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Units of Participation in IRA Common Trust Funds Offered by Commercial Banks: A Violation of the Glass-Steagall Act?

Since its passage in 1933, the Glass-Steagall Act has mandated the separation of the commercial banking industry and the investment banking industry. Recently, however, the distinction between the two has become blurred due to novel financial products and services offered by both industries. One such service is the offering by commercial banks of units of participation in common trust funds consisting of individual retirement account ("IRA") trust assets. At present, it is unclear whether a commercial bank which offers such units of participation violates the Glass-Steagall Act. The determination depends on two factors: (1) whether units of participation constitute "securities" within the meaning of the

1 A commercial bank is "an institution authorized to receive both demand and time deposits, to make loans of various types, to engage in trust services and other fiduciary funds, to issue letters of credit, to accept and pay drafts, to rent safety deposit boxes, and to engage in many similar activities." BLACK'S LAW DICTIONARY 245 (5th ed. 1979). The major activity distinguishing commercial banks from other institutions is the banks' ability to receive demand deposits. See United States v. Philadelphia Nat'l Bank, 201 F. Supp. 348, 360 (D. Pa. 1962), rev'd, 374 U.S. 321 (1963).

2 Investment banking consists of "underwriting and selling primarily new issues of stocks and bonds to investors." BLACK'S LAW DICTIONARY 741 (5th ed. 1979). The investment banker represents "the middleman between the corporation issuing new securities and the public." Id.

3 Two products now offered by investment bankers that tend to blur the line of separation are money market mutual funds and asset management accounts. In a money market mutual fund, the customer receives shares of common stock in a fund that consists of various money market instruments, i.e., short term commercial paper, certificates of deposit and Treasury bills. The value of these shares fluctuates directly with the value of the fund. In addition to the diversification feature, many of these funds offer a "check redemption" procedure that allows an investor to write a check against a checking account maintained by the fund at a commercial bank. Similarly, an asset management account provides the money market mutual fund services and further provides access to the investor's assets by either a check or credit/debit card.

Other activities include the offering of discount brokerage services through a bank affiliate. A discount broker merely executes the purchase and sell orders placed by its customers. It does not provide investment advice or analysis. See Securities Indus. Ass'n v. Board of Governors of Fed. Reserve Sys., 104 S. Ct. 3003 (1984) (commonly referred to as Schwab).


4 "Units of participation" represent the investor's interest in the common trust fund. For a general description of how the arrangement operates, see notes 33-40 infra and accompanying text. The term "units of beneficial interest" is synonymous with units of participation. This note uses "units of participation" throughout.
Glass-Steagall Act, and (2) whether these commercial bank offerings give rise to the hazards which Glass-Steagall was designed to prevent.

This note attempts to clarify the law in this area and suggests that based upon the policies underlying the Glass-Steagall Act, units of participation in IRA common trust funds are securities and may not be offered by commercial banks. Part I provides a textual analysis of the Glass-Steagall Act, emphasizing those sections which bear directly on whether a commercial bank may offer units of participation. Part II discusses two conflicting recent district court opinions which indicate the confusion that exists in this area. Part III synthesizes a two prong test from several Supreme Court decisions which have interpreted the Glass-Steagall Act in other contexts. Part IV applies this test to the units of participation problem and concludes that, under Glass-Steagall, commercial banks cannot market units of participation in IRA common trust funds.

I. The Glass-Steagall Act—A Framework of Separation

The Glass-Steagall Act was enacted in 1933 in response to the banking collapse of the 1930’s which significantly contributed to the Great Depression. Prior to the banking collapse, commercial banks had become increasingly involved in investment banking activities. Congress believed that the banking collapse could be di-
directly attributed to the involvement of commercial banks in investment banking activity.\textsuperscript{8} Thus, the Glass-Steagall Act reflects

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\textsuperscript{8} \textit{75 Cong. Rec. 9887} (1932). Indeed, Senator Carter Glass of Virginia, legislative

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the conclusion of Congress "that certain investment banking activities conflicted in fundamental ways with the institutional role of commercial banks."9 Through the Act, Congress attempted to achieve three objectives:10 (1) to structure the commercial banking system in order to make it financially sound;11 (2) to restore public confidence in the national banking system;12 and (3) to eliminate conflicts of interest that inevitably arise when commercial banks engage in investment activities.13

In short, Glass-Steagall attempts to separate the commercial and investment banking industries. The key provisions of the Glass-Steagall Act relating to securities activities are sections 5,14 16,15 20,16 21,17 and 32.18 Sections 16 and 21 prohibit direct participation by commercial banks in investment banking activities and, conversely, direct participation by investment banks in commercial banking activities.19 Section 5 extends this prohibition to state-


11 S. REP. No. 77, 73d Cong., 1st Sess. 2, 10-12 (1933).

12 H. R. REP. No. 150, 73d Cong., 1st Sess. 6-7 (1933).

13 75 CONG. REC. 9911-12 (1932) (statements of Sen. Bulkley).


