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Ownership of Member Banks by Mutual Fund Advisers Under the Glass-Steagall Act

D.A. Howard

OWNERSHIP OF MEMBER BANKS BY MUTUAL FUND ADVISERS UNDER THE GLASS-STEAGALL ACT

INTRODUCTION

Congress enacted the Glass-Steagall Act (Act)[1] in 1933 to divorce the commercial banking industry from the securities industry.[2] The drafters of the Act recognized that simultaneous conduct of the banking and securities businesses by single companies or corporate groups creates severe hazards of bank instability,[3] conflicts of interest,[4] and

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1. The Glass-Steagall Act is the popular name for the Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.), and also for those sections of the Banking Act of 1933 which regulate the securities activities of commercial banks, such as §§ 2, 16, 20, 21 and 32 (codified as amended at 12 U.S.C. §§ 221a, 24 Seventh, 377, 378 and 78, respectively (1982)).

2. *See* Investment Co. Inst. v. Camp, 401 U.S. 617, 629-34 (1971); 12 U.S.C. §§ 24 Seventh, 377, 378 (1982); *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 239 Before the Senate Comm. on Banking and Currency,* 72d Cong., 1st & 2d Sess. 101 (1932-1933) (testimony of Sen. Glass) [hereinafter cited as *1932-1933 Hearings*]; *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency,* 72d Cong., 1st Sess. 44, 45 (1932) (testimony of Sen. Glass) [hereinafter cited as *March 1932 Hearings*]; *id.* at 423 (testimony of J.W. Pole, Comptroller of the Currency); 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *id.* at 9882-83 (remarks of Sen. Glass). In addition to separating the commercial banking and securities businesses, the Glass-Steagall Act limited the securities activities of all depository institutions. See *infra* note 8. Other goals of the Act included: "(a) Strengthening of the capital of banks. (b) Provisions for closer and stronger supervision. (c) More careful restriction of investments. (d) Requirements for the truthful valuation of assets. (e) Protection of depositors and limitation of their losses through a bank deposit insurance corporation." S. Rep. No. 77, 73rd Cong., 1st Sess. 11 (1933) [hereinafter cited as 1933 Senate Report]. The Federal Deposit Insurance Corporation (FDIC) was created by § 8 of the Glass-Steagall Act, 12 U.S.C. § 1811 (1982), and most of the floor debate concerned the FDIC. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61 n.27 (1981).

3. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61-62, 66 n.38 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 630-31, 638 (1971); *see Financial Institutions Restructuring and Services Act of 1981: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs,* 97th Cong., 1st Sess. 676 (1981) (statement of the Investment Company Institute) [hereinafter cited as *October 1981 Hearings*]; *1932-1933 Hearings, supra* note 2, at 101-102 (testimony of Sen. Glass); *March 1932 Hearings, supra* note 2, at 34 (same); *id.* at 37 (testimony of Sen. Couzens); *id.* at 458 (testimony of Howard Bruce, Chairman of the Board, Baltimore Trust Co.); *Operation of the National and Federal Reserve Banking Systems: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency,* 71st Cong., 3d Sess. 365 (1931) (testimony of Owen D. Young, Chairman of the Board, General Electric Co.) [hereinafter cited as *1931 Hearings*]; 1933 Senate Report, *supra* note 2, at 18; 77 Cong. Rec. 3837 (1933) (remarks of Rep. Steagall); 75 Cong. Rec. 9911-12 (1932) (remarks of Sen. Bulkley); *id.* at 9887, 9889 (remarks of Sen. Glass).

4. Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971); *see 1932-1933 Hearings, supra* note 2, at 2030 (testimony of Ferdinand Pecora, special counsel to Senate Committee on Banking and Currency) (quoting letter from Solicitor General

investor deception.[5] Sections 16[6] and 21[7] of the Act, therefore, prohibit depository institutions from underwriting securities directly,[8] and section 20[9] prohibits banks that are members of the Federal Reserve System (member banks) from underwriting securities through affiliates.[10]

Although the Supreme Court has stated that the Glass-Steagall Act separates the commercial banking and securities industries "as completely as possible,"[11] recent changes in the economy,[12] in technology[13]

Frederick W. Lehmann to Attorney General Charles W. Wickersham); *March 1932 Hearings*, *supra* note 2, at 51 (testimony of Sen. Glass); *1931 Hearings*, *supra* note 3, at 20 (testimony of J.W. Pole, Comptroller of the Currency); *id.* app. pt. IV, at 1064; 1933 Senate Report, *supra* note 2, at 1; 77 Cong. Rec. 3907 (1933) (remarks of Rep. Kopplemann); *id.* at 3835 (remarks of Rep. Steagall); 75 Cong. Rec. 9887 (1932) (remarks of Sen. Glass); Clark & Saunders, *Judicial Interpretation of Glass-Steagall: The Need for Legislative Action*, 97 Banking L.J. 721, 723 (1980); *see also* Tagliabue, *German Banks in Uneasy Mood*, N.Y. Times, Nov. 28, 1983, at D9, col. 1 (conflicts of interest in West German banks, which are not restrained from securities activities); *id.* Nov. 3, 1983, at D5, col. 1 (same).

5. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66 n.38 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971); *October 1981 Hearings*, *supra* note 3, at 677 (statement of the Investment Company Institute); *March 1932 Hearings*, *supra* note 2, at 34 (testimony of Sen. Glass); *id.* at 37 (testimony of Sen. Couzens); 77 Cong. Rec. 4028 (1933) (remarks of Rep. Fish). *But cf. October 1981 Hearings*, *supra* note 3, at 690 (statement of the Investment Company Institute) ("[T]he maintenance of an effective banking structure, and the protection of depositors . . . . neither utilize the same tools nor achieve the same ends as investor protection.") (quoting William Cary, Chairman, SEC). Thus, a statute like the Glass-Steagall Act which is primarily designed to protect the banking system does not also protect investors.

6. 12 U.S.C. § 24 Seventh (1982).

7. *Id.* § 378.

8. Section 16 prevents national banks from underwriting securities or purchasing securities for their own accounts. *Id.* § 24 Seventh. Section 21 prevents organizations "engaged in the business of issuing, underwriting, selling, or distributing" securities from accepting deposits. *Id.* § 378(a)(1). By implication, therefore, § 21 prevents organizations that accept deposits from underwriting securities. Section 21 thus limits the securities activities of all depository institutions, not just national banks.

9. *Id.* § 377.

10. Section 20 prevents member banks from being "affiliated," within the meaning of § 2(b) of the Glass-Steagall Act, 12 U.S.C. § 221a(b) (1982), with any organization engaged principally in the underwriting or distribution of securities. *Id.* § 377.

11. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 62 (1981); *see March 1932 Hearings*, *supra* note 2, at 42 (testimony of Sen. Glass); 1933 Senate Report, *supra*, note 2, at 10.

12. *Securities Activities of Depository Insts.: Hearings on S. 1720 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 2d Sess. 1 (1982) (testimony of Sen. D'Amato) (increase in the number of mergers and aquisitions) [hereinafter cited as *1982 Hearings*]; *Competition and Conditions in the Financial System: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 71 (1981) (statement of John G. Heimann, Comptroller of the Currency) (inflation, fluctuations in interest rates, unemployment and production) [hereinafter cited as *May 1981 Hearings*]; *see*

and in demographics[14] have prompted both commercial banks and securities firms to expand into each others' fields.[15] In 1971, for example, the Court denied Citibank's predecessor permission to offer the equivalent of a mutual fund,[16] but ten years later permitted Citibank's holding company to act as investment adviser to a closed-end investment company.[17] The Court will soon decide whether Bankers Trust Co. may continue to deal in commercial paper[18] and whether BankAmerica Corp. must divest itself of Charles Schwab & Co., its discount brokerage subsidiary.[19] Over the vehement opposition of the Board of Governors of the Federal Reserve System (Board),[20] the Office of the Comptroller of the Currency (OCC) recently permitted

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Hill, *One Bank's Difficulties Can Hurt Many Others Because of Loan Links*, Wall St. J., June 21, 1982, at 1, col. 6 (volatile interest rates and unruly capital markets).

