the Pacific Northwest, of Murphey Favre, Inc., a full service broker-dealer, which provides customers with investment advice and may engage in underwriting, selling or distributing securities. These activities exceed the range contemplated by the BankAmerica-Schwab consolidation. The Commission was not asked and did not take any position on this management.

b. Security Pacific National Bank established an "introducing broker" relationship with Fidelity Brokerage Services, Inc. The Comptroller also approved the application of Security Pacific National Bank to offer discount brokerage services, on an agency basis, through a new subsidiary, Security Pacific Discount Brokerage Services, Inc. The Comptroller also recently granted Security Pacific's application to purchase Kahn & Company, a discount brokerage firm with 30,000 retail accounts. Similarly, the Commission was not asked to take any position on these matters.

c. Union Planters National Bank of Memphis obtained approval from the Comptroller to acquire the stock of Brenner Steed & Associates, Inc., a discount broker. Again, the Commission was not asked to take any position.

For the first time, I have seen written speculation in various trade publications about a CitiBank-Merrill Lynch and BankAmerica - Prudential consolidation. If this turns out to be anything more than idle speculation, the events I have mentioned would seem inconsequential. Fortunately, no one has asked the Commission to take any position on these matters.

These are but a few specific examples of expanded bank involvement, or potential involvement, in the securities business. But even though banks are expanding their securities activities, that does not mean that all bank securities activities are subject to Commission regulation. In fact, banks and broker-dealers may engage in similar activity but be regulated differently by different entities. The key differences, of course, are those of broker-dealer registration, Commission examination authority, and self-regulatory organization requirements, including personnel qualifications.

In both Schwab and SAIS, the Commission focused, to a large extent, on the fact that the bank's broker-dealer subsidiary would be a separate corporation registered with the Commission. Schwab engages in limited brokerage activities, uses qualified registered representatives and, as a separate entity, continues to be registered as a broker-dealer and subject to full Commission oversight and regulation. SAIS is

similar, in that SAIS will be a registered broker-dealer subject to full Commission regulation, and SAIS employees, including those engaged in securities activities on the premises of participating S&Ls, will be qualifed as registered representatives. The Union Planters' brokerage subsidiary also will be registered as a broker-dealer, subject to Commission regulation.

In contrast, Security Pacific will not use a separate corporation but will use bank employees who will not be trained or qualified as registered representatives and will not be subject to Commission regulation.

2. Bank Investment Management Activities

Turning to investment management activities of depository institutions, four areas merit comment: (1) School Street Fund; (2) Sweep arrangements; (3) the Master Card and Visa funds; and (4) CitiBank's pooled IRA fund.

On October 14, 1982 the Commission granted the request for acceleration of the effectiveness of the registration statement of School Street Mutual Fund, a wholly-owned subsidiary of the Boston Five Cents Savings Bank, a state-chartered, non-member bank. Boston Five has two wholly-owned subsidiaries, School Street Advisor, Inc. and School Street Fund Distributor, Inc., organized soley to advise and distribute the fund. Most of the officers and directors of the distributor and adviser are employees of the bank or its outside legal counsel. Shares of the fund will be available for purchase through the distributor or transfer agent and there will be no literature or account information available at the bank. The Commission's decision to grant acceleration was taken only after the FDIC, on August 23, 1982, issued a Statement of Policy on Applicability of Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks. That statement came after the SEC requested an opinion from the FDIC dealing specifically with School Street and Glass-Steagall. A certain amount of controversy and litigation also was involved, which I believe others at the table will cover.

Second, the operation by banks of "sweep" accounts (under which generally the bank sweeps monies in excess of a predetermined amount held in accounts with the bank to purchase shares of money market mutual funds for customers) continue to be of interest to the Commission. In a sense, the Commission has less guidance from the bank regulators on this question than on the School Street type of matter, but is not now withholding grants of acceleration of effectiveness. If the activities of the banks constitute "underwriting," "issuing," "selling" or "distributing" "securities" -- all terms of art -- those activities would violate Glass-Steagall. Glass-Steagall, however, does not define any of these terms, and the Commission generally has taken the view that such

terms should be interpreted *in pari materia* with the securities laws concepts.

