

JOHN SPARKMAN, ALA., CHAIRMAN
ALJAM PROKMIRE, WIS.
HARRISON A. WILLIAMS, JR., N.J.
THOMAS J. MC INTYRE, N.J.
ALAN GRANSTON, CALIF.
ADLAI E. STEVENSON III, ILL.
J. BENNETT JOHNSTON, JR., LA.
WILLIAM D. HATHAWAY, MAINE
JOSEPH R. BIDEN, JR., DEL.
JOHN TOWER, TEX.
WALLACE F. BENNETT, UTAH
EDWARD W. BROOKE, MASS.
BOB PACKWOOD, OREG.
BILL BROCK, TENN.
ROBERT TAFT, JR., OHIO
LOWELL P. WEICKER, JR., CONN.

DUDLEY L. O'NEAL, JR.
STAFF DIRECTOR AND GENERAL COUNSEL

United States Senate

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

RECEIVED

JAN 28 1974

S. & C. COMM.

January 28, 1974

The Honorable John Sparkman
Chairman, Committee on Banking
Housing and Urban Affairs
United States Senate
Washington, D. C.

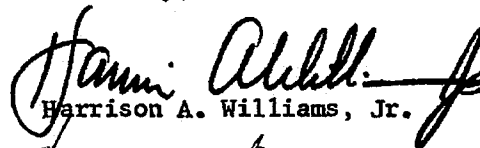
Dear Mr. Chairman:

Attached is a memorandum explaining a proposed study by the Subcommittee on Securities of the activities of commercial banks with respect to securities and the interpretation and enforcement of the limitations on these activities imposed by the Glass-Steagall Act of 1933. Because of the rapid diversification of banks and bank holding companies into areas traditionally regarded to be part of the securities business and the growing debate over appropriate regulations and the interpretation of existing statutory restrictions, we believe that such a study is needed and timely.

In conducting this study, the Subcommittee will utilize its existing staff. However, due to the complex economic considerations involved, we believe it is necessary to hire a staff economist in order to assure a thorough investigation. The addition of this professional staff member will require an increase in the Subcommittee's budget of \$30,000.

We intend to present the proposal for this study and the request for the indicated budget increase to the Banking Committee at its organizational meeting on January 29, 1974. We hope you agree with us as to the importance of the study, and that you will support our request for an adequate budget to undertake it in a responsible manner.

Sincerely,


Harrison A. Williams, Jr.


Edward W. Brooke

Enclosure

Subcommittee on Securities
Committee on Banking, Housing and Urban Affairs

- - - - -

STUDY OF BANK INVOLVEMENT IN THE SECURITIES BUSINESS

The Subcommittee on Securities proposes to carry out an in-depth study of the problems and issues related to the increasing involvement of commercial banks in various aspects of the securities business. In recent years, banks and bank holding companies have been rapidly and aggressively diversifying. A principal avenue of this diversification has been into areas traditionally regarded as part of the securities industry--e.g., stock purchase programs, mutual fund management, overseas underwriting, and investment banking advice. While providing increased competition in the financial community, the securities-related diversification of banks poses serious questions about both the integrity of the commercial banking function and the future of the securities industry as presently organized and regulated. The Subcommittee's study will explore fully the public policy implications of this diversification and the appropriateness and effectiveness of existing legal limitations on banks' securities activities.

One of the objectives of the Glass-Steagall Act of 1933 was to prevent commercial banks from engaging in the investment banking business. The experience of the 1920's had shown that the combination of commercial and investment banking functions had great potential for abuse, and the Congress concluded that the policies of competition, convenience, and expertise which might otherwise support the entry of banks into the

securities business were outweighed by the "hazards" and "financial dangers" that arise when they do so. The Congress saw these "hazards" as including:

1. The danger that a bank which is directly or indirectly involved in the trading and ownership of speculative securities may be financially damaged by a stock market decline.
2. The more subtle but potentially equally serious danger that the confidence of a bank's depositors might be severely impaired should they suffer losses on securities purchased through the bank or in reliance on its recommendations.
3. The substantial promotional pressures to which a commercial bank engaged in securities activities is exposed. For example, a commercial bank with investment banking interests may be tempted to shore up a shaky investment banking affiliate through unsound loans, or to make credit facilities available unwisely to companies in whose securities the bank or its affiliate has invested, or to make loans to customers in order that they may buy securities sponsored by the bank.
4. The serious conflicts between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice. These conflicts run the spectrum from the temptation to utilize depositors' lists for securities solicitation purposes to unloading excessive securities holdings through the bank's trust department.

