Speakers Office

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

HOLD FOR RELEASE - 9:30 a.m., May 2, 1974

"REGULATION OF BANK SECURITIES ACTIVITIES"

Address by

John R. Evans
Commissioner
Securities and Exchange Commission

Ninth Annual Banking Law Institute
New York, New York
May 2, 1974

A few years ago, commercial banks, as the name implies, were engaged primarily in accepting time and demand deposits and making commercial loans. Today, commercial banks and bank-holding companies are engaged not only in these activities but are actively involved in mortgage banking, personal loans, travel services, courier and armored car services, freight forwarding, insurance, data processing, accounting, leasing, and various securities activities.

The aggressive development by many commercial banks of the one-stop, full financial service concept has added new dimensions of competition between banks and other business and financial institutions and has led to the fear that an unacceptable degree of economic power is becoming concentrated in a few large financial institutions. Such fears, as well as the private interests of those who do not desire bank competition, have resulted in requests for administrative and legislative action to restrict banking activities. Banks, on the other hand, have been seeking administrative and and Congressional approval to continue their expansive activities.

The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for speeches by any of its Commissioners. The views expressed herein are those of the speaker and do not necessarily reflect the views of the Commission.

In responding to requests that have these kinds of competitive ramifications, a government agency, such as the Securities and Exchange Commission or a bank regulatory agency, should be sure that it does not consciously or unconsciously give in to the desire of persons under its jurisdiction to use it to protect or advance their position over the position of those under the jurisdiction of other agencies in a manner which is contrary to the public interest. On the other hand, a federal agency also has a responsibility to assure, to the extent possible, that in establishing rules and regulations, it does not put those it regulates in a position where they cannot compete effectively with persons not subject to the same regulation.

When the Securities and Exchange Commission was created in 1934,[1] it was charged with administering the securities laws which have as their primary purpose full and fair disclosure in connection with securities transactions, the maintenance of fair and honest trading markets, and the prevention of inequitable and unfair practices in such markets. It is also quite clear that Congress intended that the Commission administer these laws in a flexible and remedial fashion as appropriate and

necessary in the public interest and for the protection of investors.[2/]

At the same time, however, Congress set the stage for what has become a rather serious dilemma for the Commission in fulfilling its responsibilities by providing what some believe to be blanket exemptions for banks from various provisions of the securities laws.[3/] Whether Congress provided such exemptions because banks were already regulated by bank agencies or whether such exemptions were provided because banks were not expected to engage in securities activities to a significant degree or whether such exemptions were simply a result of bank political power is not completely clear, nor, for present purposes, is the intent of Congress in an era 40 years ago as important as the consequences of those exemptions and whether those consequences are in the public interest.

We do know that the Glass-Steagall Act, one purpose of which was to separate commercial banking from investment banking, prohibited commercial banks from underwriting and dealing in securities except for U.S. government or agency guaranteed issues and municipal obligations guaranteed under

the full faith and credit of the issuing municipality.[1] Banks were also allowed to participate in securities transactions for the account of bank customers without recourse and solely upon the order of the customer.[2] Notwithstanding the statutory limitations, banks today are engaged in direct competition with securities firms which are subject to regulation under the securities laws. Among the securities services offered by banks are investment advisory services, trust services, underwriting and trading of municipal securities, dividend reinvestment services, mini-accounts, and automatic stock purchase plans. In view of the significant bank activities in these areas, many non-bank securities firms in fact believe that their very existence is threatened.

Over the years as the securities laws have been amended and new laws enacted, the Commission has been provided with a broad range of regulatory tools to be used in protecting investors against improper practices in connection with purchases and sales of securities. However, as a result of Congressional design, the Commission is precluded from using these tools, except for the provisions relating to fraud, to assure that bank securities activities

comply with investor protection standards applicable to other participants in the securities markets.

The dilemma this creates for the Commission is how do we maintain or raise investor protection standards for those persons over whom we have jurisdiction without providing a competitive advantage to those offering competing services but who are not subject to our jurisdiction?

A major purpose of government in a free enterprise system is to establish and maintain an environment in which competing private institutions have an equal opportunity to serve the public. If the rules on participants are to be different for public policy reasons, they are usually adjusted to favor the weaker competitor in order to preserve competition. In this instance, however, so far as securities activities are concerned, the rules favor the more powerful institutions because they are exempt from standards which apply to other securities participants.

