I am happy to explain a phenomenon that, as far as I can tell, is peculiar to the United States and, thanks to U.S. influence, to Japan. That phenomenon is the legal separation between the commercial banking business and the investment banking business. Separation might not now be the correct word. Many developments over the 1980s have made the separation between commercial and investment banking in the United States a matter of historical interest rather than a practical reality. I predict these changes will continue: they will continue in the courts, they will continue in the administrative agencies, and they will continue in Congress with increasing momentum until these two businesses are again united.

Before 1933, there was no legal separation in the United States between investment banking and commercial banking. Indeed, before 1933 the banks were the largest participants in the investment banking business. The two largest securities houses in the United States were bank affiliates of the First National City Bank (now Citibank) and the Chase Manhattan Bank. Each bank operated large securities networks throughout the United States. J. P. Morgan actually conducted a deposit-taking business within its investment banking business. In 1929, the speculative bubble in stocks that had developed during the 1920s burst. Many banks failed and by 1933 the U.S. economy had ground almost to a halt—the start of the Great Depression.

Then, as now, our Congress decided to take action. The first thing they did was to hold hearings to identify the culprits and to formulate legislation to make sure that this calamity did not recur. The Senate held hearings in 1932–33 chaired by a gentleman named Ferdinand Pecora; these formed the basis of the remedial Glass-Steagall Act legislation, which separated investment and commercial banking in the United States. Senator Pecora held hearings, widely reported in newspapers throughout the country, prompted by complaints that many people had against bank-affiliated securities companies. At the time, thousands of banks were being closed and 32 states had declared banking holidays.

The Pecora hearings focused on instances where individual customers had been advised by the banks and by the banks' securities affiliates to
purchase securities that the bankers knew to be of questionable value. For example, the National City Company, which was the securities affiliate of Citibank in 1927 and 1928, underwrote approximately $90 million of Peruvian Government bonds even though the bank well knew that the country would be unable to repay principal or maintain interest payments on those bonds. No mention of this or other salient facts was made in any material National City distributed to its customers. On learning of such practices the public was outraged.

Not only individuals but banks in the United States were free to invest funds in such securities and many had done so, perhaps not too wisely in some cases. The largest bank failure in American history occurred at this point. The Bank of the United States failed because of speculation in securities as well as affiliate transactions. In these hearings, Senator Pecora spotlighted the fact that the leaders of the nation's banks had participated in improper insider trading and had benefited personally and substantially from many securities transactions in which their banks had engaged. Questionable lending practices were also brought to the public's attention: in some, the banks would lend money to issuers of securities to inflate their balance sheets and make it easier for the banks' securities affiliates to underwrite. There were instances reported where the bank would take the portion of the securities underwritten by the securities affiliate that the affiliate could not sell and dump those securities into the bank's trust department or into the bank's investment portfolio.

The hearings alone might not have caused the passage of the Glass-Steagall Act. Recent studies (and there has been much attention by U.S. academics into this period) indicate that speculation by financial institutions in the securities market did not cause the Depression and did not cause the large number of bank failures between 1929 and 1933. Modern studies show that during this period, liquidity virtually dried up in the United States, making it impossible to obtain credit. There is no question that improper securities transactions were practiced by bank securities affiliates. But these were few and appropriately addressed by the securities legislation enacted at the time, namely, the Securities Act of 1933 and the Securities and Exchange Act of 1934, which were designed to make sure the investor was protected and that brokers, dealers, and investment bankers operated within appropriate ethical boundaries.

The securities legislation might have been sufficient had there not been a convergence of events in early 1933. The public demanded that Congress take action on the banking crisis. At the same time bankers themselves had become concerned with the increasing number of failures. Shortly after he was inaugurated in March of 1933, President Franklin D. Roosevelt made one of his famous fireside chats, in which he emphasized the need to rehabilitate U.S. banking and he pointed to some of the
speculative abuses in banks that Senator Pecora had uncovered. And another legislator, Senator Carter Glass, the senator mainly responsible for setting up the Federal Reserve System in 1913 and 1914, indicated he was convinced that commercial banks had abandoned their traditional business for improper activities and should be barred from the securities business.

