BANKS AND THE SEC: A REGULATORY MISMATCH?

EUGENE F. MALONEY*

I. Background 444
II. A Regulatory Quagmire 449
  A. Statutory Uncertainty 449
    1. The "Chiefly Compensated" Test....................449
    2. The Custody Exemption 452
    3. Networking Exemption 453
  B. Interagency Philosophical Differences 454
  C. Congressional Misguidance 458
III. The SEC's Role as Functional Regulator..............................461
IV. Personal Experience with the SEC.......................................465
V. Conclusion 468

The regulation of bank securities activities historically has been one of the most quirky and unsettled areas of the law. As of this writing, it remains so.

For decades, the Securities and Exchange Commission ("SEC" or "the Agency") has been unsuccessful in its efforts to regulate banks engaged in the securities business even after the historic enactment of the "functional regulation" provisions in the Gramm-Leach-Bliley Act ("GLBA"), which granted it express authority for this purpose by repealing the blanket bank exemption from broker registration.[1] The SEC's most recent attempt to regulate

* Eugene F. Maloney is Corporate Counsel and Executive Vice President of Federated Investors, Inc., the sponsor and distributor of the Federated Family of Mutual Funds which are available through over 1,000 bank trust departments and other financial intermediaries. Mr. Maloney, who also teaches a course on the regulation of bank securities activities at the Morin Center for Banking and Financial Law at Boston University's School of Law, actively participated in the Congressional proceedings on Title II of the GLBA and has worked with the SEC's staff in its implementation of the law on behalf of Federated's banking clients.

[1] *See* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338, 1385-1407 (1999).

banks in proposed Regulation B[2] encountered fierce opposition from the banking industry as well as from federal banking regulators and members of Congress,[3] virtually stopping the SEC in its tracks.

The SEC's seeming inability to implement the law as it applies to banks raises fundamental questions as to whether the SEC has a legitimate role to play in the regulation of bank securities activities or whether Congress has created a regulatory mismatch between banks and the SEC so unworkable that the law can never be effectively implemented.

This article argues that the SEC does have a legitimate and important role to play and that any regulatory mismatch is a logical outcome of the GLBA that can be managed to ultimately benefit banks and their customers while furthering the investor protection purposes of the securities laws. Rather than continuing to resist the SEC as the functional regulator of bank securities activities, banks and their regulators should work with the SEC toward a reasonable framework that harmonizes the purposes of both the banking and securities laws.

I. Background

For many years following the enactment of the Glass-Steagall Act in 1933 ("the Act"), the conventional wisdom was that the Act prohibited banks and their affiliates from engaging in the sale of securities to their customers.[4] Notwithstanding language in the Act prohibiting a bank from affiliating with any company engaged in the "public sale" of securities, banks persuaded the federal banking

---

[2] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. pts. 240 and 242).

[3] Letter from Alan Greenspan, Chairman, Fed. Reserve Sys., John D. Hawke, Jr., Comptroller of the Currency & Donald E. Powell, Chairman, Fed. Deposit Ins. Corp., to the Sec. & Exch. Comm'n (Oct. 8, 2004). The banking regulators complained that Regulation B reflected a "profound" misinterpretation of the GLBA. *Id*. at 2; *see also* Letter from Michael G. Oxley, Chairman, House Comm. on Fin. Servs. et al., to the Sec. & Exch. Comm'n (Oct. 14, 2004); Letter from U.S. Senator Jim Bunning et al., to the Sec. & Exch. Comm'n (Mar. 4, 2005), *available at* http://www.sec.gov/rules/proposed/s72604.shtml.

[4] *See* MELANIE L. FEIN, SECURITIES ACTIVITIES OF BANKS (Aspen Law & Business, 3d ed. Supp. 2002).

agencies and the courts that this language meant something else.[5] By the mid-1980's, banks and their affiliates were full competitors in the retail securities brokerage business.[6]

Prompted by concerns that investors might be harmed if banks were not properly regulated, the SEC adopted a rule in 1985 requiring banks engaged in the sale of securities to register as broker-dealers under the Securities Exchange Act of 1934 ("Exchange Act").[7] Banks challenged the SEC's authority to adopt the rule and won. In *American Bankers Ass'n v. SEC*,[8] the D.C. Circuit Court of Appeals decided that, because of an express exemption for banks in the Exchange Act, Congress did not intend the SEC to regulate banks. Not to be undone, the SEC asked Congress to remove the bank exemption. After years of lobbying, the SEC finally prevailed with the ratification of the GLBA in 1999.[9]

Title II of GLBA ("Title II") repealed the broad exemption for banks from the definition of "broker" in the Exchange Act.[10] In its place, Congress enacted eleven specific exemptions, which banks maintained were necessary for them to continue their traditional securities activities without disruption.[11]

In order to clarify the scope of the so-called "push-out" exemptions,[12] the banking industry insisted that the SEC adopt regulations interpreting Title II rather than issue no-action letters responding to individual bank requests. Accordingly, the SEC issued

