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STUDIES--NOT PARTISAN RHETORIC--FOR GLASS-STEAGALL DECISIONS

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In 1933, after a Congressional investigation revealed that many banks and affiliated persons had participated in abusive securities activities, Congress enacted the Glass-Steagall Act to limit the extent to which individuals and institutions could be engaged in both banking and securities activities. Banks were prohibited from underwriting or distributing securities except those issued by the United States Government and its agencies and general obligations of states and their political subdivisions. Banks were also precluded from being affiliated with organizations engaged principally in underwriting and selling corporate securities and were limited in dealing in such securities to purchasing and selling ". . . without recourse, solely upon the order, and for the account of, customers, ..."

The Act also made it unlawful for persons engaged in underwriting, selling or distributing securities to engage in deposit banking to any extent and, except as provided by Federal Reserve Board regulations, officers, directors, partners or employees of investment banking firms were precluded from simultaneously serving in any of those capacities with a commercial bank.

There is general agreement that one objective of the Glass-Steagall Act was to eliminate conflicts of interest that occur when banks act as commercial lenders, financial advisers, and trustees and also engage in underwriting, distributing, and selling securities. A second objective was to encourage the maintenance of economic stability by prohibiting banks from channeling their massive deposit funds into speculative equity or debt securities. In addition, the Act was intended to encourage the safety and solvency of banks and public confidence in them by removing the opportunity and temptation to use bank assets to salvage securities affiliates and to enrich bank officials through self-dealing.

There have been many changes in bank operations and regulations since 1933. With some encouragement, and support from Congress and the bank regulators, as the economy has developed and financial services needs have expanded, banks have also expanded their activities. In addition to traditional depository and trust functions, banks now offer a full range of advisory services such as individual portfolio management for small accounts and investment advice to closed-end investment companies and real estate investment trusts, and financial consulting and private placement services to corporations. Banks have also initiated such brokerage services as dividend reinvestment plans and automatic investment services through which customers may purchase corporate securities.

As banks have expanded their securities activities they have been met with opposition from those to whom they have become competitors. Banks maintain that their activities have been beneficial to the public, and that they are within both the letter and the spirit of Glass-Steagall provisions. Moreover, they claim that the restrictions of the Glass-Steagall Act are outmoded and unnecessary, and that the public interest would be served if the law were clarified with respect to lawful bank brokerage activities and amended to permit banks to underwrite revenue bonds and to offer commingled agency accounts. The securities industry, on the other hand, believes that because of bank deposit activities and the differences between applicable bank regulation and the regulation of other securities industry participants, bank competition is unfair. Moreover, securities industry spokesmen assert that, because of the great increase in bank resources and broad range of their operations, the potential for abuse which exists today is not only equal, but greater than that which existed in 1933, and, therefore, the Act's restrictions upon bank participation in securities activities should be strengthened.

It might be expected that as a member of the Securities and Exchange Commission I would recommend or support proposals to protect non-bank securities firms, but I believe that the level of debate must be elevated to a much higher plane. From the limited evidence that is available at this time, it is my judgment that, while the conflicting claims

of banks and their regulators, as well as those of the securities industry, have strong self-interest overtones, all have a basis in fact and theory and thus merit serious consideration. What is at issue is not the narrow proposition of whether the securities industry should be protected from bank competition. At issue is the integrity and efficiency of our banking system and our capital raising mechanism for public corporations. Although it may be too much to expect all interested parties to recognize and admit the merit in their opponents' positions, I believe that this must be done, and then we must move from the rhetoric of partisan advocacy to the development and analysis of data on which informed public interest decisions can be made.

Before decisions are made with respect to retaining, altering, or removing present Glass-Steagall restrictions, it should be determined whether the benefits that could accrue from greater bank competition are likely to be offset or outweighed by the detrimental effect such competition could have on our present securities industry. It is also important to consider the benefits that could result from removing some of the uncertainty that presently exists because of conflicting interpretations of statutory language. An additional problem that must be considered is the extent to which banks and non-banks that are engaged in similar activities are subject to different regulatory schemes, and whether these differences

result in competitive inequities and disparate protections for investors. Unfortunately, these are not questions to which meaningful answers will be easily obtained, but that fact should not dissuade us from undertaking the task.