In March of 1933 most of the American public basically agreed with that point of view. More significant, the two leading banks, First National City Bank and Chase, both changed senior management and decided that they would publicly distance themselves from a business that had cost them so much in reputation. Chase announced that it was terminating its affiliate, and two days later First National City Bank followed.

With these announcements, opposition to the Glass Bill collapsed and the bill was passed on June 16, 1933. This coincidence of events—an ever-increasing wave of bank failures, the decision by the two major banks to leave the business, and the desire of many congressmen to demonstrate legislative action—resulted in the law that we know today as the Glass-Steagall Act. Its official name is the Banking Act of 1933. It accompanied the Securities Act of 1933: the securities provisions of the Banking Act are only a small part of the bill. Much of the bill is devoted to provisions setting up the Federal Deposit Insurance Corporation.7

Let us now take a moment to outline the technical provisions of the Glass-Steagall Act. This Act has four provisions aimed at separating, to the maximum extent feasible, commercial and investment banking in the United States. The heart of Glass-Steagall is Section 16.8 This section applies directly to national banks and to those state banks that chose to be members of the Federal Reserve System, that is, to most large U.S. banks. First, this provision says that banks may not invest directly in equity securities of any kind or non-investment-grade securities. Second, they may not underwrite or deal in any securities except those specifically enumerated, which generally include U.S. Government securities and general obligation bonds of state and local governments. Member banks also may not be affiliated with securities companies. A holding company or an individual cannot control both a bank and an investment bank. This provision required the divestiture by First National City Bank, Chase, the Bank of Boston, and many others of the securities affiliates that they had established in the early part of the century. Third, and this shows how far the legislators wanted to go, Congress forbade any officer, director, or employee interlocks between a member bank and any of the securities companies. Fourth, Congress specified that no underwriter or dealer in securities was permitted to take deposits. This provision was aimed at the investment houses, such as Morgan and Brown Brothers Harriman, which at the time were both underwriting securities and taking deposits.
After Congress passed the statute in 1933, its provisions were inter-
preted strictly by all concerned. The Federal Reserve had a great deal to
say about how those provisions were interpreted, as did the Comptroller
of the Currency. At that time the securities business in the United States
had all but dried up. As I noted, bankers themselves had decided to leave
the business. Consequently, banking organizations throughout the United
States divested themselves of anything to do with the securities business.

The separation of the commercial and investment banking industries in
the United States remained the case from 1933 until the 1980s. One
consequence was that an unusually strong investment banking business
developed in the United States. The Act also led to the growth of a
powerful and well-financed lobby, one of whose chief purposes appeared
to be, until recently, the maintenance of this separation of investment and
commercial banking. Called the Securities Industry Association (SIA), this
lobby has resisted the efforts of the Board, the Comptroller, and others
throughout the years to deregulate in this area, either by administrative
action or by legislative recommendation.

Consider one example of how successful the SIA was before the 1980s
in maintaining this strict separation. Under the Glass-Steagall Act, banks
may underwrite and deal in U.S. Government securities as well as bonds
and obligations of state and local governments. They may not, however,
underwrite municipal revenue bonds issued by state and local govern-
ments. Despite the close similarity of municipal revenue bonds to general
obligation bonds and repeated efforts by the Federal Reserve Board
throughout the 1950s, 1960s, and 1970s to seek modification of Glass-
Steagall to permit this limited activity, the SIA was successful in preventing
any amelioration of the Act. It was successful in the face of empirical
studies conducted by the Board showing the absence of any specific poten-
tial for harm and the real expectation of substantial public benefits for the
issuing local governments in the form of reduced underwriting cost and
more liquid markets. None of that mattered. The Act has not been
touched in any significant respect since 1933.