---

[5] In Securities Industry Ass'n v. Board of Governors, 468 U.S. 207, 218 (1984), the U.S. Supreme Court ruled that the "public sale" of securities in Section 20 refers to the underwriting of securities rather than brokerage.
[6] *Id*.
[7] 17 C.F.R. § 240.3b-9 (1985); 50 Fed. Reg. 28,394 (July 12, 1985) (adopting release).
[8] Am. Bankers Ass'n v. SEC, No. 85-2482, 1985 U.S. Dist. LEXIS 14330, *rev'd*, 804 F.2d 739 (D.C. Cir. 1986).
[9] Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999).
[10] *Id.* § 201 (codified at 15 U.S.C. § 78c(a)(4) (2000)).
[11] 12 U.S.C. § 78c(a)(4)(B)(i)-(xi) (2000). The exemptions pertain to transactions in securities involving the following: third party brokerage arrangements, trust and fiduciary activities, exempt securities, certain employee stock purchase plans, sweep accounts, affiliate transactions, private securities offerings, safekeeping and custody activities, identified banking products, municipal securities, and de minimis transactions.
[12] The Title II provisions are called the "push-out" provisions because, unless an exemption applies, the law requires banks to transfer or "push out" their securities brokerage activities to a registered broker-dealer.

"final" interim regulations on May 11, 2001.[13] The banking industry complained to Congress that the regulations included complex provisions that would force banks to terminate their traditional activities contrary to Congressional intent. The House Banking Committee immediately scheduled a hearing, at which not only the banking industry but also federal banking regulators and members of Congress castigated the SEC and threatened to rewrite the regulations themselves if the SEC did not.[14]

In response, the SEC suspended the effective date of the regulations to reconsider the regulations along with the concerns raised.[15] After additional postponements,[16] the SEC published a new proposed Regulation B on June 30, 2004 to implement the GLBA

---

[13] Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; Interim Final Rule, Exchange Act Release No. 44,291, 66 Fed. Reg. 27,760 (May 18, 2001).

[14] Pushing Back The Push-Outs: The SEC's Broker-Dealer Rules: J. Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises and the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Servs., 107th Cong. (2001). The author testified at the hearings.

[15] Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definitions of "Broker" and "Dealer" Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; Notice of Intent to Amend Rules, Exchange Act Release No. 44,570, 2001 SEC LEXIS 1407 (July 18, 2001).

[16] *See* Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definitions of "Broker" and "Dealer" Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; Notice of Intent to Amend Rules, Exchange Act Release No. 45,897, 2002 SEC LEXIS 1234 (May 8, 2002); Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definition of "Dealer" Under Section 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 46,751, 2002 SEC LEXIS 2771 (Oct. 30, 2002); Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definition of "Broker" Under Section 3(a)(4) of the Securities Exchange Act of 1934; Notice of Intent to Amend Rules, Exchange Act Release No. 47,649, 2003 SEC LEXIS 838 (April 8, 2003); Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definition of "Broker" Under Section 3(a)(4) of the Securities Exchange Act of 1934, Exchange Act Release No. 50,618, 2004 SEC LEXIS 2491 (Nov. 1, 2004).

push-out provisions.[17] Again, the banking industry,[18] federal banking regulators,[19] and members of Congress denounced the regulation.[20] This time the SEC postponed the effective date of the GLBA push-out provisions to September 30, 2005.[21] As that date approached with no clear course of action in sight, the SEC further

---

[17] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. pts. 240 and 242)..

[18] *See*, *e.g.*, Letter from the Comm. on Banking Law and the Comm. on Fed. Regulation of Secs. of the Section of Bus. Law of the American Bar Ass'n to the SEC (Sept. 23, 2004); Letter from Richard M. Whiting, Executive Director and Gen. Counsel, The Fin. Servs. Roundtable, to the SEC (Sept. 1, 2004), The SEC reported that it received over 120 comment letters on its proposal. *See* 70 Fed. Reg. 54,596 (2005). *See* comment letters posted on the SEC's web site at http://www.sec.gov/rules/proposed/s72604.shtml.

[19] *See* Letter from Alan Greenspan to the SEC, *supra* note 3 ("We believe that the Proposed Rules reflect a profound misinterpretation of the language and purposes of the 'broker' exceptions in the GLB Act. The Proposed Rules would require banks to make substantial changes in the way they conduct well established and already highly regulated lines of banking business and would impose a new, SEC-created regime of extraordinarily complex requirements and restrictions on longstanding banking functions and relationships – a regime that, in some areas, conflicts with the existing regulatory requirements already applicable to banks, such as the Department of Labor's rules under the Employee Retirement Income Security Act ('ERISA'). Far from implementing the 'exceptions' for banks adopted by Congress, the Proposed Rules would insert the Commission to an unprecedented and unforeseen degree in the management of banks' internal operations. The track record of how banks conduct the activities covered by the GLB Act's exceptions does not warrant this response, the language of the GLB Act does not require it and the legislative history of the GLB Act indicates that Congress did not want or intend it.").

[20] *See* Letter from Michael G. Oxley to the SEC, *supra* note 3 ("In seeking to establish a new regulatory scheme for traditional banking activities, the SEC has disregarded Congressional intent as reflected in the language of the statute, the Congressional Record and reaffirmed by this committee in comment letters, hearings, and numerous meetings with your staff over the last three years.").