I have difficulty understanding how any disinterested person could oppose redressing this imbalance although reasonable persons may differ as to how it should be achieved. There are several basic approaches with variations which have been recommended by responsible individuals and which,

I believe, merit consideration. First, the Commission and the Congress could do nothing but simply wring their hands and let the situation deteriorate. I do not believe a responsible Commission or Congress can ignore the inequitable competitive situation nor the lack of investor protection in our securities markets because such inaction could result in an adverse effect on the capital-raising mechanism which supports our nation's economy.

Second, the Commission in an attempt to enhance the competitive position of those subject to our authority could turn its back on investors and, to the extent necessary to permit competition on an equal basis with those not subject to our jurisdiction, relax what we consider to be necessary investor protection safeguards. I realize full well that there are those who would welcome such action by the Commission. However, we do not intend to lower our investor protection standards to the lowest common denominator of those not subject to our jurisdiction because in so doing we would not be complying with our statutory responsibilities.

Third, the Commission could utilize and extend whatever powers it already has to bring bank securities

activities within its regulatory framework. As already indicated, the general anti-fraud provisions of the securities laws, such as Section 10 of the Securities Exchange Act, apply to any person including a bank. Subparagraph 10(b) provides that the Commission may prescribe rules and regulations defining manipulative or deceptive devices or contrivances as necessary or appropriate in the public interest or for the protection of investors. I view the Commission's rulemaking power under this section to be quite broad. Accordingly, it is conceivable that rules could be adopted which define certain activities by banks and other persons to be fraudulent and manipulative. For example, these rules could include such items as disclosure of interlocking directorships, disclosure of bank dealings with issuers whose securities are being sold, and restrictions on self-dealing by bank investment managers and affiliates as well as disclosure of other possible conflicts of interest.

In my opinion, this alternative is not the most desirable regulatory approach because it would not provide the kind of protections or flexibility which we believe substantive regulation should provide. In addition, it may be difficult to "fine-tune" this kind of regulation so that

unique or peculiar situations could be accommodated. Furthermore, there is legitimate concern whether the anti-fraud provisions should be utilized in this manner. Nevertheless, it is an alternative that might be turned to if other approaches do not establish appropriate investor protections in this area.

As a fourth alternative, banks could be precluded from engaging in any securities activities. There is a great deal of support for this alternative from non-bank securities firms and some members of Congress. Some persons believe this was the intent of Congress when it enacted the Glass-Steagall Act in 1933, but that banks were allowed to continue what were intended to be strictly limited securities activities in deference to political pressures, the absence of capital and a securities network to meet municipal financing needs and the needs of investors in remote areas. Some who are concerned about the concentration of economic power in banks also support this approach.

As one who believes in a free market system with competition as the major regulator and who also can see indications that the services provided by banks may fill a gap which other firms have not been willing or able to fill

and who sees a source of capital that may be beneficial in strengthening our securities markets, I am very reluctant to accept the proposition that banks not be permitted to engage in securities activities unless it can be shown that there are serious conflicts of interest which cannot be adequately regulated, that unacceptable concentration of economic power will result, that satisfactory investor protections are not possible, or that the offering of securities services in conformance with the standards applicable to non-bank competitors would jeopardize the safety and soundness of banks.

Fifth, all who offer securities services could be made subject to rules and standards promulgated by the SEC with compliance and enforcement for banks by bank regulatory agencies and for others by the SEC. This approach could be acceptable and result in even-handed regulation if the SEC and the banking agencies were able to agree on a common approach for compliance and enforcement. While this might seem a simple condition, the difference between the responsibilities and regulatory approaches of the SEC and the banking agencies may prevent such a resolution. Let me explain why.

Bank regulators are primarily responsible to maintain the strength and stability of our banking system and thus they focus on money supply, interest rates, loans, and the safety of depositors funds. Bank requirements and standards are enforced in a "discreet" way out of concern that public knowledge of improper bank activities would cause a loss of confidence by depositors and thus jeopardize the stability so necessary to our banking system.

The basic thrust of our securities laws and regulations is full and adequate disclosure of all material information regarding the operations and management of publicly-held companies as well as the establishment of standards for those who participate in any activities relating to the purchase or sale of securities. Withholding of material information or noncompliance with standards applicable to those dealing in securities may well result in a violation of the securities laws. When it is found, in a non-public examination or investigation, that an institution under the jurisdiction of the SEC does not meet these standards, the Commission takes enforcement action which is disclosed to the public so that both present and prospective

investors may have a basis on which to make investment decisions.