Nevertheless, in the late 1970s, things began to change, although not in
the legislative arena. Pressure to change Glass-Steagall built relentlessly in
the 1980s, culminating in full bank entry into the investment banking
business without any congressional action whatsoever, a result that would
have been unthinkable for five decades.

What led to this pressure? First, the significant improvements in com-
puter and communications technology in the 1960s and the 1970s sped up
and broadened the availability of information. This development substan-
tially undermined the traditional role of banks in the United States as
credit intermediaries. With technology came deregulation, which with
changing deposit insurance rates in the late 1970s and early 1980s fueled
the competition for capital. For example, in the 1970s banks began to lose deposits to the newly created money market mutual funds. These mutual funds could pay a market rate for money; banks were limited to 5 percent or whatever the Regulation Q ceiling was at that time. These funds have grown from less than $1 billion in 1972 to more than $450 billion in 1990. The best corporate customers of banks could obtain cheaper financing through the developing commercial paper market maintained by the investment banks than by going to their commercial bank for a commercial loan. This development had a direct impact on the level of bank products and placed enormous pressure on banks to do something to maintain their customer base.

As a result banks became interested in offering mutual funds to compete with those offered by the investment banks. They also wanted to be able to facilitate their commercial customers' movement into the commercial paper market by offering the commercial customer a choice: "We will make you a commercial loan or, if you choose, we will underwrite your commercial paper for you." Banks saw that investment banking firms in the 1960s and 1970s in the United States had grown enormously profitable (probably thanks to the competitive monopoly). The banks believed that their knowledge and experience would give them a significant opportunity for product expansion and diversification in risk, if only they could find some way around the seemingly insurmountable Glass-Steagall Act barrier. Thus began the ten-year movement of banks into the investment business in the United States.

At this point, it may be helpful to look at how these changes and movements were effected. The first significant challenge to the domination of investment banks in the securities market in the United States occurred at the Federal Reserve Board in the 1970s. Something of a liberalization had occurred in the 1960s when the Board held that the Glass-Steagall Act did not apply outside the United States. As a result, U.S. banks began to underwrite corporate debt overseas—Eurobonds. (U.S. banks are now participants in the debt markets in Europe. They are also participants in the European equity markets, but to a very small extent. Under current regulations, U.S. banks overseas may underwrite equity securities up to $50 million; and the Board has the authority to change these limits. U.S. banks are now asking the Board to raise those limits or remove them altogether so that the banks can maintain competitive parity with the German and British banks that have full equity securities underwriting powers overseas.)

The first step in domestic securities deregulation was taken in 1972 when the Board adopted a minor rule that allowed bank holding companies to offer advice on open-end and closed-end mutual funds. This was part of the effort by banks to compete with the investment funds offered
by the investment banks. The regulation also allowed bank holding companies to sponsor and control closed-end funds. Before the 1970s this was the exclusive (and profitable) domain of the investment banks. Even this very small step raised a firestorm in the securities industry. The case it spawned took nine years to litigate, going to four or five different U.S. courts and finally to the Supreme Court in 1981. The Supreme Court agreed with the Board that this was a permissible activity and did not violate the Glass-Steagall Act.

The significance of the decision, however, goes beyond the limited activity that was permitted. The Supreme Court decision made it clear that the tough limits of the Glass-Steagall Act regarding bank activities did not apply to nonbanks. In the Court’s words, Glass-Steagall “established a less-stringent test for affiliates than that which is applied to the bank itself.” This dictum opened the way for the re-establishment of securities affiliates by banks that was to occur in the 1980s. Some American judges make statements that are not necessary for the expression of a decision. That is precisely what happened. This one sentence that the Supreme Court put in this decision laid the groundwork for all the liberalization and movement into the investment banking business of the 1980s. While Congress often points to the Board and the Comptroller for deregulating and undermining the Glass-Steagall Act, the U.S. courts have done just as much to foster expanded bank powers through their very favorable and very broadly worded decisions.