19 The relevant provision of § 16 is codified at 12 U.S.C.A. § 24 (seventh) (West Supp. 1984). It provides that a national banking association shall have the following power:

Seventh. 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, except that this
chartered banks which are members of the Federal Reserve System. Sections 20 and 32 prohibit national and member banks from indirectly participating in investment banking activity. In particular, section 20 prohibits a bank from creating an affiliate to

limitation shall not require any association to dispose of any securities lawfully held by it on August 23, 1935. 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. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof.

Section 21, codified at 12 U.S.C. § 378 (1982), provides in relevant part:
(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 to the extent permitted to national banking associations by the provisions of section 24 of this title.

Section 5, codified at 12 U.S.C. § 335 (1982), provides in relevant part: “State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under paragraph “seventh” of Section 24 of this title.”

Section 20, codified at 12 U.S.C. § 377 (1982), provides in relevant part:
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, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities: Provided, That nothing in this paragraph shall apply to any such organization which shall have been placed in formal liquidation and which shall transact no business except such as may be incidental to the liquidation of its affairs.

Section 32, codified at 12 U.S.C. § 78 (1982), provides:
No officer, 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 influence the investment policies of such member bank or the advice it gives its customers regarding investments.
engage in securities activity. Section 32 prohibits national and member banks from sharing personnel with investment banks.

Section 16, however, is the cornerstone of the Glass-Steagall Act. It addresses three areas of banking activity: (1) bank underwriting of securities; (2) bank purchasing and selling of securities for its customers; and (3) bank purchasing and selling of securities for its own account. With regard to the first activity, it provides a general prohibition of underwriting "securities and stocks." This prohibition has been the largest deterrent to commercial banks entering the investment banking business.

Under section 16, a commercial bank may purchase or sell securities for the account of its customers only under certain circumstances. Specifically, a commercial bank must act "without recourse" and "solely upon the order of its customers." Such language reflects Congress' desire to prohibit banks from initiating investment transactions for customers. Finally, section 16 permits a bank to purchase investment securities for its own account with certain restrictions.

Section 21 also prohibits direct participation in investment banking. This section provides that a firm engaged in the business of issuing, underwriting, selling, or distributing securities shall not also accept demand deposits. Conversely, the language of section 21 prohibits firms that accept demand deposits from engaging in

22 There has been recent congressional debate on expanding the powers of securities affiliates. The 98th Congress had before it two acts which would expand the securities powers of commercial banks, the Financial Institutions Equity Act of 1984, H.R. Rep. No. 889, 98th Cong., 2d Sess. (1984) and the Financial Services Competitive Equity Act, S. Rep. No. 560, 98th Cong., 2d Sess. (1984). Although neither was enacted, the Senate's act, found in S. 2851, did pass the first vote but died in conference. As initially passed, the bill amended § 20 of Glass-Steagall to allow a member of the Federal Reserve System, through its parent holding company or a subsidiary of the holding company, to be affiliated with a depository institution securities affiliate ("DISA"). The DISA was given authorization to engage in any securities or securities-related activities in which a national bank may engage. Moreover, DISA's were given the additional authority to underwrite and deal in revenue bonds, mortgage-backed securities, and commercial paper.

It should be noted, that although the Senate approved the additional securities power, a number of Senators strongly disapproved of such increased power, e.g., Senators Heinz, D'Amato, Riegle, and Sarbanes. In fact, Senator Heinz proposed an amendment which would have stricken the securities powers from S. 2851 but later withdrew it apparently on the belief that the powers would be removed in conference. Senator Heinz indicated that if the powers remained in the bill after conference, the bill would not "have a very easy time when it comes back to the Senate." 130 CONG. REC. S11,162 (daily ed. Sept. 13, 1984). Senator Garn, who fully supported the bill, indicated that the securities power was "the heart of this bill." 130 CONG. REC. S11,117 (daily ed. Sept. 13, 1984). See 130 CONG. REC. S11,116-71 (daily ed. Sept. 13, 1984), for debate on S. 2851. Neither act has been reintroduced into the 99th Congress.