[21] Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definition of "Broker" Under Section 3(a)(4) of the Securities Exchange Act of 1934, Exchange Act Release No. 51,328, 2005 SEC LEXIS 1157 (Mar. 8, 2005).

extended the effective date for one additional year until September 30, 2006.[22]

Thus, six years after Congress enacted the push-out provisions of the GLBA, the SEC has yet to fully implement the law.[23] The GLBA has cycled through four SEC chairmen, yet it remains uncertain as to when, if ever, Title II will become effective. While other significant matters have occupied the SEC's agenda,[24] the Agency's failure to exercise its long-sought jurisdiction over bank securities activities raises several important questions. Is the SEC incapable of doing the job? Are its hands tied in some way? Is the SEC being overly cautious and submissive to banking industry concerns at the expense of investors? Just what is going on?

The absence of any major investor complaints or problems with the conduct of bank brokerage activities suggests no urgent need for SEC action to implement the push-out provisions. In fact, few if any banks conduct a retail securities brokerage business. Large banks long ago transferred their brokerage activities to registered broker-dealer affiliates. Other banks entered into arrangements with registered broker-dealers that sell securities to bank customers in bank lobby space. SEC-regulated broker-dealers now conduct most, if not all, retail sales of securities to bank customers. The application of the securities laws to bank securities activities is largely a *fait*

---

[22] SEC Extends Time for Banks to Comply with Gramm-Leach-Bliley Act Broker Registration Requirements, SEC Release No. 2005-130, 70 Fed. Reg. 54,596 (Sept. 9, 2005) ("The Commission believes that extending the exemption from the definition of "broker" until September 30, 2006, will prevent banks and other financial institutions from unnecessarily incurring costs to comply with the statutory scheme based on the current Interim Rules and will give the Commission time to consider fully comments received on Regulation B and take any final action on the proposal as necessary, including consideration of any modification necessary to the proposed compliance date.").

[23] Final Rule: Definition of Terms in and Specific Exemptions for Banks, Savings Institutions, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 47,364, 17 C.F.R. pt. 240 (Mar. 26, 2003). The SEC did adopt regulatory provisions to implement the GLBA provisions requiring banks to register as "dealers" in securities, which proved to be less controversial.

[24] For example, the SEC has been preoccupied with such matters as the Enron and WorldCom debacles, Sarbanes-Oxley reforms, hedge funds, and mutual fund reforms, in addition to its normal agenda of supervisory and enforcement matters.

accompli, even without SEC action to implement Title II. Indeed, some might say it was a *fait accompli* even before the GLBA was enacted. Nevertheless, banks continue to effect securities transactions for fiduciary, custodial and other types of accounts.

II. A Regulatory Quagmire

The process of implementing Title II has become a regulatory quagmire for several reasons including the language of the statute, philosophical differences among the SEC and banking regulators and mixed messages from Congress.

A. Statutory Uncertainty

More precise statutory language might have effectively addressed and cured the impasse on Title II. Key provisions of Title II cry out for clarification, particularly the so-called "chiefly compensated" test in the exemption for bank fiduciary activities. The SEC's staff drafted and banking industry lobbyists agreed to this and other statutory language based on an unwritten "understanding" of its meaning. Predictably, the SEC's staff and the banking industry interpreted the language differently.[25]

1. The "Chiefly Compensated" Test

Title II amended the Exchange Act to exempt a bank from broker-dealer regulation when it effects transactions in a trustee or fiduciary capacity if, among other conditions, the bank:

> is chiefly compensated for such transactions, consistent with fiduciary principles and standards, on the basis of an administration or annual fee . . . , a percentage of assets under management, or a flat or capped per order processing fee equal to not more than the cost incurred by the bank in connection with

---

[25] Banking industry lobbyists ignored early warnings that the SEC staff had a different understanding of the statutory language. *See* Melanie L. Fein, *Comment: Is Reform Bill a Menace to Bank Retirement Plans?*, AM. BANKER, June 1, 1999, at 12; Sarah A. Miller, *Comment: Reform Won't Affect Pension Services*, AM. BANKER, June 18, 1999, at 9; Lee A Pickard, *Comment: House Version of Trust Bill Goes Too Far*, AM. BANKER, July 9, 1999, at 6.

> executing securities transactions for trustee and fiduciary customers, or any combination of such fees.[26]

The so-called "chiefly compensated" test has proven to be the most controversial provision in Title II and the most difficult to implement. Under Regulation B, a bank may meet the "chiefly compensated" test if the "relationship compensation" it receives from a given account exceeds the "sales compensation" it receives from the account.[27] "Relationship compensation" includes trustee fees and similar fees paid directly by a fiduciary account to a bank.[28] "Sales compensation" includes sales commissions and similar distribution fees received by a bank including 12b-1 fees paid by mutual funds.[29] The test generally applies on an account-by-account basis, although a bank may comply with the test on a line-of-business basis if the bank demonstrates that its ratio of sales compensation to relationship compensation in the preceding year was no greater than one to nine and meets certain other requirements.[30]

Banks protested that the SEC's test was overly complicated and would impose an undue compliance burden.[31] In his letter to the SEC, Richard M. Whiting, Executive Director and General Counsel for The Financial Services Roundtable ("the Roundtable"), stated:

---

[26] 15 U.S.C. § 78c(a)(4)(B)(ii) (2000).
[27] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. pts. 240 and 242).
[28] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. 242.724(h)).
[29] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. 242.724(i)).
[30] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. pts. 240 and.242). Among other things, a bank generally must maintain procedures reasonably designed to ensure that, before opening an account for which it will act in a trustee or fiduciary capacity, the bank reviews the account to ensure that the bank is likely to receive more relationship compensation than sales compensation with respect to that account.
[31] *See*, *e.g.*, Letter from the Committee on Banking Law and the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association to the SEC, *supra* note 18; Letter from Richard M. Whiting to the SEC, *supra* note 18.