13. *1982 Hearings*, *supra* note 12, at 1 (statement of Sen. D'Amato) (emergence of new technologies for the transfer of funds and innovative financial products); *May 1981 Hearings*, *supra* note 12, at 72 (statement of John G. Heimann, Comptroller of the Currency) (expanded competition by smaller institutions made practical and possible by technological innovation); Bennett, *Deregulation Has Freed Banks to do What They Never Could. Should They Also Be Allowed the Freedom to Fail?*, N.Y. Times, Feb. 19, 1984, § 3 (Business), at 12, col. 2 (dramatic technological advances); Wall St. J., July 18, 1983, at 1, col. 5 (high-speed computers).

14. *May 1981 Hearings*, *supra* note 12, at 72 (statement of John G. Heimann, Comptroller of the Currency) (population shift from North and East of the country to South and West expected to have major effect on financial products markets).

15. *See id.* at 1143 (statement of Edward I. O'Brien, President, Securities Industry Association); R. Jennings & H. Marsh, Securities Regulation 1382-86 (5th ed. 1982); Evans, *Regulation of Bank Securities Activities*, 91 Banking L.J. 611, 611-12 (1974); Bennett, *supra* note 13, at 1, col. 2, 12, col. 2; *Banking's Busting Out All Over*, N.Y. Times, Jan. 30, 1984 (editorial), at A16, col. 1; Blumstein, *Banking Lines Begin to Blur*, *id.* Jan. 18, 1984, at D2, col. 1; McMurray, *Wall Street Firms Headed for Record Year But Banks' Inroads Cast Pall Over Outlook*, Wall St. J., Nov. 29, 1983, at 16, col. 3; *id.* Sept. 27, 1983, at 12, col. 3; *id.* July 18, 1983, at 1, col. 5.

16. Investment Co. Inst. v. Camp, 401 U.S. 617, 639 (1971).

17. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 78 (1981).

18. A.G. Becker, Inc. v. Board of Governors of the Fed. Reserve Sys., 693 F.2d 136 (D.C. Cir. 1982), *cert. granted sub nom.* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 104 S. Ct. 65 (1983); *see May 1981 Hearings*, *supra* note 12, at 1144 (testimony of Edward I. O'Brien, President, Securities Industry Association); *id.* at 1151 (statement of Securities Industry Association).

19. Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 716 F.2d 92 (2d Cir. 1983), *cert. granted*, 104 S. Ct. 994 (1984); *see* N.Y. Times, Jan. 24, 1984, at D6, col. 4; Wall St. J., Jan. 24, 1984, at 4, col. 1. This case will affect the hundreds of commercial banks which offer discount brokerage services to their clients. *See* N.Y. Times, Jan. 19, 1984, at D10, col. 3.

20. *See* Letter from William W. Wiles, Secretary of the Board of Governors of the Federal Reserve System, to C.T. Conover, Comptroller of the Currency, at 2 (Dec. 14, 1982) [hereinafter cited as Board Letter] (available in files of Fordham Law Review); Letter from Board of Governors of the Federal Reserve System to J. & W. Seligman Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,531, at 86,749 (Mar. 28, 1983); *see also* Conte, *Deregulation of Banks Stirs Confusion, Splits Fed and White House*, Wall St. J., July 1, 1983, at 7, col. 1 ("strenuous objections by the Fed").

companies that advise, sponsor and underwrite mutual funds[21] to own member banks.[22]

This Note examines the OCC's approval of the member bank parent/mutual fund adviser-sponsor structure (bank-mutual fund structure).[23] The OCC's position is noteworthy because it diverges from

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21. A mutual fund sells shares to the public and uses the funds received to invest in corporate and government securities. A mutual fund is an "open-end" investment company, an investment company that has a legal obligation to redeem its shares. 12 C.F.R. § 218.101 (1983); *see* R. Jennings & H. Marsh, *supra* note 15, at 1365-66; Rosenblat & Lybecker, *Some Thoughts on the Federal Securities Laws Regulating External Investment Management Arrangements and the ALI Federal Securities Code Project*, 124 U. Pa. L. Rev. 587, 590-94 (1976).

22. Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464 (Feb. 4, 1983); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co. [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463 (Feb. 1, 1983); Wall St. J., Nov. 23, 1983 at 4, col. 2 (company "linked to mutual fund[s]" granted national bank charter by OCC).

23. This Note examines only the OCC's Glass-Steagall Act analysis of the member bank parent/mutual fund adviser-sponsor structure. The structure also raises controversial issues under the Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. §§ 1841-1849 (1982). Section 4(a) of the BHCA, *id.* § 1843(a), limits "bank holding companies" to the activities of banking and managing or controlling banks unless the Board, under § 4(c)(8), *id.* § 1843(c)(8), deems an otherwise prohibited activity "to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." *Id.* A "bank holding company" is a company that has control over a "bank," *id.* § 1841(a)(1), which is defined as an institution that accepts demand deposits and in addition makes commercial loans. *Id.* § 1841(c). Because this definition of "bank" is in the conjunctive, it can be argued that a bank that does not both accept demand deposits and make commercial loans, but only offers trustee or other services, is not a "bank" and its parent not a "bank holding company" within the meaning of the BHCA. This is the "non-bank bank" exception to the BHCA. *See generally* Golden, *Acquisitions of Financial Institutions That Do Not Accept Demand Deposits*, 100 Banking L.J. 177 (1983) (Legislative history and Board interpretations support the proposition that an institution is not a bank within the meaning of the BHCA unless it both accepts demand deposits and makes commercial loans.); Golden, *Corporate Acquisitions of Banks That Do Not Make Commercial Loans*, 99 Banking L.J. 259 (1982) (same). The Glass-Steagall Act issues raised by a bank-mutual fund structure are irrelevant if the structure is subject to the BHCA, because the Board will not deem mutual fund sponsorship by the bank's parent to be "closely related to banking" within the meaning of the BHCA. *See* Board Letter, *supra* note 20, at 3-4. The bank-mutual fund structures that the OCC has approved, however, fall within the "non-bank bank" exception to the BHCA. *See, e.g.*, Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,607 (Feb. 4, 1983) (national member bank will not make commercial loans but plans to offer demand deposits); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co. [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,597 (Feb. 1, 1983) (national member bank will neither make commercial loans nor offer demand deposits). The member bank parent is thus not a bank holding company within the meaning of the BHCA.

The Board objects to the "non-bank bank" loophole. *See* Board Letter, *supra* note 20, at 3-4. In an effort to narrow the loophole, the Board has provoked controversy,

see Wall St. J., Dec. 16, 1983, at 60, col. 2, by broadening its construction of the BHCA's definitions of commercial lending and demand deposits. Bank Holding Cos. and Change in Bank Control; Revision of Regulation Y, 49 Fed. Reg. 794, 798-99, 818 (1984) (to be codified at 12 C.F.R. pt. 225); Wall St. J., Dec. 15, 1983, at 2, col. 2; *see* Comment Period Extended on Proposed Revision of Regulation Y, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,602, at 86,976-77 (July 15, 1983); Proposed Revision and Update of Regulation Y, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,558, at 86,831-32 (May 19, 1983). The Board's new definition of demand deposits has already been successfully challenged before a panel of the Court of Appeals for the Tenth Circuit. *See* First Bancorporation v. Board of Governors of the Fed. Reserve Sys., No. 82-1401, slip op. at 3, 6 (10th Cir. Feb. 21, 1984); Wall St. J., Feb. 24, 1984, at 5, col. 4. The Board intends to ask for a rehearing *en banc. See id.*