25 Id.
26 Id.
securities activities. Section 21 extends the Act’s underwriting prohibition beyond the national and member banks covered in sections 5 and 16 to include any entity engaged “in the business of receiving deposits.”\(^\text{27}\) Thus, through sections 5, 16, and 21 of the Glass-Steagall Act, Congress has prohibited all commercial banks from directly participating in investment banking activities.\(^\text{28}\)

II. The Problem of Applying Glass-Steagall to Units of Participation

Recently, commercial banks have established arrangements in which the bank places the customer’s IRA trust assets into a common trust fund and, in return, issues the customer units of participation in the common fund. The issue is whether such an arrangement constitutes investment banking in violation of the Glass-Steagall Act. Two recent district court opinions have addressed the issue and, on virtually identical facts, reached different conclusions.

In *Investment Company Institute v. Conover* (“ICI 1”),\(^\text{29}\) the court set aside two rulings by the Comptroller of the Currency (“Comptroller”)\(^\text{30}\) that approved proposals by two national banks to offer units of participation in collective trust funds for IRA trust assets. ICI 1 held that the common trust funds were in the nature of an investment vehicle rather than for a bona fide fiduciary purpose and, therefore, violated the Glass-Steagall Act. In *Investment Company Institute v. Conover* (“ICI 2”),\(^\text{31}\) the court upheld the Comptroller’s ruling. Contrary to ICI 1, ICI 2 held that the activity fulfilled a bona fide fiduciary purpose and was a natural extension of traditional banking functions.\(^\text{32}\)

In each case, the commercial bank had created a common trust fund (“‘Fund’”) for the collective investment of IRA trust assets re-

\(^{28}\) Despite the broad coverage of Glass-Steagall, there is a loophole that some commercial banks may use to avoid the Act’s “flat prohibitions.” The loophole exists for state chartered banks which are not members of the Federal Reserve System. These banks, through a subsidiary, may expand their product offerings without violating Glass-Steagall. Moreover, the state non-member bank may be outside the reach of the Bank Holding Company Act of 1956, ch. 240, 80 Stat. 133 (codified at 12 U.S.C. §§ 1841-1848 (1982)), which governs permissible activities of holding company subsidiaries. See Note, *Avoiding the Glass-Steagall and Bank Holding Company Acts: An Option for Bank Product Expansion*, 59 IND. L.J. 89 (1983), for an analysis of this loophole.
\(^{30}\) The office of Comptroller was created by Act of Congress on February 25, 1863 as an integral part of the national banking system. The Comptroller is responsible for the execution of laws relating to national banks and promulgates rules and regulations governing the operations of national and District of Columbia banks. BLACK’S LAW DICTIONARY 260 (5th ed. 1979).
\(^{32}\) Id. at 1502.
ceived from bank customers. Pursuant to a trust agreement, the trust assets were invested into one of several portfolios contained in the Fund. The customer's interest in the portfolios chosen was evidenced by "units of participation." Labels attached by the banks to such portfolios included "Corporate Stock Fund" and "Small Companies Stock Funds." The trust agreement was freely revocable and the invested assets were readily transferable between the Fund's portfolios or other IRA plans offered by the bank. Further, the value of the customer's interest varied directly with the value of the particular portfolio chosen. Finally, the bank received a monthly fee based on the value of each portfolio. In both cases, the banks contended that offering of units of participation in the funds was authorized under three separate areas of law: (1) the Glass-Steagall Act, (2) the Comptroller's regulations, and