> Requiring banks to provide specific data on "sales" and "relationship" compensation for accounts in trust departments would be burdensome. The Roundtable believes that excluding "unrelated compensation" from the "chiefly compensated" calculation is unreasonable. We believe that "sales compensation" should be measured against all revenues received by a bank in connection with its trust and fiduciary activities. We *recommend* that banks be allowed to measure "sales compensation" against total compensation. We urge the Commission to revise the Proposed Rules to provide banks with an alternative to the account-by-account method of compliance whereby the proportion of "sales compensation" for trust and fiduciary account may not exceed a certain percentage of the total compensation from trust and fiduciary activities. This would simplify banks' task of complying with the "chiefly compensated" test.[32]

Echoing these complaints, the federal banking agencies disputed the statutory basis for the SEC's test, stating that it countermanded the language and purposes of the GLBA and reflected a misunderstanding of the way that banks conduct their trust and fiduciary activities:

> The Proposed Rules . . . interpret the statute's "chiefly compensated" test in a manner that does not comport with the language and purposes of the statute or the existing trust and fiduciary activities of banks.
>
> . . . .
>
> The Commission's interpretation of the chiefly compensated test simply would not work for a wide variety of the trust and fiduciary accounts of banks, including essentially all of the corporate trust and employee benefit plan trust and fiduciary relationships of banks. Thus, the Commission's interpretation, if implemented, would force banks to either cease

[32] *See* Letter from Richard M. Whiting to the SEC, *supra* note 18 at 4-5.

> providing securities transaction services to many corporate and employee benefit plan customers or significantly restructure their trust and fiduciary operations in these areas. We do not believe that Congress established a "chiefly compensated" test that would not work for some of the most important trust and fiduciary business lines of banks.[33]

2. The Custody Exemption

Title II also amended the Exchange Act to exempt a bank from registration as a securities broker when, as part of customary banking activities, the bank "provides safekeeping or custody services with respect to securities . . . ."[34] Contrary to the banking industry's understanding, the SEC interpreted this language to exclude the taking of orders for securities transactions, a service customarily performed by banks for their custodial customers.[35]

Through Regulation B, the SEC provided a limited exemption for order-taking activities limited to qualified investors and grandfathered accounts, which banks and their regulators said was inadequate.[36] The banking regulators in particular challenged the SEC's interpretation as contrary to the GLBA and potentially disruptive and burdensome to banks:

> This interpretation is not consistent with the Act, its legislative history, or the purposes of the Custody and Safekeeping Exception. In addition, this interpretation is flatly at odds with the customary practices and customer relationships of banks and, if implemented,

---

[33] *See* Letter from Alan Greenspan to the SEC, *supra* note 3 at 3-4.

[34] 15 U.S.C. § 78c(a)(4)(B)(viii) (2000). The exemption, among other provisions, exempts a bank that "serves as a custodian or provider of other related administrative services to any individual retirement account, pension, retirement, profit sharing, bonus, thrift savings, incentive, or other similar benefit plan." 15 U.S.C. § 78c(a)(4)(B)(viii)(I)(ee).

[35] *See* Letter from Richard M. Whiting to the SEC, *supra* note 18 at 9; Letter from Alan Greenspan to the SEC, *supra* note 3, at 6. For example, banks often take orders for individual retirement accounts (IRAs), 401(k) and employee benefit plan accounts, and as an accommodation to other custodial customers.

[36] *See* Letter from Alan Greenspan, et al., to the SEC, *supra* note 3 at 6.

> would force banks and their customers to radically restructure their long-standing custodial relationships and force bank customers to incur additional and unnecessary burdens and expenses to effect occasional trades related to their custodial assets.[37]

3. Networking Exemption

Title II also amended the Exchange Act to exempt a bank from broker-dealer registration when it enters into a contractual agreement or so-called "networking arrangement" with a registered broker-dealer for the sale of securities to the bank's customers by the broker.[38] The bank must comply with certain restrictions on its activities.

Among other things, unlicensed bank employees may not receive incentive compensation for any brokerage transactions but may receive a referral fee of a fixed dollar amount not contingent on whether the referral results in a transaction.[39] In Regulation B, the SEC proposed to limit the referral fees to a payment having a value that does not exceed the greater of: (1) the employee's base hourly rate of pay, (2) twenty-five dollars, or (3) a dollar amount that does not exceed the whole dollar amount nearest to fifteen dollars in 1999 dollars indexed for inflation.[40]

The banking industry objected that Regulation B would effectively allow the SEC to scrutinize a bank's overall employee compensation and bonus programs.[41] The banking regulators criticized the regulation as arbitrary and excessive:

> The Proposed Rules would establish a new, highly complex, restrictive and inflexible definition of what constitutes a nominal cash referral fee rather than allowing examiners, as they do today, to review these fees in light of the geographic location of the bank involved and other relevant factors during the supervisory and examination process. We believe that

---

[37] *Id.*
[38] *See* 15 U.S.C. § 78c(a)(4)(B)(i) (2000).
[39] 15 U.S.C. § 78c(a)(4)(B)(i)(VI) (2000).
[40] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. 242.710(a)).
[41] Letter from Richard M. Whiting to the SEC, *supra* note 18, at 2.