In determining whether "sweeps" violate Glass-Steagall, the key factor is the role played by banks in selling shares of the funds, a role which may vary considerably. An active role by the bank in promoting the sale of fund shares -- with direct bank advertising, on-premises distribution of prospectuses and direct responses by bank employees to inquiries about the fund -- suggests "underwriting" or "distributing." If a fund compensates the bank, the question is further complicated.

Arrangements between depository institutions and mutual funds involving reciprocal practices also were reviewed by the Commission in 1982. These principally include the Money Manager Fund, sponsored by the Master Card organization and Fidelity Management and Research Company, and the Visa Money Fund, sponsored through the Visa USA Inc. network composed of 12,000 finanical institutions. The Money Manager Fund registration statement filed with the Commission became effective last year. The Money Manager Fund has two main parts: a demand deposit or "NOW" account with a participating depository institution and an account with the Money Manager Fund, a no-load money market fund. The Fund's registration statement, as originally filed, stated that the Fund would purchase instruments issued by the participating bank when such instruments being issued by the banks are comparable to other obligations of that type in terms of yield, quality and maturity. The Fund's investment policy plainly stated that instruments of participating banks would be preferred over those of other financial institutions.

In response to the concerns of the Commission's staff about the reciprocal nature of the Fund's proposed investment policy, the Fund revised its policy to state that whenever the Fund purchases instruments which participating banks generally issue, it will not give a preference to those banks that participate with the Fund, although it may purchase such instruments from those banks in the normal course of purchasing portfolio instruments.

The Visa Fund concept is similar to the Money Manager Fund, except Visa Fund intends to invest in bank certificates of deposit in amounts closely approximating the value of Visa Fund shares purchased by customers of a particular bank. Customers' funds would not even be transmitted to Visa Fund. Instead, when a customer purchases Fund shares and pays the participating banks, the bank using the Visa communication network would transmit its certificate of deposit to the Fund in the amount of one or more customer orders.

While permitting the registration statement of the Money Manager Fund to become effective, the Commission has not declared

the Visa Fund's registration statement effective. In September, 1982, the Commission held public hearings on the broad issues of reciprocity, Sections 17 and 36 of the Investment Company Act, and other issues raised by the Visa Fund. Since then, the Visa matter essentially has been dormant, perhaps have being outdated before it got off the ground by the Garn - St. Germain Money Market Deposit Account. The registration statement, however, has not been withdrawn.

I note that many of the issues raised by the Master Card and Visa approaches are not confined to Glass-Steagall but arise under the Investment Company Act. Also, to the extent objections could be raised under Glass-Steagall Act, those objections essentially would be premised on an _in pari materia_ interpretation of various key Glass-Steagall terms, using securities laws concepts. And I note further -- in the interest of full disclosure -- that last November, the Court of Appeals for the District of Columbia Circuit reversed the District Court in _A.G. Becker, Inc._ v. _Board of Governors of the Federal Reserve System_, and held that national banks may sell commercial paper issued by third parties without violating Glass-Steagall. The District Court had ruled that commercial paper is a security for Glass-Steagall purposes and had invalidated a ruling of the Federal Reserve Board that Bankers Trust's commercial paper activities did not violate Glass-Steagall. The District Court reasoned that commercial paper is a security under the Securities Act of 1933 and that Glass-Steagall and the Securities Act should be similarly interpreted _in pari materia_.

The Court of Appeals rejected this view: "We must assign the term 'security' a different meaning in the Glass-Steagall and the Securities Act if a different interpretation is called for by the respective policies of those Acts." The Court of Appeals noted that the dangers Glass-Steagall was designed to prevent are not present in the case of commercial paper. Bank sales of commercial paper do not create the danger that bank underwritings may tie up depositors' funds in speculative securities because the bank acts simply as an agent in the sales; the bank does not agree to purchase the paper on its own account, with the funds of depositors; and the bank's reputation for prudence will not suffer by its association with the issue of commercial paper, which is a highly sound, short-term investment, and sophisticated purchasers of commercial paper will understand that this paper is not backed by the guarantees of commercial bank deposits. This decision provides precedent for interpreting terms in the securities laws and Glass-Steagall differently, contrary to Commission arguments.