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33 593 F. Supp. at 848; 596 F. Supp. at 1498-1499.
34 593 F. Supp. at 848; 596 F. Supp. at 1499.
35 593 F. Supp. at 848; 596 F. Supp. at 1499.
36 593 F. Supp. at 856.
37 Id.
38 593 F. Supp. at 849; 596 F. Supp. at 1499. Although the investor may "redeem" his shares at any time, he may subject himself to an "early withdrawal" penalty provided for in I.R.C. § 408(f)(1) (1984). This section provides that if a "distribution from an individual retirement account . . . is made before such individual attains age 59-1/2 his tax . . . for the taxable year in which such distribution is received shall be increased by an amount equal to 10 percent of the amount of the distribution." Notwithstanding such a penalty, it is possible that an investor may be willing to pay the 10% tax either to cash in on a significant increase in the value of a portfolio where a decrease is expected or to mitigate future losses in a poorly performing portfolio. Thus, the "redeemable" feature must be considered when identifying the potential hazards created by this arrangement.
40 593 F. Supp. at 849; 596 F. Supp. at 1499.
41 See generally 12 C.F.R. § 9.18 (1984). The banks argued that the selling of units of participation in IRA common trust funds is authorized by the Comptroller's regulations. It is interesting to note, however, that several requirements in the regulations were waived by the Comptroller. Basically, the requirements waived were those in direct conflict with provisions under the Investment Company Act of 1940 ("ICA"). Rather than attempt to obtain an exemption under the ICA, the banks asked the Comptroller to waive the conflicting provisions in its regulations.

Interestingly, the banks indicated they opted not to pursue exemptions from the SEC as they feared that avenue might be costly and time-consuming. 593 F. Supp. at 852; 569 F. Supp. at 1499. However, and perhaps more important to their decision not to pursue these exemptions, the SEC has, in a series of interpretative letters, maintained that no exemption is available under the Securities Act and the ICA when a bank seeks to collectively invest IRA trust assets in a manner sought by the banks in ICI I and ICI 2. See Fed. Banking L. Rep. (CCH), Transfer Binder, ¶ 99,339, at 86,375 (1982). See also SEC Release No. 33-6188 (Feb. 1, 1980). The SEC contends it would grant an exemption if the funds were maintained for a "bona fide fiduciary purpose" but that it will not when the funds are "maintained as vehicles for direct investment." Thus, because the SEC has steadfastly refused to grant an exemption, one can find further support for the "investment" character of the funds, if need be.

One provision waived by the Comptroller is the requirement that there be "exclusive bank management" of the common trust fund. 12 C.F.R. § 9.18(b)(12) (1984). In the Funds set up, only a minority of those managing the funds were affiliated with the bank.
In *ICI 1*, the court applied a "fiduciary purpose v. investment purpose" test. The court held that if the Fund was created solely for an investment purpose rather than for a bona fide fiduciary purpose, the Fund would violate the Act. Conversely, if the bank created the Fund solely for a fiduciary purpose, the Fund would be proper. Finding that the Fund was created for an investment purpose, the Court held that the units of participation were securities and could not be offered without violating Glass-Steagall.

The *ICI 2* court, on the other hand, believed that the units of participation represented "a natural extension of a traditional

This was done in order to qualify under the ICA which requires that a majority of the Fund's directors not be affiliated with any one banks. 15 U.S.C. § 80a-10c (1982). Another provision waived by the Comptroller provides: "No bank administering a collective investment fund shall issue any certificate or other document evidencing a direct or indirect interest in such fund in any form." 12 C.F.R. § 9.18(b)(13) (1984) (emphasis added). The plain language of this provision prohibits the type of activity at issue. Nevertheless, the Comptroller, without explanation, waived its application. Based on these waivers, it is apparent the Comptroller was intent on approving these Funds. Moreover, the effectiveness of arguing that the Comptroller's regulations should supersede the Glass-Steagall Act is undercut by the fact that Congress rejected a regulatory approach when it drafted the statute. See *Becker*, 104 S. Ct. at 2988-89. Thus, notwithstanding adherence to the Comptroller's regulations, the banks cannot escape the prohibitions of the Glass-Steagall Act.

The banks further argued that the offering of units of participation is expressly authorized under the Employee Retirement Income Security Act ("ERISA"), 26 U.S.C. § 408 (1982). Specifically, § 408(a)(5) provides: "The assets of the trust fund will not be commingled with other property except in a common trust fund or common investment fund." This argument fails to recognize the difference between using a collective trust fund for the commingling of trust assets and the offering of units in such a fund. The distinction is critical.

Assuming, arguendo, that ERISA does authorize such activity, the banks nevertheless cannot escape the reach of the Glass-Steagall Act. This conclusion follows from an excerpt from a House Conference Report on ERISA: "this legislation . . . is not intended to limit in any way the application of the Federal securities laws to [IRA's] or the application to them of the laws relating to common trust or investment funds maintained by any institution." H. CONF. REP. No. 807, 93d Cong., 2d Sess. (1974), reprinted in 1974 U.S. CODE CONG. & AD. NEWS 5117.