According to the Supreme Court:

"Congress acted by the Glass-Steagall Act to keep commercial banks out of the investment banking business largely because it believed the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system." Investment Company Institute Camp, 401 U.S. 617 (1971).

The Congress has not investigated the extent or nature of banks' securities-related activities since the passage of the Glass-Steagall Act. Nor has it studied the effectiveness of that Act's limitations in preventing the abuses and dangers identified in 1933. As a result of active bank diversification, however, the entire subject has now been reopened and the proper interpretation of the Glass-Steagall Act has become a matter of increasing debate, with the various federal-regulatory commissions often taking opposing positions. Furthermore, under the 1970 amendments to the Bank Holding Company Act serious questions have arisen as to what, if any, securities activities are permitted by reason of being ". . . so closely related to banking or managing or controlling banks as to be a proper incident thereto."

One of the objectives of the Subcommittee's study will be to analyze the restrictions imposed by the Glass-Steagall Act and the Bank Holding Company Act on banks' securities activities and then to conduct a thorough investigation of banking and regulatory practices to determine whether the intent of these restrictions has been achieved, whether the original reasons for imposing such restrictions continue to exist, and whether the line the statutes draw between permissible and impermissible securities activities continues to make sense in light of changed economic conditions and arrangements.

The Subcommittee will specifically investigate the nature and appropriateness of bank activities in the areas of:

- Corporate finance, including investment banking advice, facilitation of the private placement of securities, and the underwriting of equity securities outside of the United States;
- Investment advice, including management of registered investment companies, discretionary investment advice for individuals, and economic and statistical services;
- Brokerage activities, including automatic dividend reinvestment plans, automatic investment plans, and the ownership and financing of registered brokers; and
- Underwriting of exempt securities, including syndicate and distribution practices, regulatory structure, and the desirability of banks being permitted to underwrite industrial revenue bonds.

In examining particular bank activities, the Subcommittee will give special attention to the manner in which banks' securities-related activities are regulated, the competitive position of banks vis-a-vis the securities industry, and the dangers which may be attendant to bank involvement in the securities business because of conflicts of interest, interlocking directorates and control arrangements, concentration of corporate ownership, and limitations of available sources of credit and financing.

The Report of the President's Commission on Financial Structure and Regulation, the so-called "Hunt Report", examined the problems relating to competition among and the diverse regulation of commercial banks, mutual savings banks, savings and loan associations, credit unions, private pension plans and reserve life insurance companies. Important as this study is as a first step toward rationalizing the country's financial structure, the Hunt Report did not examine relations between commercial banks and the securities industry. The Subcommittee's study will explore

this subject and thus take a further step in the important analysis of the structure and regulation of our financial institutions.

The Subcommittee plans to conduct a careful, detailed study and investigation of the present and proposed activities of banks in the securities business. It is expected that the gathering of data, hearings, and intensive staff analysis can point to solutions to some of the problems now surfacing as a result of rapid bank diversification. Also it is hoped that the Subcommittee's experience will enable it to make meaningful recommendations to the Congress. It is to be expected that many of these recommendations would take the form of proposed legislation.

In order to undertake this study, the Subcommittee proposes to utilize its existing staff with the addition of a full-time professional who has expertise in the field of bank economics. It is the intention of the Subcommittee to seek out for employment the best talent and most expert advice that is available. The total additional cost involved in hiring such a person and undertaking this study will be \$30,000.