In a conciliatory move, the Comptroller assented to a Board proposal, Noble, *Bankers Split Over Fed Stand*, N.Y. Times, May 4, 1983, at D6, col. 5, and declared a nine-month moratorium on the chartering of non-bank banks by parent companies which was to expire at the end of 1983, Comptroller of the Currency Announces a Moratorium on the Chartering of "Non-bank" Banks, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,528 (April 5, 1983); Wall St. J., Oct. 7, 1983 at 3, col. 4. The Board later proposed a permanent, legislative moratorium which was introduced as S. 1532, 98th Cong., 1st Sess. (1983), and as H.R. 3413, 98th Cong., 1st Sess. (1983). *Financial Services Industry—Oversight: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 98th Cong., 1st Sess., pt. II, at 396 (1983) (SEC Memorandum from Office of the General Counsel to John Shad, Chairman of the SEC) [hereinafter cited as *1983 Hearings*]. The Comptroller has not yet made the moratorium on non-bank banks permanent but has extended it. Wall St. J., Nov. 15, 1983 at 4, col. 2. Stopgap measures such as the OCC's moratorium sometimes become permanent law. The Glass-Steagall Act was in fact originally considered a stopgap measure. *See* 1933 Senate Report, *supra* note 2, at 2. If the moratorium is made permanent, companies which advise and sponsor mutual funds will be unable to charter or acquire member banks in the future, regardless of the Glass-Steagall Act questions involved. However, the moratorium is not applicable to previously filed applications for non-bank bank status. Bennett, *supra* note 13, at 12, col. 6. Thus the existing bank-mutual fund structures can coexist with even a permanent moratorium and the validity of these structures under the Glass-Steagall Act will remain an issue.

In contrast to the possibility of a non-bank bank moratorium, the Reagan Administration has sought passage of legislation that would permit mutual fund adviser-sponsors to own member banks. In 1983, for example, the administration had pending S. 1609, 98th Cong., 1st Sess. (1983), *1983 Hearings*, *supra*, pt. II, at 386 (SEC Memorandum from the Office of the General Counsel to John Shad, Chairman of the SEC), and H.R. 3537, 98th Cong., 1st Sess. (1983), *id.* at 395-96 (same). In 1982, the administration submitted S. 2490, 97th Cong., 2d Sess. (1983), which similarly would have permitted the bank-mutual fund structure, but would not have allowed a bank to offer mutual fund services directly. *1983 Hearings*, *supra*, pt. I, at 6 (testimony of Donald T. Regan, Secretary of the Treasury); *see 1982 Hearings*, *supra* note 12, at 17 (same); S. Rep. No. 536, 97th Cong., 2d Sess. 2 (1982), *reprinted in* 1982 U.S. Code Cong. & Ad. News 3054, 3056 [hereinafter cited as 1982 Senate Report]; N.Y. Times, July 9, 1983, at 43, col. 1. Senator Garn, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, has sponsored S. 1720, 97th Cong., 2d Sess. (1983), which would let a bank offer mutual fund services directly out of the bank and not require that they be offered through an affiliate. *1983 Hearings*, *supra*, pt. I, at 333 (statement of James Herrington, President, Independent Bankers Association of America); *1982 Hearings*, *supra* note 12, at 2

traditional Glass-Steagall Act interpretation by ignoring the Act's purposes and relying solely on semantic analysis of the Act's language. Part I of this Note demonstrates that the bank-mutual fund structure is replete with all the hazards that the Act was designed to prevent. Part II scrutinizes the OCC's semantic analysis and the Supreme Court's approach to interpreting the Act. The Note concludes that the OCC's approval of the structure is incorrect for two reasons. First, the OCC's semantic analysis is flawed; close examination demonstrates that the structure does violate the Glass-Steagall Act's language. Moreover, even if scrutiny of the language were inconclusive, the structure would violate the Act because it gives rise to the hazards that the Act is intended to prevent.

I. Evaluation of the Bank-Mutual Fund Structure in Light of the Purposes of the Glass-Steagall Act

The Glass-Steagall Act was enacted to promote public confidence in banking institutions, to prevent investor deception and to avoid conflicts of interest in the management of the banking and securities businesses.[24] The drafters deliberated extensively over whether these three aims required complete prohibition of relationships between banking and securities enterprises or whether these relationships should be permitted subject to elaborate regulation.[25] Congress chose outright prohibition in the belief that the dangers arising from these relationships were so subtle and variegated that regulation could not be entirely effective.[26]

(testimony of Sen. Garn); *October 1981 Hearings*, *supra* note 3, at 678-79 (statement of David Silver, President of the Investment Company Institute); 1982 Senate Report, *supra*, at 2, *reprinted in* 1982 U.S. Code Cong. & Ad. News at 3055. These proposed revisions of the Glass-Steagall Act would legitimate the bank-mutual fund structure.

24. See *supra* notes 3-5 and accompanying text.

25. 75 Cong. Rec. 9888 (1932) (remarks of Sen. Glass); *see March 1932 Hearings*, *supra* note 2, at 42-43 (testimony of Sen. Glass); *1931 Hearings*, *supra* note 3, at 19-22 (testimony of J.W. Pole, Comptroller of the Currency); *id.* at 191-92 (statement of Albert H. Wiggin, Chairman of the Governing Board, Chase National Bank); *id.* at 238-41 (testimony of B.W. Trafford, Vice-Chairman, First National Bank of Boston); *id.* at 301-03, 318 (testimony of Charles E. Mitchell, Chairman, National City Bank of New York); *id.* at 356, 364-65 (testimony of Owen D. Young, Chairman of the Board, General Electric Co.); *id.* at 364-65 (testimony of Sen. Walcott); *id.* at 539-40 (statement of Colonel Allan M. Pope, Executive Vice-President, First National Old Colony Corp.).

26. *See* Investment Co. Inst. v. Camp, 401 U.S. 617, 630 (1971); *1931 Hearings*, *supra* note 3, at 21 (testimony of J.W. Pole, Comptroller of the Currency); 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *id.* at 9888 (remarks of Sen. Glass). *See generally* Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 Banking L.J. 483, 506-514 (1971) (summarizing testimony in favor of and opposed to outright prohibition).

In the context of the bank-mutual fund structure, the conflict of interest problem may be particularly acute. In this form of corporate organization a company owns a member bank and also acts as underwriter and investment adviser for mutual funds it has organized.[27] This structure raises conflicts of interest in part because the mutual funds are likely to require bank resources.[28] Mutual funds are obligated to redeem their outstanding shares on demand and do so constantly.[29] Therefore, to maintain adequate capitalization mutual funds continuously require infusions of money such as new purchases of their securities.[30]

Moreover, the bank may be predisposed or induced to satisfy the mutual funds' needs. It might be induced to do so by its parent which may participate in the mutual funds' earnings[31] and whose investment

27. *See* Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,607 (Feb. 4, 1983) (company chartering a member bank acts as underwriter and investment adviser for mutual funds it has organized); Decision of the Comptroller of the Currency on the Application of J. & W. Seligman Trust Co. [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,599 (Feb. 1, 1983) (company chartering a member bank acts as underwriter, investment adviser and broker for mutual funds it has organized); Bennett, *supra* note 13, at 12, col. 6 (national bank charter granted by OCC to corporation that operates group of mutual funds); Wall St. J., Nov. 23, 1983, at 4, col. 2 (company "linked to mutual fund[s]" granted a national bank charter by OCC). Many mutual fund advisers, such as the Dreyfus Corporation, are not in the general securities business, have no seat on any exchange, and therefore cannot act as broker for their mutual funds. R. Jennings & H. Marsh, *supra* note 15, at 1390; *see* 1 T. Frankel, The Regulation of Money Managers, ch. I, § 4, at 11 (1978). In the *Dreyfus* and *Seligman* cases the mutual fund advisers sought to charter national banks, Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,606 (Feb. 4, 1983); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,597 (Feb. 1, 1983), which must be member banks, 12 U.S.C. § 222 (1982). Mutual funds are typically organized, promoted, and controlled by persons with an existing investment management organization, such as a securities underwriting firm. The organizers pay the organizational expenses, provide the required amount of initial capital, and name the first board of directors. The new mutual funds then enter into an underwriting and investment advisory agreement with the organizer. R. Jennings & H. Marsh, *supra* note 15, at 1398; *see* 2 T. Frankel, *supra*, ch. XI, § 15, at 259.