> setting, by regulation, an inflexible and restrictive definition is ill-advised because what is "nominal" depends on the marketplace and the circumstances.[42]

B. Interagency Philosophical Differences

The disagreement between the SEC and federal banking agencies as to how Title II should be implemented reflects fundamental philosophical differences that historically have divided the agencies.

Banking regulation emphasizes safety and soundness of both banks and the banking system as a whole, using a comprehensive supervisory process and periodic on-site examinations designed to resolve problems privately. This approach historically has reflected concerns that disclosure of bank problems could trigger a run on bank deposits and destabilize the banking system. Federal Reserve Board Chairman Alan Greenspan has described the purposes of banking regulation as twofold:

> First, to promote and enforce sound practices so that banks do not present unacceptable threats to U.S. or world financial markets or impose unacceptable costs on the insurance funds and, ultimately, the U.S. taxpayers. And second, to maintain a supervisory and regulatory environment that encourages innovation and efficient competition in financial services and that does not require excessive risk-taking by banks in order to generate competitive returns.[43]

Securities regulation, on the other hand, emphasizes investor protection and market integrity, relying on disclosures and enforcement proceedings designed to expose and deter misconduct. Banking regulation promotes a cooperative, consultative relationship between banks and their regulators, whereas securities regulation

---

[42] *See* Letter from Alan Greenspan to the SEC, *supra* note 3, at 7.
[43] Alan Greenspan, Chairman, Fed, Reserve Bd., Remarks at the Conference of State Banking Supervisors (May 18, 2001).

relies on the *in terrorem* effect of SEC enforcement actions. Banks have developed a deep antipathy to SEC regulation based on the SEC's reputation as a ruthless enforcer with a "take no prisoners" mentality. Accustomed to the consultative approach of the federal banking regulators, banks are fearful of being called to account by a federal agency that strikes without warning, especially in an area as arcane as the securities laws where missteps can be costly. The banking agencies generally are viewed as supervisory agencies whereas the SEC is viewed as an enforcement agency – the "cops on the beat" as SEC staffers refer to themselves.[44]

The SEC staff has long felt that it needs jurisdiction over bank trust department activities in order to fulfill its investor protection mission under the securities laws. The staff is skeptical that applicable bank regulatory standards afford the same measure of investor protection that broker-dealer regulation does under the securities laws, and scoffs when banking regulators claim to have the tools to do the job.

---

[44] William H. Donaldson, Chairman, Sec. & Exch. Comm'n, Speech Before the Sec. Indus. Ass'n (Nov. 7, 2003) ("The SEC Enforcement Division's track record is impressive. Over the past year we have placed new cops "on the beat," and stepped up enforcement of the securities laws in all areas."); Paul S. Atkins, Comm'r, Sec. & Exch. Comm'n, Speech Before the Inv. Co. Inst. (Dec. 9, 2002) ("Nothing can substitute for a strong, effective cop on the beat with a big billy club who is not afraid to wield it."); Harvey L. Pitt, Chairman, Sec. & Exch. Comm'n, Speech Before the New York Fin. Writers Ass'n (June 13, 2002) ("Your reporting on the SEC's enforcement actions is part of what bolsters confidence in our markets. It reminds investors there is a tough cop on the beat, looking out for their interests."); William H. Donaldson, Chairman, Sec. & Exch. Comm'n, Speech Before the Foreign Policy Ass'n (Sept. 25, 2003) ("The Commission is in the midst of significantly enlarging our professional staff, which will help get new cops "on the beat" to enforce the new rules.").

In fact, the two regulatory schemes at bottom share the same goal of protecting customers—depositors in the case of banks, and investors in the case of securities firms. Moreover, in addition to their vast examination resources and broad supervisory authority, the banking agencies have formidable enforcement powers which they do not hesitate to use in appropriate circumstances. The SEC also has a sizeable examination staff and issues voluminous regulatory guidance to market participants, in addition to taking enforcement action.

While the philosophical divergence between banking and securities regulation has narrowed in recent years,[45] it clearly persists in the debate over Title II. In arguing that bank securities activities should be subject to the securities laws, the SEC has articulated the difference between banking and securities regulation as follows:

> The federal securities laws provide a comprehensive and coordinated system of regulation of securities activities. They are specifically and uniquely designed to assure the protection of investors through full disclosure concerning securities and the prevention of unfair and inequitable practices in the securities markets. The securities laws also have as a goal fair competition among all participants in the securities markets. Broker-dealer registration is an important element of this regulatory system. Absent broker-dealer registration, bank securities activities generally are regulated only under banking law, which has as its primary purposes the protection of depositors and the preservation of the financial soundness of banks. Thus, bank securities activities take place outside of the coordinated system of