In the area of collective investment vehicles, the Comptroller of the Currency recently granted an application of Citibank for various exemptions from the Comptroller's

trust regulations for a common trust fund for IRA's. Citibank will act as trustee of the individual IRA's and invest the IRA assets in a trust maintained by Citibank. As trustee, the bank also acts as investment adviser and performs other services for the funds. The Comptroller concluded that IRA assets maybe commingled in either of the two types of funds permitted by the Comptroller's regulations: common trust funds for assets held in trust or a similar fiduciary capacity, and funds consisting solely of assets of retirement or similar trusts exempt from federal income tax.

Citibank's registration statement, filed with the Commission on behalf of the trust under the Investment Company Act and the Securities Act of 1933, became effective in February, 1983. As a result of staff review of the registration statement, Citibank agreed to include:

(1) disclosure emphasizing that the funds invested in the trust are not bank deposits and are not insured by the FDIC;

(2) a description of Glass-Steagall issues raised in the 1971 Supreme Court decision in ICI v. Camp, in which the Court held that the Glass-Steagall Act prohibits a national bank from operating a fund for the collective investment of managed agency accounts; and

(3) disclosure of the complaint for declaratory and injunctive relief filed by the Investment Company Institute attacking the Comptroller's decision.

3. Disclosure Issues

While disclosure may not appear to be a direct Glass-Steagall issue, I nonetheless believe that the erosion of Glass-Steagall, inter-industry consolidations, and potential consolidations of regulators give rise to some interesting disclosure issues. In a sense, these are not new, but are part of the continuing tension between banking and securities regulators' attitudes toward disclosure. Let me touch briefly on three developments: (1) The Fidelity Financial Section 21(a) Report; (2) the Youmans decision; and (3) Section 12(i) of the Exchange Act.

In July, 1982, the Commission issued a Section 21(a) Report, concluding that Fidelity Financial Corporation and Fidelity Savings and Loan Association had violated the anti-fraud provisions of the securities laws in connection with the sale of retail repo's. The Commission found that the Association failed to disclose of the material facts concerning the risks of investing, including uncertainties as to the status of secured interests in the underlying collateral and the Association's greatly deteriorating financial condition, which directly affected its capacity to meet its obligations on the repo's. The Commission stated:

"[S]ince a retail repo issuer's financial condition is material to investors, disclosure is clearly necessary where the issuer of such securities is in such financial difficulty as to call in question its ability to meet its obligations with respect to such securities."

The FHLBB, I believe, views that Report as a favorable development, since it serves to educate an industry in which the stock form of company has not been widespread about disclosure obligations.

The recent case of SEC v. Youmans, 543 F. Supp. 1292 (E.D. Tenn. 1982), points up the continuing conflict between bank and securities disclosure attitudes but, at the same time, may suggest a narrowing of differences. The case arose from the 1976 failure of Hamilton National Bank of Chattanooga, Tennessee, then the third largest bank failure in American history. Officers responsible for the bank holding company's periodic reports and proxy materials were found to have violated various anti-fraud, proxy and reporting provisions of the federal securities laws by failing to disclose material information about the holding company's financial condition and business practices of its wholly-owned bank subsidiaries, of which Hamilton was the largest.

The court found that an examination report was "highly critical" of the Hamilton National Bank, criticizing the "speculative nature of the loans, the lack of proper documentation, the poor management of the bank, the domination of the bank by the holding company" and certain irregular accounting practices. These facts were not disclosed in any SEC filings of the holding company. Bank officials contended that the Comptroller's report was "confidential," therefore disclosure of the conditions described in the report was prohibited. The court rejected this argument, noting that "most, if not all of these conditions were either known or should have been known to holding company officials from sources other than the examiner's report." While Youmans may not be read so broadly as to destroy the confidentiality of bank examination reports, it also seems clear that it puts banks and bank regulators on notice that material, adverse information in an examination report cannot be omitted from SEC filings merely because the information surfaces in a report labelled confidential.