28. Investment Co. Inst. v. Camp, 401 U.S. 617, 636-37 (1971).

29. 1 T. Frankel, *supra* note 27, ch. IV, § 32.1, at 337; Rosenblat & Lybecker, *supra* note 21, at 593 & n.17; *see* R. Jennings & H. Marsh, *supra* note 15, at 1369-70.

30. 1 T. Frankel, *supra* note 27, ch. IV, § 32.1, at 337; Rosenblat & Lybecker, *supra* note 21, at 593-94.

31. The bank's parent participates in the mutual fund's earnings to the extent that it owns shares issued by the mutual funds. Shares may represent, among other things, a right to dividends. *See* W. Cary & M. Eisenberg, Corporations 1335 (5th ed. 1980). The bank's parent, however, is likely to avoid owning a large number of shares in its mutual funds because the bank and the mutual funds will be indisputably and impermissibly affiliated if the bank's parent controls the funds through stock ownership. See *infra* notes 44-50 and accompanying text.

advising and underwriting fees increase with the number of outstanding mutual fund shares.[32] The bank might be predisposed to aid the mutual funds because it participates in the parent's wealth if the funds are thriving[33] or in their difficulties if the funds are struggling.[34]

The bank might satisfy the needs of the mutual funds directly or indirectly. The bank may do so directly by purchasing the mutual funds' own-issue[35] or excess portfolio securities[36] or by engaging in other transactions with the funds.[37] The bank may also assist the mutual funds directly by sacrificing human rather than financial resources. Management may neglect the bank in order to minister to the mutual funds.[38] The bank may indirectly aid the mutual funds by

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32. *See* 2 T. Frankel, *supra* note 27, ch. XI, § 15, at 255; Rosenblat & Lybecker, *supra* note 21, at 593. The bank's parent has tremendous incentive to see that the mutual funds' shares are aggressively marketed. 2 T. Frankel, *supra* note 27, ch. XI, § 15, at 257; Rosenblat & Lybecker, *supra* note 21, at 593-94; *see* Investment Co. Inst. v. Camp, 401 U.S. 617, 633 (1971); *see also 1983 Hearings*, *supra* note 23, pt. I, at 66-67 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System) (bank holding company would be under pressure to draw on bank funds to support securities subsidiaries).

33. *See* S. Rep. No. 1095, 84th Cong., 1st Sess., pt. 1, at 15 (1955), *reprinted in* 1956 U.S. Code Cong. & Ad. News 2482, 2496; *see also 1983 Hearings*, *supra* note 23, pt. I, 66-67 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System) (securities subsidiary of bank holding company source of strength for deposit-taking affiliate).

34. *See* Investment Co. Inst. v. Camp, 401 U.S. 617, 630-31 (1971); *1931 Hearings*, *supra* note 3, app. pt. IV, at 1063; *cf. October 1981 Hearings*, *supra* note 3, at 674, 676-77 (statement of David Silver, President, Investment Company Institute) (real estate investment trusts); Hill, *supra* note 12, at 1, col. 6 (one bank's difficulties hurt many others because of loan links). See *infra* notes 41-42 and accompanying text.

35. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 633 (1971).

36. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 63 n.33 (1981) (quoting 77 Cong. Rec. 4179 (1933) (remarks of Sen. Glass)); *1931 Hearings*, *supra* note 3, app. pt. IV, at 1064; 75 Cong. Rec. 9887 (remarks of Sen. Glass); Clark & Saunders, *supra* note 4, at 723.

37. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66 n.38 (1981) (unsound loans); Investment Co. Inst. v. Camp, 401 U.S. 617, 630-31 (1971) (same); *1931 Hearings*, *supra* note 3, at 20 (testimony of J.W. Pole, Comptroller of the Currency) (same); *id.*, app. introduction, at 999 (security collateral loans); *id.*, app. pt. I, at 1018 (same); *id.*, app. pt. IV, at 1063 (bank buys from or sells to securities affiliate under repurchase agreement); *id.*, app. pt. IV, at 1065 (loan lines not covered by specific collateral); 1933 Senate Report, *supra* note 2, at 1 (diversion of funds); *id.* at 10 (advances or loans); 77 Cong. Rec. 3907 (1933) (remarks of Rep. Kopplemann) (diversion of bank funds into speculative operations); *cf. October 1981 Hearings*, *supra* note 3, at 674-77 (statement of the Investment Company Institute) (bank may directly aid an affiliated real estate investment trust by extending credit to and otherwise subsidizing operations of the trust); *May 1981 Hearings*, *supra* note 12, at 1153 (statement of the Securities Industry Association) (same).

38. *See 1983 Hearings*, *supra* note 23, pt. I, at 67 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System).

augmenting purchases of the mutual funds' securities by third parties.[39] Indirect assistance might also take the form of loans or credit-line advances to a struggling issuer in whose questionable securities the mutual funds imprudently invested.[40]

In addition to conflicts of interest, the bank-mutual fund structure gives rise to the other hazards that the Glass-Steagall Act was designed to prevent. If the member bank, the mutual funds and the bank's parent are associated in the public mind,[41] and if a mutual fund or the bank's parent fares poorly, then loss of public confidence, a run on the bank and bank failure might follow.[42] The relationship between the bank, its parent and the mutual funds might also mislead investors. In misguided reliance on the corporate relationship, bank depositors or the public at large might invest in the mutual funds.[43]

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39. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 67 n.39 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 632 (1971). One way in which the bank can increase the number of purchases of the mutual funds' securities is by using its lending powers. The bank might, for example, extend credit more readily to borrowers who indicate an intention to invest in the mutual funds. *1931 Hearings*, *supra* note 3, app. pt. IV, at 1064; American Law Division, Congressional Research Service of the Library of Congress, 98th Cong., 1st Sess., Formation and Powers of National Banking Associations—A Legal Primer 4-7 (Comm. Print 1983). The bank might also make loans on condition that the borrower purchase the mutual funds' securities. *May 1981 Hearings*, *supra* note 12, at 1161-62 (statement of the Securities Industry Association); *see* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66-67 & n.38 (1981); *October 1981 Hearings*, *supra* note 3, at 710 (Investment Company Institute, *Restructuring the Financial Services Industry: The Need for Comprehensive Review*); 1933 Senate Report, *supra* note 2, at 9, 14, 15.

40. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66 n.38 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971); *1931 Hearings*, *supra* note 3, app. pt. IV, at 1063; *cf. October 1981 Hearings*, *supra* note 3, at 674-77 (statement of the Investment Company Institute) (bank might indirectly aid an affiliated real estate investment trust by shoring up one of the trust's investments).

41. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66 n.38 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971); *1983 Hearings*, *supra* note 23, pt. I, at 66-67 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System); *March 1932 Hearings*, *supra* note 2, at 34 (testimony of Sen. Glass); *id.* at 37 (testimony of Sen. Couzens); *cf. October 1981 Hearings*, *supra* note 3, at 674 (statement of the Investment Company Institute) (bank and affiliated real estate investment trust).

42. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 61 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971); *see 1931 Hearings*, *supra* note 3, at 20 (testimony of J.W. Pole, Comptroller of the Currency) (fate of bank and securities affiliate intertwined); 75 Cong. Rec. 9889 (1932) (remarks of Sen. Glass) (failure of small banks in a region leads to runs on even unrelated larger banks); *cf. October 1981 Hearings*, *supra* note 3, at 676 (statement of the Investment Company Institute) (bank and affiliated real estate investment trust).

43. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66 n.38 (1981); *see* Investment Co. Inst. v. Camp, 401 U.S. 617, 631 (1971); *cf.*

A major purpose of the Act is to prohibit such hazardous relationships.[44] Section 20 effectuates this purpose[45] only if the relationship between the member bank and the mutual funds is an "affilia[tion]" within the broad definition contained in section 2(b)(2).[46] Under sec-

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October 1981 Hearings, *supra* note 3, at 677 (statement of the Investment Company Institute) (bank and affiliated real estate investment trust).

44. *1983 Hearings*, *supra* note 23, pt. II, at 771 (statement of Investment Company Institute) (bank-mutual fund relationships "raise all the traditional Glass-Steagall concerns") (quoting Donald Regan, Secretary of the Treasury).

45. Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78 (1982), also effectuates bank-mutual fund separation by preventing individuals from serving simultaneously as employees or directors of both a member bank and an organization "primarily engaged" in securities activities. *Id. See generally* Lehr, *The Affiliation of Commercial Bank and Mutual Fund Personnel—Part I*, 83 Banking L.J. 377 (1966) (comparing § 32's approach to protecting member banks from conflicts of interest with Congress' approach to protecting mutual funds from similar conflicts). Mutual funds appear to be "primarily engaged" entities because the Board holds that they are "engaged principally" within the meaning of § 20, Board Letter, *supra* note 20, at 2, the Comptroller has not disputed this, *see* Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,613 n.17 (Feb. 4, 1983), and the Supreme Court has indicated that "primarily engaged" is a broader phrase than "engaged principally." *See* Board of Governors of the Fed. Reserve Sys. v. Agnew, 329 U.S. 441, 447-49 (1947). Unlike Glass-Steagall Act §§ 20 and 32, §§ 16 and 21 do not limit the mutual fund activities of the bank's parent or of the personnel of the bank's parent. Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 58 n.24 (1981).

46. 12 U.S.C. § 221a(b)(2) (1982). Section 20 of the Glass-Steagall Act would also prohibit the relationship between the bank and the mutual funds if it were an "affilia[tion]" within the meaning of the other subsections of Glass-Steagall Act § 2(b). However, in the bank-mutual fund structure, the bank does not own or control a majority of the voting shares of any of the mutual funds, *see* Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,613 (Feb. 4, 1983); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,602-03 (Feb. 1, 1983), as required by § 2(b)(1), 12 U.S.C. § 221a(b)(1) (1982). No majority of directors of any mutual fund is on the bank's board of directors, *see Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,613; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,603, pursuant to § 2(b)(3), 12 U.S.C. § 221a(b)(3) (1982). No mutual fund owns or controls a majority of the bank's shares, or controls in any manner the election of a majority of the bank's directors, *see Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,613; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,603, under § 2(b)(4), 12 U.S.C. § 221a(b)(4) (1982). Only under § 2(b)(2) are the bank and mutual funds arguably "affiliate[d]," a necessary precondition to a § 20 prohibition.

Another precondition to a § 20 prohibition is that the bank be a member bank. This is of course the case in the relationship between the member bank and the mutual fund. Section 20 does not cover a mutual fund adviser-sponsor that owns a state non-member bank. Nevertheless, mutual fund adviser-sponsors are eager to acquire national member banks. See *supra* note 27. National banks may be attractive because of their ability under 12 U.S.C. § 85 (1982) to charge out-of-state borrowers

interest rates which are higher than those permitted by the borrowers' home state. *See* Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 302 (1978). National banks may also be attractive to mutual fund sponsors simply because their competitors have sought national banks and because national banks can be operated nationwide with relative ease. *See* Wall St. J., Nov. 28, 1983, at 10, col. 2. The Board has proposed legislation, introduced as S. 1532, 98th Cong., 1st Sess. (1983) and H.R. 3413, 98th Cong., 1st Sess. (1983), that would make § 20 of the Act applicable not only to national and state member banks but to all banks insured by either a state agency or the FDIC. *1983 Hearings*, *supra* note 23, pt. II, at 396 (SEC Memorandum from Office of the General Counsel to John Shad, Chairman of the SEC).

The final precondition to a § 20 violation is that the member bank's affiliation be with entities "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities. 12 U.S.C. § 377 (1982). Mutual funds, according to the Board, are "engaged principally" entities, Board Letter, *supra* note 20, at 2, because they constantly issue new securities to replace those that they are legally obligated to redeem. See *supra* note 21. Because all other preconditions to a § 20 violation are satisfied, the pivotal question in evaluating the relationship between the bank and the funds is whether they are affiliated under § 2(b)(2).

In contrast, the bank's parent is clearly affiliated with its bank subsidiary within the meaning of § 2(b)(4) of the Act, 12 U.S.C. § 221a(b)(4), because it owns the bank. See *supra* note 27 and accompanying text. Whether the bank's relationship with its parent is impermissible under § 20 depends primarily on whether the parent is "engaged principally" in the underwriting of its mutual funds' securities. 12 U.S.C. § 377 (1982). The OCC determines whether the parent is "engaged principally" in underwriting by comparing the parent's gross revenues from underwriting with its total gross revenues. *See* Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,611-12 (Feb. 4, 1983); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,599-601 (Feb. 1, 1983). Because gross revenues from investment advising are notoriously high, *see Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,611-12; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,599, 86,601, it is likely that the adviser-sponsor will not be deemed to be "engaged principally" in securities underwriting under the percentage of gross revenue test. *See Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,612; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,601. Thus, the affiliation between the bank and its parent is permissible under § 20. The Board tacitly accepts the gross revenue test, concentrating all of its opposition to the bank-mutual fund structure on the relationship between the bank and the mutual funds rather than on that between the bank and its parent. *See* Board Letter, *supra* note 20, at 3.

The bank's relationship with other subsidiaries of its parent is also problematic. Often the only business which the parent adviser-sponsor engages in is investment advising. *See, e.g.*, *Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,607, 86,611, 86,613; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,598-99. All mutual fund underwriting is done by a separately incorporated subsidiary, the sole business of which is underwriting the mutual funds. *See, e.g.*, *Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,607; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,599. Thus the underwriting subsidiary's gross revenues from underwriting are a very high percentage of its total gross revenues and the subsidiary is therefore "engaged principally" in underwriting under § 20 of the Act. It is also affiliated with the bank within the meaning of § 2(b)(2) of the Act because it is wholly-owned and controlled by its

tion 2(b)(2), the bank and funds are affiliated if the bank's parent controls the funds "through stock ownership or in any other manner."[47] An investment adviser-sponsor typically dictates its funds' in-

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parent which also wholly owns the bank. The affiliation between the bank and the underwriting subsidiaries, however, is permissible under § 20 because the OCC treats the parent and all its non-bank subsidiaries as a single entity. *See, e.g., Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) at 86,612; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) at 86,601. Thus, the tainted underwriting revenues of the underwriting subsidiary are in a sense diluted in the enormous revenues from investment advising, and the single consolidated entity is not "engaged principally" in securities activites. *See Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,612; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. at 86,601. The consolidated entity, which includes the non-bank subsidiaries, is therefore permissibly affiliated with its bank subsidiary. The Board impliedly assents to use of the single entity theory to permit the relationship between the bank and the non-bank subsidiaries. *See* Board Letter, *supra* note 20, at 3. Thus, the Board again concentrates all its opposition to the bank-mutual fund structure on the relationship between the bank and the mutual funds.