The court's approach appears to be based on an interpretation of a statement in Investment Co. Inst v. Camp that indicates it is proper for a bank to commingle assets received for "a true fiduciary purpose" but not for an investment purpose. 401 U.S. 617, 638 (1971). The Court's language, however, cannot be read so broadly as to create a "fiduciary purpose v. investment purpose" distinction to determine whether a security is present. Rather, the Court merely is specifying when a bank might commingle the assets of its customers. The offering of units of participation in collective trusts, however, differs significantly from the commingling of trust assets. The court in *ICI 1* recognized this distinction, 593 F. Supp. at 858, and the Comptroller's own regulations recognize such a distinction, 12 C.F.R. § 9.18(b)(13) (1984). In any event, the Supreme Court appears to have rejected an analysis of an instrument's "investment" character to determine whether it is a security. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 104 S. Ct. 2979, 2988 (1984). In rejecting this analysis, the Court concluded that the Act's flat prohibition does not allow for nebulous inquiry into the particular characteristics of a financial instrument. *Id.* at 2988.
banking service.” Thus, based on its interpretation of Investment Company Institute v. Camp, the court held that units of participation were not securities within the meaning of the Glass-Steagall Act and therefore could be offered without violating the Act.

III. Developing The Two Prong Test

The conflict between the two district courts indicates the need for guidance in determining the applicability of the Glass-Steagall Act to IRA units of participation. To date, the Supreme Court has addressed the scope of the Act on three occasions but has never specifically addressed the IRA units of participation problem. Nevertheless, from these cases it is possible to synthesize a two prong test for determining the Act’s applicability. In essence, the Act applies if (1) the instrument in question is a “security” within the meaning of the Act, and (2) the bank’s activity gives rise to the hazards that prompted Congress to pass the Act.

A. What is a “Security” Under Glass-Steagall?

Because the Glass-Steagall Act does not define the term “securities,” the courts have had to formulate a definition. The Supreme Court first considered what constitutes a security under the Act in Investment Company Institute v. Camp. In Camp, a commercial bank established a collective investment fund pursuant to regulations issued by the Comptroller. Under the fund, the customer would give the bank between $10,000 and $500,000. The bank would then act as the customer’s managing agent. In return, the bank would give the customer written evidence of his interest in the fund identified as “units of participation.” The units were freely redeemable and transferable. Further, the units’ value was directly tied to the value of the fund. The bank registered the fund as an investment company under the Investment Company Act of

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45 596 F. Supp. at 1500, 1502.
46 Investment Co. Inst. v. Camp, 401 U.S. 617, 624 (1971). Arguably, Camp’s statement does not create the “traditional v. nontraditional” analysis suggested by the Comptroller and ICI 2. Rather, Camp merely states a historical fact. Moreover, Camp fails to later mention this fact when analyzing in depth the reach of Glass-Steagall. Consequently, to argue Camp establishes some type of “historical” test is to read too much into Camp.
47 596 F. Supp. at 1501.
49 401 U.S. 617 (1971).
50 Id. at 622.
51 Id.
52 Id.
53 Id.
1940 ("ICA")\textsuperscript{54} and filed a registration statement pursuant to the Securities Act of 1933.\textsuperscript{55} The plaintiff, an association of open-ended investment companies, challenged the regulations and the Comptroller’s approval of the fund.\textsuperscript{56}

The Supreme Court found the fund to be in "direct competition with the mutual fund industry" and therefore held that the bank’s activity was prohibited under sections 16 and 21 of the Glass-Steagall Act.\textsuperscript{57} Significantly, the Court indicated that "there is nothing in the phrasing of either §§ 16 or 21 that suggests a narrow reading of the word 'securities.'"\textsuperscript{58} With its expansive approach to the definition of securities, the Court then engaged in a limited "functional analysis,"\textsuperscript{59} comparing the particular characteristics of the instruments in issue with other valid bank instruments. The Court, in a later case, rejected such an analysis.\textsuperscript{60} \textit{Camp}, however, remains important precedent for an expansive interpretation of the term "securities" under the Glass-Steagall Act.