I do not suggest that our approach to enforcement would be appropriate for bank regulation.[1] On the other hand, I feel strongly that private enforcement action is not appropriate to protect investors and prospective investors from misconduct on the part of securities professionals whether they are bank related or not.

Equal regulation requires equal enforcement, particularly in the financial services market where public confidence is a prime competitive tool. It may be that the securities and banking industries are irreconcilable in this regard. It is possible, however, that the two enforcement approaches may be combined so that bank agencies could examine bank securities activities and bring appropriate enforcement actions as self-regulatory bodies presently do in the securities industry if Congress is willing to authorize the SEC to review self-regulatory body and bank agency disciplinary decisions regarding bank securities activities with powers to either increase or decrease the sanctions imposed, and if necessary, initiate procedures on its own in order to assure comparability. This may be

the most reasonable solution at this time because it would utilize, to the maximum extent possible, existing self-regulatory structures, avoid the creation of a new self-regulatory body, and thus minimize additional regulation with its attendant burdens and expenses.

The sixth alternative is to subject all persons who offer securities services to the securities laws and the jurisdiction of the SEC to establish appropriate rules of practice in securities activities and enforce compliance with those rules. This alternative would ensure equal investor protection standards and even-handed regulation. If the prior alternative cannot be worked out satisfactorily, this would be my second choice.

I do not wish to alarm you, but you should expect banks either to be prohibited from engaging in securities activities or for bank securities activities to come under SEC jurisdiction. I believe it will be the latter. If this occurs, it will not be based on any Commission desire to expand its jurisdiction but will occur because it is fair and logical.

Strong indications in that direction already exist. Because of the exemptions for banks contained in securities laws, most of the action is in the form of legislative proposals. However, last Tuesday the Commission

issued a release (Securities Act Release No. 5491) which described certain bank-sponsored investment services, summarized the applicable statutory provisions, pointed out our desire to protect investors and the public interest, and asked for the views of all interested persons.[3] Congress has already determined that transactions in securities both upon securities exchanges and in the over-the-counter markets are affected with a national public interest which makes it necessary to provide regulation and control of such transactions and practices.[4] The Commission has a duty to develop and implement appropriate regulation and recommend appropriate legislation to fulfill this Congressional objective. But to formulate reasonable proposals concerning bank securities activities, we must have information and views from all participants in the securities markets, professionals and investors alike, so that our actions in this area will enhance investor protections in a prudent manner.

In your best interest, I would like to invite everyone who is associated with a bank providing securities services to read our release closely and submit comments. I have brought some copies of the release with me and the Commission would be glad to make additional copies available.

In the release, you will notice that the Commission expects to publish for comment proposed positions with respect to nondiscretionary and discretionary individual portfolio management services offered to investors concerning such questions as whether such services, when actively merchandised to small investors, would be considered securities subject to the registration requirements of the Securities Act of 1933 and whether such services would involve the creation of an investment company and thus require registration under the Investment Company Act of 1940.

In the legislative area, many proposals relating to bank securities activities are pending. The Senate has passed and the House is presently considering legislation which would provide for SEC regulation of all securities transfer agents, clearing agencies, and depositories.[19] While bank regulatory agencies would assist the Commission in the examination and enforcement of various standards for banks, the SEC will have explicit rulemaking, examination, and enforcement authority over such bank activities.

Senator Brooke has introduced a bill which would subject bank automatic stock investment programs to SEC jurisdiction and the investor protection standards of the

Exchange Act.[11] The SEC has not taken a position on this legislation but has informed the Committee we need information such as that requested in our Tuesday release before making a recommendation.

Legislation has also been introduced which would require disclosure under SEC rules and regulations of security holdings and transactions by institutions, including banks and insurance companies, similar to that now required of investment companies.[12] There is a good deal of support for this legislation, and it can be expected to become law in some form. The Commission has proposed the most flexible and least burdensome approach presently before Congress.

Another proposal which may be introduced by Chairman Patman of the House Banking Committee would require trust departments with assets of $200 million or more to be divested by commercial banks in order to resolve certain conflicts of interest and diffuse concentrations of economic power. If such a separation were to be required by Congress, the Securities and Exchange Commission would likely be given the responsibility to regulate these investment advisory institutions.