[45] The philosophical conflict increasingly has been resolved in recent years in favor of the imposition on banks of more securities-like regulation and disclosure requirements. The banking laws were amended in 1991 to require public disclosure of enforcement actions against banks, 12 U.S.C. § 1818(u)(1)(A), (B) (2000), and bank ratings assignments under the Community Reinvestment Act, 12 U.S.C. § 2906 (2000). The banking agencies increasingly are relying on market discipline as a supplementary tool in bank supervision. *See*, *e.g.*, Fed. Reserve Bd., Enhancements in Public Disclosure, SR 01-6 (SUP) (March 23, 2001) ("The Federal Reserve has long supported meaningful public disclosure by banking and financial organizations with the objective of enhancing market discipline and fostering stable financial markets. Public disclosure and market discipline are important complements to bank supervision and regulation. With sufficient information, market participants can better evaluate counterparty risks and adjust the availability and pricing of funds in ways that can promote more efficient financial markets and sound practices by banks. In order to advance public disclosure efforts and to strengthen market discipline regarding banking organizations, the Federal Reserve has worked with other regulators, accounting authorities, users of financial statements and the banking industry.").

> securities regulation that is designed to protect investors, leading to regulatory disparities.
>
> . . . .
>
> Another area in which banking and securities regulation differ is communications with the public, including advertising. Broker-dealers must comply with specific guidelines concerning the content and review of communications with the public, including advertisements. With certain limited exceptions, there are no equivalent rules governing the advertisement of bank securities activities.
>
> Broker-dealers are subject to inspections and examinations not only by our staff but also by the [self-regulatory organizations ("SROs")] with our supervision. SRO examinations are designed to assure compliance with the federal securities laws, in particular sales practices and financial responsibility regulations. Banks, on the other hand, are not members of SROs. While bank examiners may review for violations of the banking agencies' securities guidelines, the primary focus is on ensuring the safety and soundness of the bank rather than the protection of investors.[46]

The banking regulators, on the other hand, argue that bank securities activities are adequately regulated under the banking laws and have not created any investor protection concerns. They have criticized Regulation B as "fundamentally inconsistent with the principles of functional regulation" and premised on "misunderstandings" of how banks operate:

---

[46] 66 Fed. Reg. 27,760, 27,764 (2001) (footnotes omitted). *See also* 68 Fed. Reg. 8686, 8688 (Feb. 24, 2003) (noting that the primary purpose of the banking laws is to protect the solvency of banks and that "the federal securities laws are unique in providing a comprehensive, uniform, and coordinated system of regulation of securities activities under the oversight of a single expert regulator with the protection of investors as its overarching purpose."); Cynthia A. Glassman, Comm'r, Sec. & Exch. Comm'n, The SEC's Role as Functional Regulator of Bank Securities Activities, Remarks (June 18, 2004), *available at* http://www.sec.gov/news/speech/spch061804cag.htm.

> [Regulation B] will significantly disrupt and may force discontinuation of major lines of business for banks and longstanding relationships with their customers. Because of the complexity and numerous non-statutory conditions imposed by [Regulation B], [Regulation B] will also impose substantial additional costs on banks. As a result, customer costs may increase. These consequences of [Regulation B] are wholly unwarranted given longstanding customer protections provided under the federal and state banking and fiduciary laws, and congressional recognition that banks have provided these services without any problem for years.[47]

The inter-agency jousting over Regulation B reflects a long-standing bureaucratic "turf battle" over bank securities activities. Such a battle can only undermine investor protection and expose banks to the costs of regulatory uncertainty.

C. Congressional Misguidance

Much of the blame for the debacle over Regulation B lies with Congress. By enacting statutory language that appears to subject banks to securities regulation without really doing so, Congress set up a costly charade that makes a mockery of the law and undermines the SEC's credibility as the "functional regulator" of bank securities activities.

The detailed provisions of the Title II exemptions for banks – particularly the "chiefly compensated" test – are subject to widely varying interpretations, as the public comment letters on Regulation B show.[48] Given Congress' intent not to interfere with traditional banking activities, the detailed language of Title II was unnecessary and has caused needless confusion. The only bank brokerage activity

---

[47] Letter from Alan Greenspan, Chairman, Federal Reserve System, John D. Hawke, Jr., Comptroller of the Currency, and Donna Tanoue, Chairman, Federal Deposit Insurance Corporation to the SEC (June 29, 2001).

[48] *See* SEC Home Page, http://www.sec.gov, for public comment letters on Regulation B.

that Congress clearly did not exempt from SEC regulation in Title II was retail brokerage, which most banks did not conduct in any case.[49] Rather than simply subject such activities to SEC regulation and retain the prior blanket exemption for traditional banking activities, Congress took the far more convoluted approach of repealing the blanket exemption and substituting eleven highly-specific exemptions to encompass the traditional activities.[50] Had Congress not intended the SEC to interpret and implement the exemptions, it should not have set up such an awkward framework.

The sensible approach eluded Congress in part because of competing pressures from the SEC and the banking industry. Title II reflects a compromise in which the SEC agreed to the broader provisions of the GLBA permitting affiliations between banks and securities firms in exchange for provisions making the SEC the "functional regulator" of bank securities activities. The banking industry accepted the SEC's Title II language based on an unwritten understanding that the SEC would not seek to enforce it. The scenario contemplated by the banking industry – and acquiesced to by Congress – was that banks would pretend to be regulated by the SEC and the SEC would pretend to regulate them.