The Supreme Court’s most recent case construing the Glass-Steagall Act is \textit{Securities Industry Association v. Board of Governors of Federal Reserve System} ("\textit{Becker}").\textsuperscript{61} In \textit{Becker}, a state-chartered commercial bank, acting as agent, attempted to sell the commercial paper of its corporate customers.\textsuperscript{62} The Securities Industry Association ("SIA") challenged the Federal Reserve Board’s ruling that sections 16 and 21 do not prohibit the sale of commercial paper.\textsuperscript{63}

The district court in \textit{Becker}, in reversing the Board’s ruling, found that the Board had used a "functional analysis" to determine that the instrument offered by the bank was not a security under the Act.\textsuperscript{64} The court indicated that such an analysis could transform a transaction "unquestionably at the heart of the securities industry

\begin{footnotesize}
\[56] 401 U.S. at 617.
\[57] \textit{id.} at 625.
\[58] \textit{id.} at 635. This expansive approach is significant because it reflects an approach similar to that used in defining "securities" under the federal securities law. This similarity in treatment indicates that the federal securities laws should be looked to when attempting to define a "security" under Glass-Steagall. See notes 70-74 infra and accompanying text for this argument.
\[59] 401 U.S. at 624-25, 637. The Court compared the bank investment fund at issue with a mutual fund and found subtle differences at best. Because competition with mutual funds requires a bank to make accommodations that Congress firmly concluded could not be prudently mixed with the business of commercial banking, the activity must be prohibited.
\[60] See \textit{Becker}, 104 S. Ct. at 2989.
\[62] \textit{id.} at 2981.
\[63] \textit{id.} at 2982.
\[64] 519 F. Supp. at 615-16.
\end{footnotesize}
into permissible activity for commercial depository banks.”

On appeal, however, the Court of Appeals for the District of Columbia Circuit endorsed the Board’s functional analysis. The court of appeals, concluding that the commercial paper did not possess the characteristics that prompted passage of the Act, determined that the commercial paper did not constitute securities under the Act.

The Supreme Court reversed the court of appeals decision, stating “we find it difficult to imagine that Congress intended the Board to engage in the subtle and ad hoc ‘functional analysis’ . . . .” The Court held that “the Act’s underwriting prohibition does not demonstrate any sensitivity to the characteristics of a particular issue; the Act simply prohibits commercial banks from underwriting them all.”

The Court declined to engage in the functional analysis it developed in Camp. Instead, the Court looked to the plain and ordinary meaning of the term “securities” as evidenced by other legislation enacted at the time of Glass-Steagall. Thus, although the Court did not hold that a “security” under the Securities Act of 1933 is also a “security” under Glass-Steagall, what constitutes a “security” under the Securities Act is persuasive. The Court’s willingness to refer to the federal securities laws for guidance as to what constitutes a security under Glass-Steagall appears based on its belief that both pieces of legislation are “collectively designed to restore public confidence in financial markets.”

Because of the common purpose, the Court reasoned that the term “security” under both pieces of legislation should have the same meaning. Finally, in attempting to define a security under Glass-Steagall, the Court refused to engage in what it terms a “nebulous inquiry”
whereby the particular characteristics of an instrument are analyzed in detail to determine whether it is a security under Glass-Steagall. The Court reasoned that the "flat prohibitions" in the Act prohibiting commercial banks from entering the investment banking area do not permit such an inquiry. In essence, Camp and Becker suggest that the Supreme Court will take an expansive view of the term securities in the Glass-Steagall Act and will be predisposed to finding that the particular instrument involved is a security. Accordingly, the second prong which considers the bank's role in the transaction will often be crucial in determining the Act's applicability.

B. The Role of the Bank in the Transaction

After the court determines that the instrument is a security, it must then consider the second prong of the test—the role of the bank in the transaction. Only if the bank's activity gives rise to the hazards that prompted Congress to enact Glass-Steagall will a violation be found. This second prong is developed in Board of Governors of Federal Reserve System v. Investment Company Institute ("ICI"), the Supreme Court's second case interpreting Glass-Steagall. In ICI, the bank attempted to offer investment advice through its affiliated closed-end investment company. The parties conceded that the shares of the investment company were securities. Nevertheless, the Court examined the bank's role to determine if the bank had violated the Act.