The Board, in fact, uses the OCC's single entity theory to attack the relationship between the bank and the mutual funds. The Board's argument for prohibition of this relationship can be characterized in either of two ways. In the characterization of the Board's argument apparently adopted by the OCC, *see Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) at 86,615; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) at 86,603, the Board first attempts to establish that the mutual funds can be considered to be part of the single consolidated entity along with all the non-bank subsidiaries of the parent. If the OCC's characterization of the Board's argument for prohibition is correct, the argument's support is that the parent company and its non-bank subsidiaries, particularly its underwriting subsidiary, provide all the business services that the mutual funds require for their operation. Board Letter, *supra* note 20, at 3. After establishing that the mutual funds are part of the single consolidated entity, the Board attributes the mutual funds' principal engagement in the distribution of securities to the consolidated entity. *Dreyfus*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH), at 86,615; *Seligman*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH), at 86,603. In this characterization of the Board's argument, the Board uses the single entity theory without deeming the revenues of the mutual funds to be diluted in the revenues of the consolidated entity. Thus § 20 would prohibit the consolidated enterprise's affiliation with its bank subsidiary. In contrast, when the OCC views the underwriting subsidiary as part of a single entity with the parent, the OCC treats the revenues from the subsidiary's business as being diluted in the revenues of the larger entity.

Another and possibly better characterization of the Board's attack on the bank-mutual fund relationship derives from the use of the single entity and revenue dilution theories to permit the bank-underwriting subsidiary relationship. If the subsidiary that provides the mutual funds with their necessary services is deemed to be one with its parent, then its parent should be deemed to control the mutual funds. Thus the mutual funds, which are "engaged principally" in issuing securities, *see supra*, are controlled by the bank's parent and affiliated with the bank within the meaning of § 2(b)(2) of the Glass-Steagall Act. This characterization of the Board's argument concludes that the mutual funds are controlled by their adviser-sponsor, but for different reasons than the argument advanced in this Note. See *infra* notes 62-64 and accompanying text.

47. 12 U.S.C. § 221a(b)(2) (1982).

vestment decisions[48] and has substantial or dominating influence over their day-to-day operations.[49] Consequently, even an investment adviser-sponsor owning no stock issued by its mutual funds appears to control them[50] within the broad definition contained in section 2(b)(2). Despite this plain-language conclusion that the hazardous relationship between the bank and mutual funds is an affiliation, the OCC has repeatedly permitted the bank-mutual fund structure[51] by narrowly construing the language of section 2(b)(2).[52] Scrutiny of the OCC analysis is warranted because this semantic result is at variance with the plain meaning and purposes of the Act.[53]

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48. *See* 2 T. Frankel, *supra* note 27, ch. VIII, § 19; *id.* ch. XI, §15, at 259; R. Jennings & H. Marsh, *supra* note 15, at 1398; Rosenblat & Lybecker, *supra* note 21, at 593; Note, *The Inapplicability of the Demand Requirement of Rule 23.1 to Mutual Fund Shareholder Suits Under Section 36(b)*, 51 Fordham L. Rev. 1403, 1409-10 & nn.37-41 (1983) [hereinafter cited as *Shareholder Suits*].

49. *See* Rosenfeld v. Black, 445 F.2d 1337, 1344 (2d Cir. 1971), *cert. dismissed*, 409 U.S. 802 (1972); 1933 Senate Report, *supra* note 2, at 10; 2 T. Frankel, *supra* note 27, ch. VIII, § 19; *id.* ch. XI, § 15, at 259; R. Jennings & H. Marsh, *supra* note 15, at 1399, 1401, 1402, 1412; Rosenblat & Lybecker, *supra* note 21, at 593; *Shareholder Suits*, *supra* note 48, at 1409.

50. *See* Burks v. Lasker, 441 U.S. 471, 481 (1979) (quoting S. Rep. No. 184, 91st Cong., 1st Sess. 5 (1969), *reprinted in* 1970 U.S. Code Cong. & Ad. News 4897, 4901); Zell v. Intercapital Income Sec., Inc., 675 F.2d 1041, 1043, 1046 (9th Cir. 1982); Tannenbaum v. Zeller, 552 F.2d 402, 405 (2d Cir.), *cert. denied*, 434 U.S. 934 (1977); Grossman v. Johnson, 89 F.R.D. 656, 663 (D. Mass. 1981), *aff'd*, 674 F.2d 115 (1st Cir.), *cert. denied*, 103 S. Ct. 85 (1982); *Mutual Fund Amendments: Hearings on H.R. 11995, S. 2224, H.R. 13754, and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 768 (1969) (statement of Abraham L. Pomerantz); *Mutual Fund Legislation of 1967: Hearings on S. 1659 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 10 (1967) (statement of Manuel F. Cohen, Chairman, SEC); H.R. Rep. No. 1382, 91st Cong., 2d Sess. 7 (1970); H.R. Rep. No. 2274, 87th Cong., 2d Sess. 66-68, 70 (1962); 2 T. Frankel, *supra* note 27, ch. XI, § 9.1, at 212-13; R. Jennings & H. Marsh, *supra* note 15, at 1399, 1402; Note, *Mutual Fund Independent Directors: Putting a Leash on the Watchdogs*, 47 Fordham L. Rev. 568, 568 (1979).

51. See *supra* note 22 and accompanying text. Despite the Board's opposition, see *supra* note 20 and accompanying text, at least two of the member bank subsidiaries chartered by a mutual fund adviser-sponsor with the permission of the OCC are now doing business. *See* Pitt & Williams, *The Glass-Steagall Act: Key Issues for the Financial Services Industry*, 11 Sec. Reg. L.J. 234, 253 (1983); Bennett, *supra* note 13, at 12; N.Y. Times, Dec. 15, 1983, at D22, col. 6. *But cf.* Wall St. J., Nov. 23, 1983, at 4, col. 2 (J. & W. Seligman Co. acceded to Board pressure and now operates its bank as a state non-member bank); Conte, *supra* note 20, at 7, col. 1 (same).

52. 12 U.S.C. § 221a(b)(2) (1982). See *infra* notes 54-61 and accompanying text.

53. Semantic care is even more critical if, as has recently been suggested, the current Supreme Court is prone to emphasize statutory language over statutory purpose. Note, *Intent, Clear Statements, and the Common Law: Statutory Interpretation in the Supreme Court*, 95 Harv. L. Rev. 892, 894-95 (1982).

II. Evaluation of the Bank-Mutual Fund Structure Under the Language of the Act

A. *The OCC's Semantic Analysis*

The OCC's approach to interpreting bank parent "control [of its mutual funds] . . . through stock ownership or in any other manner"[54] focuses on the language of the Act and not on its purposes.[55] The OCC narrowly construes the phrase "control . . . in any other manner" to exclude the substantial or dominating influence that an investment adviser normally has over its mutual funds[56] and to encompass only those types of control similar to the specific example of control—"control . . . through stock ownership."

Applying the ejusdem generis doctrine of statutory construction to the phrase "control . . . through stock ownership or in any other manner," the OCC holds that the phrase's one specific example of control defines a narrow class of control that enables the holder of control to select directors and dictate their decisions.[57] Thus, the OCC concludes that the phrase "control . . . in any other manner" must also be limited to control in that class.[58] In the OCC's view, however, an adviser-sponsor without stock holdings does not have director-selection power because the Investment Company Act of 1940 (ICA)[59] requires that at least forty percent of a mutual fund's directors be independent of the adviser.[60] Consequently, by narrowly construing

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54. 12 U.S.C. § 221(a)(b)(2) (1982).

55. *See, e.g.*, Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,613-15 (Feb. 4, 1983); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,602-06 (Feb. 1, 1983).

Although the Board vehemently disagrees with these OCC decisions, the Board itself has also focused on semantic considerations at times. *See* Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 Yale L.J. 102, 111 (1981). For example, the Board determines whether a bank allegedly underwriting securities is violating § 16 by first questioning whether the article which the bank is buying and selling qualifies as a "security" within the meaning of the Act. If the Board finds that a Glass-Steagall Act security is not involved, then it approves the activity without questioning whether it creates the sorts of hazards which the Act was intended to prevent. *Id.* at 110-11.

56. See *supra* notes 48-50 and accompanying text.

57. *See* Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,613 (Feb. 4, 1983).