The problem is that the SEC did not pretend as contemplated but rather made a serious effort to fulfill its Congressionally-designated role as functional regulator and implement the law. Its refusal to participate in a charade has angered some members of Congress who, at the behest of the banking industry, have urged the SEC to scrap its Regulation B initiative:

> The proposed regulation is fundamentally inconsistent with Congressional intent and would impose burdensome and wholly unjustifiable compliance costs on the entire banking industry. Accordingly, we strongly urge the Commission not to finalize the proposed regulation in its current form but instead to prepare – and again seek public

[49] *See* Letter from Jim Bunning to the SEC, *supra* note 3, at 2 ("The only activities Congress intended to 'push out' were those activities conducted outside the scope of the statutory exceptions.").

[50] H.R. Rep. No. 106-434, at 163-64 (1999); *see also* S. Rep. No. 106-44, at 10 (1999).

> comment on – a new proposal that is consistent with the language and legislative history of GLBA.[51]

Apart from unofficial directives by individual legislators, Congress itself has given no further statutory guidance to the SEC. Ordinarily, the SEC might not give great weight to such *ex parte* communications from members of Congress. However, the new SEC chairman, Christopher Cox, is a former U.S. Senator himself and thus may be more likely to defer to his former brethren.

The most forthright solution would be for Congress to clarify its intent through specific statutory amendments to Title II. Among other provisions, Congress could eliminate the troublesome "chiefly compensated" test. Yet, members of Congress have made it clear that they are unwilling to reopen the GLBA for discussion in the foreseeable future.[52]

It is not unusual for Congress to punt on difficult financial regulatory issues by forcing the agencies to work together toward a compromise solution.[53] Other regulatory impasses between the agencies have been resolved when Congress compelled the agencies to work together.[54] Still, by refusing to enact statutory language that embodies its true legislative intent, Congress has created a situation where Title II is becoming a meaningless law and the SEC's authority and credibility as a functional regulator is being undermined.

---

[51] Letter from Jim Bunning to the SEC, *supra* note 3, at 1. *See also* Letter from Michael G. Oxley, Chairman, House Comm. on Fin. Servs. et al., to the SEC (Oct. 14, 2004); *Pushing Back the Pushouts: The SEC's Broker-Dealer Rules: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit, and the Subcomm. on Capital Markets. Insurance and Government Sponsored Enterprises*, 107th Cong. (2001) (statement of Eugene F. Maloney, Executive Vice President and Corporate Counsel, Federated Investors, Inc.).

[52] *See infra* note 78. The banking industry also prefers not to reopen the GLBA in view of many other provisions that would be reopened to debate.

[53] For example, differences between the SEC and banking regulators over loan loss reserves resulted in a stand-off that was resolved only after Congressional hearings and enactment of legislation requiring the SEC to consult with the banking agencies before taking any action concerning the manner in which banks and their holding companies report loan loss reserves in their financial statements. Gramm-Leach-Bliley Act § 241, Pub. L. No. 102-106, 113 Stat. 1338 (1999).

[54] *Id.*

III. The SEC's Role as Functional Regulator

Title II is premised on the concept of "functional regulation."[55] In adopting the GLBA, Congress described functional regulation as follows:

> The bill generally adheres to the principle of functional regulation, which holds that similar activities should be regulated by the same regulator. Different regulators have expertise at supervising different activities. It is inefficient and impractical to expect a regulator to have or to develop expertise in regulating all aspects of financial services. Accordingly, the bill is intended to ensure that banking activities are regulated by banking regulators, securities activities are regulated by securities regulators, and insurance activities are regulated by insurance regulators.[56]

As the functional regulator of bank securities activities, the SEC has an important role to play in ensuring that bank brokerage activities are conducted in a manner consistent with the investor protection aims of the securities laws. No one can deny that the framework of federal broker-dealer regulation affords significant protections for investors.[57]

At a conference on Regulation B sponsored by the Morin Center on Banking and Financial Law, SEC Commissioner Cynthia Glassman articulated the SEC's role as the functional regulator of bank securities activities, as follows:

> Under the federal securities regulatory scheme, investor protection starts with the registration of the broker-dealers that sell securities and the people they employ to do the selling. Before it can engage in a securities business, a broker-dealer must become registered with the Commission, become a member of a [SRO] such as the NASD or the New York

---

[55] Indeed, Title II is entitled "Functional Regulation."

[56] S. REP. NO. 106-44, at 7 (2000).

[57] The SROs such as the NASD and New York Stock Exchange also play a significant role in investor protection.

Stock Exchange, and get licensed in the states in which it plans to conduct business. It must meet the initial and ongoing financial criteria and reporting requirements specified in rules under the Securities Exchange Act of 1934, disclose its principal officers and their disciplinary history, if any, provide information about its business and control relationships, and maintain and enforce compliance and supervisory procedures.

The salespeople who represent the broker-dealer in dealings with the public must also be registered with an SRO and the appropriate states. This involves taking securities exams and keeping up with continuing education requirements. Persons who have been enjoined or convicted of a securities-related offense or been barred by a securities regulatory authority may not work for a broker-dealer unless and until the broker-dealer's SRO and, in some cases, the Commission, has considered the past circumstances and determined that current supervisory controls are adequate to prevent future misconduct.