In the judicial area there is evidence of a change of attitude in the United States. Previously, the courts took a very stringent view of Glass-Steagall. For example, in the early 1970s, the Supreme Court read the Glass-Steagall Act to prohibit banks from advertising their common trust funds on the grounds that this would amount to underwriting or distributing securities. The case was not decided on the literal words of the statute but on the Court’s perception at that time that Congress intended to keep banks out of the securities business. Of course, there is language in the Court’s opinion that says the Glass-Steagall Act is an insurmountable barrier to banks in the investment banking business. The decision by the Supreme Court in 1981 marked a 180-degree change in the Court’s opinion. Instead of reading the statute to forbid any kind of bank entry into the securities business, the Supreme Court seemed to say that if banks formed a separate subsidiary, they could get into the business.

Following the 1981 decision, the next major step came in 1982 in the brokerage business. With the unbundling of services provided by brokerage houses as a result of the abolition of fixed brokerage commissions, the Bank of America saw an opportunity to enter the discount brokerage business through the acquisition of Charles Schwab and Co., then the largest discount brokerage in the United States. Discount brokerage de-
veloped after fixed commissions were eliminated. In discount brokerage, the customer selects the security to be purchased without advice from the broker; the broker merely executes the trade. Again, brokerage was thought to be prohibited to banks by the Glass-Steagall Act. The Comptroller had so ruled in the 1930s, although subsequently it had backed away from that opinion. After holding a yearlong hearing, the Board concluded that acting as a discount broker did not violate the Glass-Steagall Act, and the courts agreed with the Board. This decision led to still further liberalization. Although the decision does not seem so significant now, ten years later, it was then a major step for the Board.

The next step was an application by a British bank, the National Westminster Bank, to offer both investment advice and brokerage as a bundle. In June of 1986, the Board concluded that this combination of financial services was permissible and did not violate the Glass-Steagall Act. Again, the SIA took the Board to court but was unsuccessful in its challenge. Since that time the Board and the Comptroller have continued to expand the scope of these agency-type or brokerage securities activities. Bank holding company affiliates may now offer a full range of securities brokerage activities.

A clear example of a banking organization attempting to follow its customers into the securities business was Bankers Trust's successful attempt to engage in the private placement of commercial paper for its corporate clients. Over the 1970s, corporate borrowings at commercial banks declined steadily as large U.S. corporations realized that they could issue their own commercial paper more inexpensively than they could borrow the same funds from banks. In response, in the early 1980s, Bankers Trust began, with the Board's permission, to act as agent in privately placing commercial paper for its customers. I emphasize the word "agent." Bankers Trust did not underwrite the shares; it acted only as intermediary between buyer and seller, much like a broker. It did not buy the shares for its own account or otherwise act as a principal. It simply brought a willing buyer and a willing seller together. This was an important decision for the SIA and naturally they sued the Board. The Board first ruled that commercial paper was not a security and so was not covered by the Glass-Steagall Act. The Board lost that case. The Supreme Court said that commercial paper is a security and thus covered by the Glass-Steagall Act. The Board then hit upon the private placement mechanism, claiming that what Bankers Trust was doing was not underwriting but acting as an agent in a nonpublic offering and that that was not covered by the technical terms of the Glass-Steagall Act, which was directed at underwriting, dealing, and public sale. This time the courts agreed with the Board, and as a result, American banks may now underwrite not only commercial paper but securities of any kind—corporate
The Line Between Investment and Commercial Banking

debt securities, government debt securities, or corporate debt and equity securities.