In determining the propriety of the bank's role in ICI, the Court examined several factors which it had identified in Camp. Camp listed a number of hazards that arise when a commercial bank directly or indirectly enters the investment banking business. Those hazards include: (1) the bank's investment of its own assets in frozen or otherwise imprudent stock or security investments;

73 104 S. Ct. at 2988.
74 Id. at 2985.
76 Id. at 58-60. A closed-end investment company is "any management company other than an open-end company." 15 U.S.C. § 80a-5(a)(2) (1982). In contrast, an open-end company "means a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer." 15 U.S.C. § 80a-5(a)(1) (1982). Thus, the major distinction between the two is whether the investment company issues redeemable securities. The typical open-end company (commonly referred to as a "mutual fund") issues only redeemable shares which it stands ready to redeem at all times. A "redeemable security" is one that entitles the holder upon presentation to the issuer to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof. 15 U.S.C. § 80a-2(a)(32) (1982). In contrast, the holder of the closed-end company's stock typically must sell his shares to another person in the open market. See R. Jennings & H. Marsh, Jr., Securities Regulation—Cases and Materials 1356-66 (5th ed. 1982), for a general discussion of "open-end" and "closed-end" companies.
(2) the creation of promotional pressures upon banks to shore up an affiliate engaged in securities; (3) the possibility that a bank might make its credit facilities more available to those companies in whose stock or security the affiliate has invested or become otherwise involved; (4) the creation of a salesman's interest that might impair the bank's ability to function as an impartial source of credit; (5) the danger that depositors might suffer losses on investments that they purchased in reliance upon the prudence of the bank; (6) the temptation to make loans to customers with the expectation that the loan would facilitate the purchase of stocks and securities; and (7) the danger that the bank's reputation for prudence and restraint would be undercut by the risks necessarily incident to the investment banking business.\footnote{77} In *ICI*, the Court determined that the bank's activity did not violate Glass-Steagall.\footnote{78}

In *Becker*, the Supreme Court again considered the role of the bank, using the hazards listed in *Camp* as a framework for its analysis. Indeed, *Becker* rejected the Board's "functional analysis" primarily because the Board failed to consider the bank's conduct.\footnote{79} Because the *Becker* Court found a number of the hazards present in the bank's conduct, it held that the bank had violated the Act.\footnote{80}

IV. Applying the Two Prong Test to IRA Units of Participation

The two prong test which considers whether the instrument involved is a security, and whether the bank's activity tends to create certain hazards, may be applied to IRA units of participation to determine Glass-Steagall applicability. This test demonstrates that Glass-Steagall applies to IRA units of participation. First, units of participation in IRA common trust funds constitute securities under the Glass-Steagall Act. The Supreme Court has refused to narrowly interpret the term "securities" in the Glass-Steagall Act. It is, therefore, irrelevant that IRA units of participation are not traditional securities. Second, to determine which instruments are securities under the Act, the Court has referred to the contemporaneously enacted federal securities laws. A review of the Securities Act of 1933 suggests that units of participation in com-

\footnote{77} 401 U.S. at 630-32.  
\footnote{78} 450 U.S. at 67. The Court found that the absence of an obligation to redeem sharply distinguishes a closed-end investment company from the open-end investment company found to violate Glass-Steagall in *Camp*. Without such an obligation, the closed-end investment company "would not be constantly involved in the search for new capital to cover redemptions." *Id.* The effort to cover redemptions was thought to be a hazard which Congress attempted to eliminate through the passage of Glass-Steagall. *Id.*  
\footnote{79} 104 S. Ct. at 2989.  
\footnote{80} *Id.* at 2989-91.
mon trust funds are securities under the 1933 Act. Although a security under the federal securities laws is not necessarily a security under Glass-Steagall, the security laws are nevertheless highly persuasive. For example, in Becker, the Court relied extensively on the federal securities laws in defining a security under the Glass-Steagall Act.

The third factor in determining whether an instrument is a security under the Act is the Court's refusal to engage in a nebulous inquiry into the instrument's investment characteristics. This refusal effectively prohibits any test which balances the instrument's investment characteristics against its fiduciary characteristics to determine whether the instrument is a security. The Court's refusal to delve into the particular characteristics of an instrument, its refusal to narrowly interpret the term "securities," and its willingness to refer to the federal securities laws make it likely that the Court will hold that units of participation in IRA common trust funds are securities under the Glass-Steagall Act. Thus, IRA units of participation satisfy the first prong of the test for Glass-Steagall applicability.