Although Section 12(i) of the Exchange Act requires bank regulators to amend certain of their securities disclosure regulations to reflect corresponding Commission amendments, some have been relatively slow in doing so. There is one notable exception, the Federal Home Loan Bank Board, whose regulations consist of one section, which incorporates SEC regulations by reference as they are adopted. The Commission has suggested informally that the other bank regulators might consider this approach, and none of them seems violently

opposed to moving more rapidly.

4. The Vice Presidential Task Force;

Commission Testimony on Glass-Steagall

As many of you are aware, the Chairman of the Commission is a member of the Task Force on Regulation of Financial Services headed by Vice President Bush. The Task Force has under study proposals to eliminate criticisms "that the exsisting allocation of responsibilities among federal agencies regulating financial institutions is highly complex, evoking characterizations such as 'crazy quilt' and 'labrynth'."

Among problems cited by the Commission for consideration in the Task Force study are:

1. Administration of the disclosure, reporting and proxy sections of the Securities Exchange Act under Section 12(i) is conducted by both the Commission and bank regulators. To achieve consolidation and uniformity, should all filings be made with and reviewed by the Commission?

2. Administration of clearing and settlement of securities transactions is also conducted by both the Commission and the bank regulators, with the Commission having overall policy-making authority for the clearance and settlement process. Does this duplication impose inconsistent requirements?

3. Bank-sponsored collective investment vehicles and investment companies are subject to substantially different regulatory schemes. As a result, is the regulation of essentially similar products fundamentally inconsistent?

In Congressional testimony last year, Chairman Shad stated that the Commission does not object to the entry of banks into the mutual fund and municipal revenue bond business, and supported proposals made by the Treasury Department to require banks to carry on these new activities by means of corporate securities affiliates which would be fully subject to the federal securies laws. The Commission has also recommended that, once banks enter these activities, their present securities activities be transferred to the securities affiliates.

5. Some Specific Issues to be Faced

It occurs tó me that many of the various debates about Glass-Steagall perhaps can be characterized as one chapter of the current debate about "regulation-by-function" versus "regulation by historical industry labels." Those concepts, however, seem to mean different things to different people.

At least, the idea of streamlining the regulatory process to assure uniform standards and to eradicate duplication seems generally accepted. But the stakes, both from the standpoint of industry participants and regulators who might have turf to protect, are high.

So, in an effort to tie together some of my random thoughts, particularly those about disclosure and regulatory agency structure, why don't I wrap this up by posing a few questions about Glass-Steagall which all of us may have to face:

1. Proponents of deregulation also seem to be the strongest advocates of consolidating regulatory agencies governing the financial services industry. But would consolidation into fewer agencies necessarily will mean less regulation? Or will one or a few consolidated regulators be more powerful and intrusive than multiple, smaller regulators?

2. Would the existence of a single, all-powerful regulator have the potential for stifling innovation and creativity? For example, if all pooled investment vehicles had been subject to regulation by bank regulators, would money market funds ever have gotten off the ground?

3. If "regulation by function" means a major consolidation of agencies, would consolidation mean fewer or less serious regulatory conflicts than those arising under the present system? For example, if securities and banking regulators were consolidated, and if a regulated entity engaged in both functions became troubled, how would such an agency resolve the conflict inherent in protecting investors on the one hand through full and prompt disclosure and protecting the enterprise on the other hand by less disclosure?

4. Does the trend of interpreting Glass-Steagall so as to permit banks to engage in broader brokerage activities carry with it the possibility that a situation may arise where the SEC will insist on access to bank records and scrutiny of bank transactions and bank business practices? And with what outcome to the enterprise, to the investors, and regulator to regulator?

5. If banks are permitted to manage mutual funds, does that carry with it the same potential for conflict and problems?

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