By far the most aggressive step to date taken by banks was in 1987 and 1989 when the Board permitted member banks to re-establish the various securities affiliates that had been divested 56 years before. In doing this, the Board used and built on the cases it had won during the 1980s: the mutual fund case, the brokerage cases, and the commercial paper case. Taking its cue from the 1981 Supreme Court mutual fund decision, the Board concluded that the absolute prohibition of the Glass-Steagall Act on underwriting by banks did not apply to an affiliate of a bank. Instead, affiliates were governed by the less-stringent standard of Section 20 of the Glass-Steagall Act. Section 20 prohibits a bank from being affiliated with a company engaged principally in underwriting and dealing. So if the banks could set up an affiliate engaged principally in some other activity, they could engage (to a less-than-principal extent) in the securities business. The Board held that the banks could move their government securities activities out of the bank and could use that permissible activity to generate a base of revenue against which they could underwrite impermissible securities. The level of activity set by the Board was 5 to 10 percent of the affiliate’s revenues. There was a heated dispute in the United States about this level. The securities industry said it should be zero, the banks said it should be 49 percent, and Congress thought it should be 15 percent. The Board decided to set it at 5 percent initially and raised this eventually to 10 percent.

In its order, the Board also established a prudential framework of conditions to ensure that the underwriting activity would be conducted consistent with safe and sound banking practices, would avoid conflicts of interest, and would avoid the other adverse effects that had led to the Glass-Steagall Act in 1933. These conditions had become known in the United States as “fire walls” because they attempt to wall off the bank and the federal safety net from the risk of the underwriting company. The Board’s action was challenged by the SIA but in 1988 was upheld by the courts. The Supreme Court has declined to review this case.

The 1987 approvals were limited to four types of securities that banks have had some experience with: commercial paper, municipal revenue bonds, mortgage-backed securities, and consumer-receivables-related securities. In January of 1989, the Board allowed banks to form subsidiaries to engage in full underwriting of all types of debt and all types of equity securities. After the Board conducted examinations to determine that the banks had set up the appropriate procedures, it allowed debt underwriting activities to begin in June of 1989. In June and July of 1989, J.P. Morgan, Citicorp, Chase, and Bankers Trust each began underwriting corporate debt securities. While approving the underwriting of equity securities in
January of 1989, the Board delayed implementation of that decision for one year, to allow Congress the opportunity to stop it, if Congress so chose. The year elapsed and the Board, in September 1990, allowed those activities to go forward. Since 1989, the Board also has allowed banking organizations to shift private placement activities from the bank to Section 20 subsidiaries. What that does is increase the base of eligible activities and allow these securities affiliates a broader range of ineligible securities activities.

In January of 1990, the Board was required to act on applications by two Canadian banks and a British bank to set up securities affiliates in the United States. This raised a substantial question for the Board because, unlike American banks that operate through the bank holding companies system, the Canadian and British banks operate in a universal bank mode. They do not have a holding company. The securities affiliates that they set up in the United States would be owned directly by the banks and would be funded by the banks. In the United States, the Section 20 subsidiaries that the Board has permitted are owned not by the bank, but by the bank holding company; moreover, bank affiliates are forbidden to fund those subsidiaries. The principal issue raised by these applications (they were at the Board for almost a year) was how to adjust the fire walls to account for the fact that foreign banks are both banks and bank holding companies.

In addressing these issues, the Board had to balance making sure that foreign banks were not given a competitive advantage over U.S. banks in U.S. markets, with making sure that fire walls were not given inappropriate extraterritorial effect. Generally, the Board resolved this dilemma by treating a foreign bank as a bank holding company. In doing this, the Board allowed the foreign bank to fund the Section 20 subsidiary in the United States, an activity that is forbidden to U.S. banks. On the other hand, the Board forbade the arms, branches, and subsidiaries of the foreign bank in the United States from raising monies in the United States to fund the securities activity.

An important development in the United States in the banks' drive into the investment banking business took place not at the Federal Reserve Board, but at the Office of the Comptroller of the Currency, which regulates national banks. In 1987, the Comptroller authorized the Security Pacific National Bank to sell what are called mortgage pass-through certificates. These are instruments or certificates representing interests in a pool of residential real estate mortgages originated by the bank. The Comptroller reasoned that issuing and underwriting these certificates was tantamount to a sale of bank assets, and thus a permissible banking (rather than an impermissible securities) activity, which should be exempt from Glass-Steagall. This interpretation was upheld by the courts, and thus national
banks are now permitted to package, issue, and underwrite securities representing interests in assets that they originate. This decision is an important precedent for expanding the power of banks in the investment banking business. The impetus for this expansion comes from developments in technology that permit banks efficiently to pool and sell instruments representing interests in these residential real estate mortgages. The financial institution generally retains the servicing rights and the responsibility when it sells portions of the pool.