58. *Id.* In Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co. [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463 (Feb. 1, 1983), the OCC also narrowly construed the phrase "control . . . in any other manner" to mean only control in the class of control that enables the holder to select directors. *Id.* at 86,605. However, the OCC did not specifically refer to ejusdem generis.

59. 15 U.S.C. § 80a-1 to -52 (1982).

60. *Id.* § 80a-10(a).

"control . . . in any other manner" to mean only director-selection control, and by referring to the ICA as a barrier to director-selection control, the OCC holds that the adviser-sponsor does not have Glass-Steagall Act "control" over its funds.[61]

B. *A Contrary Semantic Analysis*

The OCC's reliance upon the ejusdem generis doctrine is inappropriate because the doctrine should not be applied to the phrase "control . . . through stock ownership or in any other manner." Ejusdem generis is apposite only if a statute enumerates various specific examples and then supplements the enumeration with a catchall phrase in the nature of "and so forth."[62] "[C]ontrol . . . through stock ownership or in any other manner" satisfies neither of these requirements.

The phrase does not enumerate a number of specific examples constituting a class. Rather, the phrase contains only a single specific example of control—"control . . . through stock ownership." Moreover, the phrase "control . . . in any other manner" is not similar to "and so forth." "And so forth" refers only to the specific examples preceding it. The catchall "control . . . in any other manner" expressly alludes to all types of control, even those of a kind quite different from the single specific example of control preceding the catchall. Because the catchall is so broadly phrased and ejusdem generis cannot properly be applied,[63] the catchall should be construed to include the substantial or dominating influence that an investment adviser normally has over its mutual funds.[64] Consequently, even a mutual fund adviser-sponsor that avoids stock ownership in its mutual

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61. Decision of the Comptroller of the Currency to Charter Dreyfus Nat'l Bank & Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,464, at 86,615 (Feb. 4, 1983); Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co., [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,463, at 86,606 (Feb. 1, 1983).

62. 2A C. Sands, Sutherland Statutory Construction § 47.18, at 110 (4th ed. 1973). There are additional preconditions to application of ejusdem generis. The class constituted by the members of the enumeration must not be exhausted by the enumeration. *Id.* at 109. There must not be an intent that the catchall phrase supplementing the enumeration be given a meaning broader than that suggested by the ejusdem generis doctrine. *Id.*

63. *Cf.* Harrison v. PPG Indus., Inc., 446 U.S. 578, 588-89 (1980) (ejusdem generis not applicable to the phrase "any other final action" because no uncertainty found in the phrase's broad literal connotation); Hawaiian Elec. Co. v. United States Environmental Protection Agency, No. 83-7259, slip. op. at 284 (9th Cir. Jan. 20, 1984) (phrase "any other final action" to be interpreted broadly); Sierra Club v. Watt, 566 F. Supp. 380, 383 (D. Utah 1983) (ejusdem generis not applicable to the phrase "sand, gravel, and other minerals and building materials"); Lifschitz v. American Express Co., 560 F. Supp. 458, 463 (E.D. Pa. 1983) (ejusdem generis inapplicable to the phrase "any other charges").

64. See *supra* notes 48-50 and accompanying text.

funds controls them within the meaning of section 2(b)(2). Thus, any member bank subsidiary of the mutual fund adviser-sponsor is impermissibly affiliated with the mutual funds. This conclusion is supported by the Glass-Steagall Act's purposes because the relationship between the bank and the mutual funds gives rise to Glass-Steagall Act hazards. Reliance on the purposes of the Act is consistent with the Supreme Court's approach to interpreting the Act's language.

C. *The Supreme Court Approach to Interpreting the Glass-Steagall Act*

In its Glass-Steagall Act decisions, the Supreme Court has consistently emphasized the Act's purposes[65] as well as its language.[66] Whether semantic analysis prohibits or permits a corporate structure or is inconclusive, the Court looks to the purposes of the Act for support or clarification.[67] Thus, the hazardous nature of the bank-mutual fund structure reinforces the conclusion that the structure is impermissible.

Under the Supreme Court approach, however, the hazardous nature of the bank-mutual fund structure may not necessarily support its prohibition if law other than the Act safeguards against the hazards. In *Board of Governors of Federal Reserve System v. Investment Company Institute*,[68] the Court considered hypothetically whether a bank acting as investment adviser to a closed-end investment company would be engaging in securities underwriting in violation of section 16 of the Act.[69] The Court noted various Glass-Steagall Act hazards including the possibility that the bank would be tempted to extend credit to or promote the investment company or give the names of its depositors to the investment company.[70] The Court then stated in dictum that the hazards would be safeguarded against by certain Board rulings that the Court assumed would apply to the hypothetical situation.[71] The rulings, for example, would permit the bank to act as

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65. *See, e.g.*, Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 66-67 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 629-34 (1971); Board of Governors of the Fed. Reserve Sys. v. Agnew, 329 U.S. 441, 447 (1947); *see also* Pitt & Williams, *supra* note 51, at 260-63 (analysis of appellate court cases and federal bank agency determinations that emphasize substance over language in interpreting the Glass-Steagall Act).

66. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 62 (1981); Investment Co. Inst. v. Camp, 401 U.S. 617, 625 (1971); Board of Governors of the Fed. Reserve Sys. v. Agnew, 329 U.S. 441, 446 (1947).

67. See *supra* note 65.

68. 450 U.S. 46 (1981).

69. *Id.* at 52, 58-60.

70. *See id.* at 67 & n.39.

71. *Id.*

investment adviser only if it did not extend credit or give the names of its depositors to the investment company.[72] Consequently, the Court intimated that it might ignore clear Glass-Steagall Act hazards in interpreting the Act, if they are safeguarded against by other law.[73] Even if the *Board of Governors* dictum accurately represents the Supreme Court approach, the relationship between the bank and

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72. *Id.*

73. This possibility is inconsistent with the legislative history of the Act. Congress barred banks from engaging in securities activities because bank securities activities presented so many subtle hazards that regulation could not be entirely effective. See *supra* notes 24-26 and accompanying text. Thus, it would be contrary to the legislative intent to permit a corporate relationship that arguably violates the Act's language and clearly presents Glass-Steagall Act hazards on the ground that the hazards are safeguarded against by other law. *See 1983 Hearings*, *supra* note 23, pt. II, at 756 (testimony of David Silver, President of the Investment Company Institute) (Sen. Glass and Rep. Steagall intended prohibition and therefore safeguards cannot constitutionally substitute for prohibition.).

Assuming, however, that effective regulation can be a substitute for a Glass-Steagall Act prohibition, the OCC may regard the ICA's system of mutual fund director independence as a comprehensive safeguard against Glass-Steagall Act hazards. In its semantic analysis, see *supra* notes 54-61 and accompanying text, the OCC reasons that § 2(b)(2) mutual fund control is precluded by the mutual fund director independence mandated by the ICA. See *supra* notes 59-60 and accompanying text. Reliance on mutual fund director independence as an effective safeguard, however, would be misplaced. Mutual fund director independence fails to protect against even direct business transactions between the bank and the mutual funds, let alone against the indirect ways in which the banks can benefit the funds and the danger that the bank and funds would be associated in the public mind. See *supra* notes 28-43 and accompanying text.