The final legislative proposal I want to discuss was introduced by Senator Williams to remove the exemption for municipal securities under the Securities Exchange Act establishing the SEC as the federal agency responsible to assure appropriate standards and trading practices for all persons underwriting and dealing in municipal securities.[13] There is general agreement that the appropriate federal body to provide regulation for both bank and non-bank dealers is the SEC but despite many conferences and diligent attempts to work out a resolution of enforcement procedures which would accommodate the banks and banking agencies and still assure equal treatment of bank and non-bank underwriters and dealers in municipal securities, we have not been able to agree on a position which could be supported by all interested parties. I believe, however, that most parties could support a position which would be acceptable to the Commission. We will testify on the bill next Monday and trust that the Congress, with whatever assistance all of us can provide, will resolve the remaining conflicts in a manner which will provide equal regulation.

In reviewing major bank legislation enacted during the year I have been on the Commission and refreshing my

memory on legislation passed during the time I was a staff member of the Senate Banking Committee, I discovered a statement made by Mr. Wriston, Chairman of the Board of the First National City Bank of New York, which I would like to quote in conclusion. He made the statement in testimony before the Senate Banking Committee on the 1970 Amendments to the Bank Holding Company Act. After discussing the fact that the SEC and various other governmental departments and agencies had become concerned with bank activities, he said:

> "What seems to be emerging is a division of labor in banks and bank holding company watching. It is not a bad principle. The classic regulatory agencies might concentrate on the original purpose of bank regulation, which has always been to assure that the depositor will get his money back when he needs it.
>
> "The other agencies and departments are concerned with aspects of our other financial activities. This seems to me to make sense . . . ." /14/

His statement indicates great foresight and reflects what I consider a responsible approach for the banking community to adopt.

LIST OF FOOTNOTES FOR MAY 2, 1974 SPEECH

1/Section 4(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78d(a).

2/Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 12 (1971); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); Securities and Exchange Commission v. Harwyn Industries Corp., 326 F. Supp. 943 (S.D.N.Y. 1971).

3/See e.g., Section 3(a)(2) of the Securities Act of 1933, 15 U.S.C. 77c(a)(2); Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(4) and 15 U.S.C. 78c(a)(5); Section 3(c)(3) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(3); and Section 2(a)(11)(A) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a)(11)(A).

4/Section 16 of the Glass-Steagall Act of 1933, 12 U.S.C. 24.

5/Id.

6/15 U.S.C. 78j.

7/Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818.

8/Securities Act Release No. 5491 (April 30, 1974).

9/Section 2 of the Securities Exchange Act of 1934, 15 U.S.C. 78b.

10/S. 2058, 93d Cong., 1st Sess. (1973); H.R. 5050, 93d Cong., 1st Sess., Title IV (1973).

11/S. 2707, 93d Cong., 1st Sess. (1973).

12/S. 2234 and S. 2683, 93d Cong., 1st Sess. (1973); H.R. 13986, 93d Cong., 2d Sess. (1973).

13/S. 2474, 93d Cong., 1st Sess. (1973).

14/Hearings On S. 1052, S. 1211, S. 1664, S. 3823, And H.R. 6778 Before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess., Pt. 2, pp. 782-783 (1970).

LIST OF FOOTNOTES FOR MAY 2, 1974 SPEECH

1/Section 4(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78d(a).

2/Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 12 (1971); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); Securities and Exchange Commission v. Harwyn Industries Corp., 326 F. Supp. 943 (S.D.N.Y. 1971).

3/See e.g., Section 3(a)(2) of the Securities Act of 1933, 15 U.S.C. 77c(a)(2); Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(4) and 15 U.S.C. 78c(a)(5); Section 3(c)(3) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(3); and Section 2(a)(11)(A) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a)(11)(A).

4/Section 16 of the Glass-Steagall Act of 1933, 12 U.S.C. 24.

5/Id.

6/15 U.S.C. 78j.

7/Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818.

8/Securities Act Release No. 5491 (April 30, 1974).

9/Section 2 of the Securities Exchange Act of 1934, 15 U.S.C. 78b.

10/S. 2058, 93d Cong., 1st Sess. (1973); H.R. 5050, 93d Cong., 1st Sess., Title IV (1973).

11/S. 2707, 93d Cong., 1st Sess. (1973).

12/S. 2234 and S. 2683, 93d Cong., 1st Sess. (1973); H.R. 13986, 93d Cong., 2d Sess. (1973).

13/S. 2474, 93d Cong., 1st Sess. (1973).

14/Hearings On S. 1052, S. 1211, S. 1664, S. 3823, And H.R. 6778 Before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess., Pt. 2, pp. 782-783 (1970).