As recognized by the court, increased securitization of bank assets offers banks the opportunity to increase their liquidity. This may permit banks efficiently to originate long-term mortgages with short-term deposits. Market developments of this type should permit banks' return on assets. The *Security Pacific* decision is also important because it may set the stage for further bank expansion in the securities business. The language of the decision of the Comptroller and the Court indicates that so long as a bank is engaged in the business of banking, the activity is not prohibited by the Glass-Steagall Act. Under this decision a national bank might be able to issue securities representing interest in commercial debt under the bank's authority to make or discount commercial loans. Thus, this *Security Pacific* ruling may set a precedent for a bank to underwrite corporate debt securities that represent interest in commercial loans originated by the bank or its affiliates. We have to see how this particular decision develops.

Besides the Federal Reserve Board and the Comptroller of the Currency, during the 1980s the Federal Deposit Insurance Corporation, which regulates nonmember banks, and the Federal Home Loan Bank Board, which represents thrift institutions, also acted to expand the ability of nonmember banks and thrifts to engage in securities activities. All four agencies have tried to keep pace with market developments in the United States, the demands of financial service providers, and the needs of corporate and individual customers by attempting to expand the powers of banking organizations in the securities area, on a case-by-case basis, after careful consideration of the safety and soundness issues involved, while still maintaining consistency with the literal terms of an antiquated statute. Although this incremental approach is slow and painful at times, and certainly not without controversy and litigation, it has led to a consensus and has spurred Congress to act on the restructuring of the financial services industry.

Mirroring the developments in the administrative agencies and the courts, Congress finally in the 1980s took action. In 1982 and 1983, the Senate Banking Committee worked on legislation recommended by the Federal Reserve Board and the Treasury to allow banks to underwrite and
deal in a limited range of securities through separate subsidiaries of bank holding companies. The committee, however, was not able to secure a majority in favor of the bill.

In 1987, Senator William Proxmire put his weight behind a final effort to repeal the Glass-Steagall Act, and he very nearly succeeded. He proposed a bill much like the earlier Board-Treasury proposal, but modified to reflect the Board's recent Section 20 decisions. The draft bill required that securities activity be conducted in a holding company subsidiary rather than a bank subsidiary and established fire walls between the bank and the securities affiliate. The most important of the fire walls forbade the bank to provide credit to the securities affiliate or to enhance securities being underwritten by the affiliate. The Proxmire bill also required the bank to move its securities activity from the bank to the authorized securities affiliate. This time the bill passed with an overwhelming majority of the Banking Committee and in 1987 of the full Senate (by a vote of 98 to 2). The bill was then sent to the House of Representatives, where it passed the Banking Committee by a wide margin and the Securities Committee by a significant margin. But because of a jurisdictional dispute between those two powerful committees, the bill did not get to the floor of the House by the end of 1988, and therefore died.

In 1989, the thrift crisis in the United States preoccupied Congress, which then had no mind to pursue Glass-Steagall Act reform. It seems unlikely that there will be any action on this in the near future. While in 1987 there was consensus that the Proxmire approach was right for the United States, support for that process has clearly waned since. It is not clear that the Proxmire approach will be adopted. The banks have raised increasing concerns and objections that the holding company structure is not right. The banks contend that it is unrealistic from the perspective of international competitiveness. They also claim that the fire walls make the activity unprofitable and doom them in any contest with German and British universal banks. The banks are pushing very hard for legislation that will permit securities activities through the banks rather than through the holding companies. They will push for modifications to the fire walls that will permit the banks to lend support to securities activities.