The purpose of the ICA is to protect investors in the mutual fund. *See* 15 U.S.C. § 80a-1 (1982); Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 789. Independent mutual fund directors are intended to accomplish this by, for example, preventing the investment adviser from manipulating the mutual fund for the benefit of a bank owned by the investment adviser. *See* 15 U.S.C. §§ 80a-1(b)(2), -17(a) (1982). Although the drafters of the Glass-Steagall Act may have intended to protect mutual fund investors as well, the drafters certainly intended to protect the banking system and bank depositors. See *supra* notes 1-5 and accompanying text. These other intended beneficiaries of the Glass-Steagall Act are not part of the constituency of mutual fund directors, whether independent or not; the interests of the mutual fund shareholders are actually furthered if the mutual fund's investment adviser manipulates a bank it owns so as to aid the mutal fund. Thus, it would be incorrect to characterize mutual fund director independence as a Glass-Steagall Act safeguard against Glass-Steagall Act hazards. *Cf.* A.G. Becker, Inc. v. Board of Governors of the Fed. Reserve Sys., 693 F.2d 136, 146 (D.C. Cir. 1982) ("Congress enacted the Glass-Steagall Act primarily to protect *bank depositors*. By contrast, '[t]he primary purpose of the [Securities] Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securites market. . . . *and to protect the interest of investors*.' ") (footnote omitted) (emphasis in original) (quoting United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975)), *cert. granted sub nom.* Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 104 S. Ct. 65 (1983).

mutual funds should be prohibited because not all its inherent hazards are or could be safeguarded against by other law.[74]

Law other than the Glass-Steagall Act does guard against obvious conflicts of interest in which the bank purchases securities from[75] or makes loans to the mutual funds on terms that are unduly favorable to the funds.[76] Section 17(b)[77] of the ICA requires that transactions between the mutual funds and subsidiaries of the mutual funds' adviser be fair to all parties involved.[78] Thus, the section protects the bank from hazardous transactions with its affiliates. Similarly, section 23A of the Federal Reserve Act[79] requires that transactions between the bank and mutual funds sponsored by the bank's parent be consistent with sound banking practice[80] and limited in the aggregate to twenty percent of the bank's capital stock and surplus.[81] Moreover,

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74. *See 1983 Hearings, supra* note 23, pt. II, at 771 (statement of Investment Company Institute). *See generally id.* at 384-92 (SEC letter from Office of the General Counsel to John Shad, Chairman of the SEC) (failure of non-Glass-Steagall safeguards to protect all interests of public policy); *October 1981 Hearings, supra* note 3, at 635 (testimony of David Silver, President of the Investment Company Institute) (discussing applicability or inapplicability to banks of non-Glass-Steagall regulatory laws). *But see 1983 Hearings, supra* note 23, pt. II, at 771 (statement of the Investment Company Institute) (a bank's indirect relationship to mutual funds sponsored and advised by the bank's parent is a safeguard) (quoting Donald Regan, Secretary of the Treasury); *1982 Hearings, supra* note 12, at 17 (testimony of Donald Regan, Secretary of the Treasury) (same).

75. See *supra* notes 35-36 and accompanying text.

76. See *supra* note 37 and accompanying text.

77. 15 U.S.C. § 80a-17(b) (1982).

78. *Id.*; *see* Rosenblat & Lybecker, *supra* note 21, at 598-99. For example, in *In re* Bowser, Inc., 43 S.E.C. 277 (1967), the Equity Corporation, a closed-end investment company, owned about 12% of the voting securities of another corporation which, in turn, owned about 20% of Bowser, Inc.'s voting securities. *Id.* at 279 n.3. Thus, Bowser was an affiliate of Equity under the ICA, and SEC approval had to be obtained for Equity to sell shares of its own issue to Bowser. *Id.* at 279. The Commission refused to approve the transaction, not on the basis that there would be any harm to the shareholders of Equity Corporation, but on the basis that the transaction was not fair to the shareholders of Bowser. *Id.* at 282; *accord* Harriman v. E.I. DuPont de Nemours & Co., 411 F. Supp. 133, 159 (D. Del. 1975); *In re* Talley Indus., Inc., 44 S.E.C. 165, 181 (1970); *cf. October 1981 Hearings, supra* note 3, at 635 (testimony of David Silver, President of the Investment Company Institute) (Conflicts of interest in bank-real estate investment trust relationships can be safeguarded against by legislative analogs of the federal securities laws, especially the ICA.).

79. 12 U.S.C. § 371c (1982).

80. *Id.* § 371c(a)(4).

81. *Id.* § 371c(a)(1)(B); *see 1983 Hearings, supra* note 23, pt. I, at 66-67 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System). Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c (1982), also limits transactions with any one of the mutual funds to 10% of the bank's capital stock and surplus. *Id.* § 371c(a)(1)(A).

the Board may prevent hazardous transactions between the bank and the mutual funds advised by the bank's parent by forbidding the bank to extend credit to the mutual funds[82] or to purchase their securities.[83]

Regulation is also feasible when the bank seeks to aid the mutual funds indirectly by attempting to enhance purchases of the mutual funds' securities by third parties.[84] The Board may prohibit the bank from divulging the names of its depositors to the mutual funds,[85] from distributing the mutual funds' sales literature,[86] and from advising or causing its clients to purchase the securities.[87]

Regulation would not be effective, however, against the subtle conflicts of interest in which management attention and diligence shift from the bank to the mutual funds.[88] Similarly, the hazards of bank instability and investor deception would survive regulatory attack.[89] These hazards arise from investor knowledge of the relationship between the bank and the mutual funds,[90] and regulation cannot preclude knowledge of such a relationship.[91] These unavoidable problems are typical of the subtle but serious hazards that led the Act's drafters to forego what they perceived as vain attempts to regulate in favor of outright prohibition.[92] The bank-mutual fund structure,

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82. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 67 & n.39 (1981); 12 U.S.C. §§ 301, 338 (1982); *March 1932 Hearings*, *supra* note 2, at 55 (remarks of Sen. Glass); 12 C.F.R. § 221 (1983).

83. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 67 & n.39 (1981); 12 U.S.C. § 338 (1982); *March 1932 Hearings*, *supra* note 2, at 55-56 (remarks of Sen. Glass). Direct transactions between the bank and mutual funds are also regulated to some extent by the federal securities laws, the anti-fraud provisions of which cover all purchases and sales of securities. *See May 1981 Hearings*, *supra* note 12, at 1186 (statement of the Investment Company Institute). For proposed legislative safeguards, see *1983 Hearings*, *supra* note 23, pt. II, at 697 (paper submitted by North American Securities Administrators Association).

84. See *supra* note 39 and accompanying text.

85. *See* Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 67 n.39 (1981).

86. *See id.*

87. *See id.*

88. *See 1983 Hearings*, *supra* note 23, pt. I, at 66-67 (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System).

89. *Id.*; *see* Noble, *Examining the Bank Examiners*, N.Y. Times, Nov. 25, 1983, at D1, col. 3; *id.* Nov. 17, 1983, at D1, col. 1; *id.* Nov. 1, 1983, at D6, col. 1; Conte, *Regulators Say Banking Safeguards are Faulty and Need an Overhaul*, Wall St. J., Mar. 21, 1983, at 23, col. 4.

90. See *supra* notes 41-43 and accompanying text.

91. *See 1982 Hearings*, *supra* note 12, at 54-55 (statement of J. Charles Partee, Member, Board of Governors of the Federal Reserve System); *id.* at 60 (statement of J. Charles Partee in response to the written questions of Sen. D'Amato); *id.* at 68 (statement of J. Charles Partee in response to the written questions of Sen. Riegle). The Supreme Court has recognized that the degree of association can be lessened but "cannot be completely obliterated." Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 67 n.39 (1981).

92. See *supra* notes 24-26 and accompanying text.

therefore, cannot be effectively safeguarded against and is unavoidably hazardous. Thus, the intimation of *Board of Governors* that clear Glass-Steagall Act hazards may not necessarily support a Glass-Steagall Act prohibition is rendered academic. The structure's unavoidably hazardous nature supports the conclusion that the bank and funds are impermissibly affiliated.

Conclusion

The bank-mutual fund structure is illegal under the Glass-Steagall Act. The structure's mutual funds are "controlled" within the meaning of section 2(b)(2) by their adviser-sponsor and therefore affiliated with their adviser's member bank subsidiary in violation of section 20. The unavoidably hazardous nature of the relationship between the bank and mutual funds supports this conclusion. A company which advises and sponsors mutual funds, therefore, should not be permitted to own a member bank under the Act.

D.A. Howard