In April of 1974, the Securities and Exchange Commission issued a release soliciting written comments from all interested parties on policy and legal questions related to certain securities services sponsored by banks. Our purpose in seeking comments was not to involve ourselves in interpreting or administering the Glass-Steagall Act, for which we have no responsibility, but to provide us with information which would be helpful in determining how bank-sponsored investment services affect our securities markets for which we do have a responsibility, and whether investors are provided appropriate protections in connection with bank-sponsored securities services or whether the Commission should recommend that bank securities services be subject to the same type of regulation as are securities services offered by non-bank firms.

Our interests cannot be divorced completely from Glass-Steagall considerations, and the responses to our release contain some of the most thoughtful material available on Glass-Steagall issues.

Late last year, committees in both the Senate and the House initiated studies which will consider bank securities activities. Perhaps, because the Senate Committee on Banking, Housing and Urban Affairs has jurisdiction over both the banking

and securities industries and their federal regulatory agencies, the stated objective of the Senate Securities Subcommittee study is to:

> reexamine the provisions of both the securities and banking laws which set the pattern of regulation applicable to bank securities and investment management services as well as analyze the economic and competitive consequences of failure to take any legislative action.

To be more specific, the Subcommittee intends to determine:

1. the permissible bounds of new and traditional activities of banks, bank holding companies, and securities related firms under the Glass-Steagall and Bank Holding Company Acts;

2. whether the line drawn by statutes and by administrative and judicial decisions between permissible and impermissible securities activities for banks and securities related firms continues to be appropriate in light of present and predicted economic conditions and needs;

3. how the existing statutory and regulatory framework applicable to these bank securities activities affects investors, depositors, banks, brokerage firms and investment companies;

4. whether investors utilizing these services are adequately protected under the banking and securities laws and regulations;

5. whether competition in these services between the banking industry and the brokerage and investment company industries promotes efficiency and innovation in the delivery of financial services to investors and savers;

6. whether such competition could lead to undue concentration of economic power as a result of significant economies of scale;

7. whether competition endangers the safety and solvency of banks or investor confidence in capital markets; and

8. [finally to formulate] recommendations for legislative changes to implement the findings and conclusions of the Subcommittee.

The Subcommittee's Study Outline indicates that its efforts will be concentrated primarily upon bank brokerage and advisory services such as dividend reinvestment plans, automatic investment services, individual portfolio management services, advisory services for investment companies and REITs, tax-benefited retirement plans, commingled agency accounts, and the possible underwriting of municipal revenue bonds. During recent hearings, the Subcommittee Chairman, Senator Harrison F. Williams, also indicated a willingness to consider examining other areas such as bank corporate financing services, which are essentially advisory in nature, and the possibility of a case study approach to describe factually certain bank activities. Apparently, however, the Subcommittee does not intend to reconsider Glass-Steagall provisions separating commercial banking functions from underwriting and dealing in corporate securities.

The Study by the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Currency and Housing has an

entirely different focus. The House Committee does not have jurisdiction over our securities markets and its study of "Financial Institutions and the Nation's Economy" (FINE Study) is an examination of Discussion Principles which have an ambitious purpose to remove constraints, broaden powers and completely restructure our financial depository institutions in order to promote efficiency through increased competition.

As part of this massive restructuring, a new Federal Depository Institutions Commission would be created to fulfill the financial institution regulatory and supervisory functions now performed by the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, Federal Home Loan Bank System, and the National Credit Union Administration. Trust activities presently limited to commercial banks would be extended to savings and loan associations, mutual savings banks, and credit unions. Other current investment advisory and brokerage activities of banks are not specifically mentioned in the Discussion Principles as subjects of the House Study. The only direct reference to a reconsideration of Glass-Steagall restrictions is Item 11 of Title I which would permit banks to engage in the underwriting of state and municipal revenue bonds. The prohibition against underwriting of corporate securities by depository institutions would be retained.