Other proposals are being floated for amendment of the Glass-Steagall Act. The most provocative was unveiled by the SIA in 1990. This would give banking organizations full securities powers and would allow securities companies to establish banks. It would also open the Federal Reserve discount window to these investment banks. The proposal would require, however, that there be strong fire walls between the insured bank and its securities activities and that funding of the securities activities be carried out only through financing companies that cannot issue federally
insured deposits. While some aspects of this proposal raise significant issues, particularly for the banking community, the importance of this proposal is that it signals that the SIA is prepared to join the movement for repeal or reform of Glass-Steagall.

In conclusion, the coming years will bring three important developments. First, the Board will continue to fine-tune its January 1989 order, including allowing Section 20 securities companies to engage in equity underwriting and dealing activities. The Comptroller's Office will probably expand the bridgehead it has made with the Security Pacific decision, allowing banks to further securitize their assets. Second, we will see the introduction of additional legislative proposals, most probably from the banking trade groups, to counterbalance the SIA proposal. Finally, the Board will probably decide how the overseas securities powers of U.S. banking organizations should be expanded. This presents difficult issues for the Board because it requires a choice between allowing the securities activities to be conducted by a bank or by a bank holding company subsidiary, as the Board has recommended domestically.
COMMENT
WILLIAM GLIDDEN

It is clear that the Glass-Steagall Act is doomed and will be repealed within the decade. In the meantime, it is being repealed every day in practice through the Section 20 subsidiaries approved by the Federal Reserve Board and also through expanding interpretations out of the Office of the Comptroller of the Currency (OCC). All three of the banking agencies agree on Glass-Steagall repeal. In fact, the Federal Deposit Insurance Corporation (FDIC), in its study *A Mandate for Change* in 1987, advocated the complete elimination of all bank and nonbank barriers, and the expansion of banks into all lines of commercial activity.¹

Between commercial banking and investment banking, there is no doubt that the riskier activity is on the commercial banking side. On comparing commercial loans with the typical activities in an investment bank, for example, the commercial lending is more likely to result in a loss. As much as possible of the investment banking business should eventually be conducted within banks. This is not going to add to risk; in fact, it will decrease risk. Bank dealer departments historically have been great profit centers, and supplementing them within the bank will probably result in a more efficient delivery of services and a stronger bank.

Other considerations undoubtedly will cause Congress, following repeal of the Glass-Steagall Act, to require some of the securities business to be done in a corporation separate from the bank. The conflict of interest issues, and perhaps the concern for functional regulation, are advanced by having a bank affiliated with a separate securities company. The position of the Comptroller, and of the FDIC, is that while the bank holding company model is one option, perhaps a direct bank subsidiary option ought to be retained.

The bank holding company structure is unique to the United States. Most of the other major banking nations in the world have banks where investment and commercial banking activities are carried on entirely within the bank, or they have bank-owned subsidiaries doing the securities business. It should be kept in mind that there are certain costs associated with the bank holding company structure. One-third of our banks now do not have a bank holding company. Thus, if we were to follow a bank holding company model, and if they wanted to engage in some securities activities, they would have to incorporate a holding company. That
involves some duplication of regulation, additional regulators, and additional reports.

One important law currently on the books, Sections 23A and B of the Federal Reserve Act, places capital-based limits on the amount of transactions that a bank can have with an affiliate. Essentially, the bank cannot lend more than 10 percent to any one affiliate or 20 percent to all affiliates in aggregate. There are also collateral requirements, and there are requirements that any transaction be on a fair arm's-length basis. Those protections could be extended to a bank operating subsidiary.

If the bank-subsidiary model is adopted as an option, it would be the task of the bank regulator to focus on the bank and to regulate the bank to ensure that its conduct is safe and legal and that its investments and its dealings with a securities affiliate are on prudential terms and do not involve conflict of interest or other abusive practices. Then the Securities Exchange Commission, for example, could be left to regulate the securities company just as it regulates all other securities companies that are not affiliated with a bank.