Units of participation also satisfy the second prong, the role of the bank in the transaction. In determining whether the bank's conduct gives rise to the hazards which Congress attempted to alleviate by passing the Act, it is necessary to refer to the dangers listed in Camp. When a commercial bank offers IRA units of participation, it risks many of the hazards Congress sought to avoid. Most significantly, the commercial bank acquires a "salesman's stake" in selling the units of participation. This salesman's interest arises in part because the commercial bank's monthly fee is directly related to the value of the particular Fund portfolio. Accordingly, the commercial bank can increase its fee each month merely by selling additional units in the portfolios. As the Court in Camp indicated, "[i]t is not a matter of indifference to the bank whether the customer buys an interest in the bank fund or makes some other investment." It is this type of salesman's interest which Glass-Steagall

81 15 U.S.C. § 77(c) (1982) provides an exemption from the Act's disclosure requirements for a number of classes of securities. One such class of securities is described as: "any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian" 15 U.S.C. § 77(c)(a)(2) (1982) (emphasis added). Based on this description, it is apparent that units of participation in IRA common trust funds would be considered a security under the federal securities laws. See Becker, 104 S. Ct. at 2987.

82 See notes 70-74 supra and accompanying text.
83 104 S. Ct. at 2987.
84 Id. at 2988.
85 See note 77 supra and accompanying text.
86 401 U.S. at 636.
attempts to prevent.

Moreover, the "salesman's stake" in selling units of participation causes the commercial banks to engage in a manner of advertising forbidden under the Act. In advertising the Fund portfolios, the banks often directly compare the Fund to mutual funds. Such a comparison is precisely what Congress feared. As the Camp Court states: "When a bank puts itself in competition with mutual funds, the bank must make an accommodation to the kind of ground rules that Congress firmly concluded could not be prudently mixed with the business of commercial banking."\(^{87}\)

A second hazard that arises when a commercial bank offers units of participation is the impairment of the bank's role as a disinterested investment advisor.\(^{88}\) In selling units of participation, the bank stands to gain profits because its fee is based, in part, on the amount it sells each month. Given the similarity between the Fund portfolios and mutual funds, bank investment advisors naturally lose their impartiality and opt to sell an in-house product. In fact, it could be a tenuous situation for banking personnel to advise customers to invest their money in a mutual fund when the bank offers a similar product. Consequently, rather than weighing the merits of the investment alternatives, the bank's investment advisor may feel "forced" to sell the in-house product to the bank customers.

Also, when a commercial bank offers units of participation in IRA trust funds, it risks the impairment of public confidence if the Fund is unsuccessful, a possibility given the volatility of the stock market in recent years. Further, given the redemption feature of units of participation, banks could find themselves constantly involved in the search for new capital to cover redemptions. The effort to cover redemptions was also thought to be a hazard which the Act attempted to alleviate.\(^{89}\) Finally, the commercial bank's reputation for prudence and restraint could lead customers into a false sense of security when placing money into the bank's portfolios. Clearly, the investor who places IRA funds with a mutual fund recognizes some level of risk. Because of the bank's traditional reputation for prudence, however, an investor may believe that depositing IRA funds with a bank involves less risk, even though the product offered by the bank is identical to that offered by the mutual fund. It is the manipulation of this false sense of security which

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\(^{87}\) Id. at 637.

\(^{88}\) Senator Bulkley indicated that when a bank has something to sell in which it stands to receive some form of underwriting profit, it is much less qualified to render disinterested investment advice than the banker who has nothing to sell to his depositors. 75 Cong. Rec. 9912 (1932).

\(^{89}\) See note 38 supra and accompanying text.
the Act aims to prevent.90 The potential hazards created when a bank offers units of participation indicates that IRA units of participation also satisfy the second prong of the test. Accordingly, the Glass-Steagall Act should apply and prohibit commercial banks from offering these units of participation in IRA common trust funds.

V. Conclusion

The Glass-Steagall Act has separated the investment banking industry and the commercial banking industry for over fifty years. Recent attempts by both industries to engage in the other's business have brought the Act's provisions under careful scrutiny. Unfortunately, the Comptroller and some lower federal courts have created various approaches to interpreting the Act that have led to ad hoc, inconsistent decisions. In the most recent dispute, confusion exists in distinguishing collective trust funds from units of participation in such funds and in the propriety of using a functional analysis approach in defining a security under the Act. An analysis of the Supreme Court's decisions in Camp, ICI, and Becker, however, reveals a principled, two prong test for determining the Act's application. This test demonstrates that Glass-Steagall applies to IRA units of participation. Accordingly, the Act prohibits commercial banks from offering units of participation in IRA common trust funds.

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90 See note 77 supra and accompanying text.