It appears certain that the changes recommended in the Discussion Principles would bring about more competition by

depository financial intermediaries, not only with each other, but also with non-depository firms offering securities services. Recognition of the inter-relationship between activities of depository institutions and our securities markets is implicitly evident from the recommendation in the Discussion Principles that a member of the Securities and Exchange Commission would serve on the Federal Depository Institutions Commission. While such an arrangement might assure appropriate coordination, in my opinion, serving on both commissions could create serious problems, unless, among other things, changes are contemplated to resolve the differences between the disclosure and enforcement philosophies of depository institution regulators and the philosophy of the Securities and Exchange Commission.

In November of last year the Treasury Department, which also has a keen interest in our capital markets, issued a paper entitled "Public Policy Aspects of Bank Securities Activities" prepared by the Capital Markets Working Group and solicited comments from all interested parties. The Treasury Department Paper provides a good discussion of the policy issues which must be considered and the opposing arguments on these issues, but it does not reach conclusions nor does it provide a sufficient basis for reaching objective conclusions with respect to these issues.

In addition to the Congressional studies and the Treasury Paper, Section 11A(e) of the Securities Exchange Act,

as amended by the Securities Acts Amendments of 1975, directs the Commission to study the extent to which banks maintain accounts on behalf of public customers to purchase and sell securities registered under Section 12 of the Act. The Commission is also directed to consider whether the exclusion of banks from the definition of broker and dealer is consistent with investor protections and other purposes of the Act. This mandate requires the Commission to study the present bank involvement in securities activities, and, at least initially, this appears to include a study of all bank brokerage and advisory services. Our study will also consider other related securities activities performed by banks such as bank corporate finance and advisory services with respect to private placements, mergers and acquisitions, asset financings and similar transactions, and, in addition, may involve matters relating to the foreign banking activities of U.S. banks, as well as domestic activities of foreign banks.

Although the primary mandated objective of our study may not seem very broad, we must consider bank securities activities in the context of the vitality and efficiency of our securities markets and the ability of our capital raising factilities to meet anticipated demands for capital. We expect to develop data indicating whether adequate investor protections are available to those who utilize bank securities services, whether bank securities activities have beneficial or adverse effects upon the flow

and allocation of debt and equity capital to public corporations, the effect, if any, such activities may have on the operation of secondary trading markets in securities, and whether bank securities services are likely to result in a concentration of economic and political power that would not be in the public interest. While some may consider it heresy for me to suggest that our findings could indicate that present regulation of bank securities activities is sufficient to protect the interests of investors and the public, and that changes in our regulations are appropriate, we must also accept that as a possibility.

One could reach the conclusion that the involvement of banks and other depository institutions in securities activities is being over-studied. I certainly cannot agree with such an assessment. In my opinion, the danger instead is that the studies will not be sufficiently thorough and comprehensive to assess adequately the ramifications of alternative decisions. Just last Friday, the Commission and some of our key staff personnel had a full day of discussions with five top economists whose views we sought regarding specific data gathering efforts. My interpretation of their comments was that it would be impossible to obtain sufficient empirical data to form the sole basis for decisions with respect to bank securities activities. Seldom, if ever, do policymakers have sufficient information on issues as complex as the structure of our capital markets to eliminate the element of risk in their interpretative or policy decisions.

In the absence of such information, it is necessary and appropriate to use an eclectic approach combining available empirical data and economic theory to reach meaningful conclusions. On balance, economic theory would lean toward allowing competitive market forces to determine the extent of participation appropriate for competing financing institutions.

We can be sure, however, that the characteristics of human nature that brought about the abuses leading to Glass-Steagall restrictions still exist. There is no question that combining the authority to engage in commercial banking activities with brokerage services, investment advisory services, and investment banking creates potential conflicts of interest, and the opportunity for unfair competition, self-dealing, and the concentration of economic and political power. There are those who believe that the actions of some banks with respect to real estate investment trusts may not be so different from the rescue efforts by banks of their securities affiliates prior to the Glass-Steagall Act. The absence of action to resolve present Glass-Steagall problems is a decision equally as important to our capital markets as any other decision. In the public interest, we must combine our efforts to measure and evaluate whether it is possible to channel the activities of banks and other depository institutions in our securities markets through full disclosure and other regulatory measures so that investors and the general public may receive the benefits of increased competition.