Once broker-dealers and their associated persons are appropriately registered, they become subject to a comprehensive body of federal, state and SRO rules and regulations. The core provisions of the federal securities laws make it unlawful for anyone to commit fraudulent or deceptive acts in connection with the purchase or sale of securities. The Commission's examinations and inspections of registered persons, along with its enforcement proceedings, give teeth to this statutory prohibition. Moreover, the securities laws impose liability on supervisors for failing to supervise the securities activities of their salespersons and on controlling persons for the securities law violations of persons they control. This also strengthens the federal laws' substantive investor protections.

> Of course, federal requirements evolve as market practices and problems evolve. Under SEC Rule 10b-10, for example, broker-dealers must provide their customers confirmations disclosing such trade-specific information as the securities bought or sold, the price paid or received, and whether the broker-dealers received certain types of additional compensation. In light of the mutual fund scandals and evolving arrangements between mutual funds and broker-dealers, including revenue-sharing, the Commission recently proposed to expand confirmation disclosures to include information highlighting distribution-related costs and the conflicts that may arise when mutual funds pay brokers to sell their funds. Under the proposal, related disclosures would also have to be made at the point of sale. Since some funds pay more than others to get on brokers' recommended lists, a broker may have a financial incentive to recommend one fund over another – separate and apart from whether the recommendation is made in the best interests of the investor. The Commission's proposal is intended to help investors better understand the incentives, so they can take them into account in making investment decisions.[58]

Commissioner Glassman also identified the purposes of federal broker-dealer regulation:

> So far I've been talking primarily about SEC requirements. However, as you know, the SROs are also an integral part of the federal securities regulatory framework. Not only do NASD and NYSE rules make it a violation to engage in fraudulent activity, but they also require broker-dealers and their associated persons to adhere to ethical standards and just and equitable principles of trade. SRO rules govern the truthfulness of

---

[58] Cynthia A. Glassman, Comm'r, Sec. & Exch. Comm'n, The SEC's Role as Functional Regulator of Bank Securities Activities, Remarks (June 18, 2004), *available at* http://www.sec.gov/news/speech/spch061804cag.htm.

> advertising, sales literature and other communications with customers; they prohibit excessive commissions and unfair mark-ups on transactions with customers; they impose suitability and disclosure requirements; and they impose supervisory requirements on broker-dealers and their principals and supervisors.
>
> Of course, the states play an important role in overseeing broker-dealers too. States have registration and licensing requirements, and they carry out rigorous examination and enforcement programs. They're the "local cops on the beat."
>
> While the SEC, the SROs and state securities regulators strive to ensure that securities markets are fair and free of fraud and deceit, there can always be problems. Investors aggrieved by the actions of their brokers may seek redress through the SRO arbitration process overseen by the Commission. In the event of a broker-dealer bankruptcy, customers of the broker-dealer may be entitled to recover cash and securities held with the broker-dealer from the Securities Investor Protection Corporation.
>
> Viewed as a whole, the federal securities regulatory framework provides a comprehensive body of investor protections. In adopting Gramm-Leach-Bliley and a system of functional regulation, Congress sought to make these protections available to purchasers and sellers of securities, regardless of whether they effect transactions through a bank or a broker-dealer.[59]

Commissioner Glassman's statement makes clear that the SEC has a valuable role to play in the regulation of bank securities activities. Whether and how it can do so in the current environment

[59] Id.

of hostility from the banking industry, banking regulators and Congress is the challenge it must answer.

IV. Personal Experience with the SEC

Based on my company's experience in dealing with the SEC on Regulation B, I believe that the current hostility to the agency as the functional regulator of bank securities activities is unwarranted. In my experience, the agency has shown a willingness to be reasonable and responsive when legitimate concerns are presented to it, supported by concrete data and first hand accounts by the people who actually run the business.[60]

My company's principal concern was to ensure that banks would not be required to register as broker-dealers by virtue of performing administrative services in connection with the investment of fiduciary assets in mutual funds and receiving compensation for such services. We discussed several approaches with the SEC to avoid this result, and the SEC addressed our concerns in its interim regulations by excluding administrative fees paid to banks by mutual funds from the "chiefly compensated" test.[61]

We also discussed with the staff the need to avoid regulating banks when they act as trustees for participant-directed employee benefit plans (such as 401(k) plans and individual retirement accounts).[62] In addition, we requested confirmation that a bank acting as an indenture trustee pursuant to the Trust Indenture Act of 1939 may invest indentured assets in a mutual fund and receive

---

[60] We approached the SEC staff in 2001 after learning that the staff was reading Title II in ways that would preclude banks from engaging in certain traditional activities. We first visited with senior officials of the federal banking agencies, who told us that they were not prepared to intervene with the SEC concerning the implementation of Title II and that we should deal with the SEC directly.

[61] The regulation defines "sales compensation" to exclude mutual fund administrative fees other than 12b-1 fees. *See* Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. 242.724(i)(6)).

[62] *See* Letter from Melanie L. Fein, Esq., representing Federated Investors, Inc., to Robert L. D. Colby, Deputy Dir., and Catherine McGuire, Assoc. Dir. and Chief Counsel, Div. of Mkt. Regulation, Sec. & Exch. Comm'n (Mar. 13, 2001) (on file with the Annual Review of Banking & Financial Law).

service fees from the fund without registering as a broker-dealer.[63] We also provided a legal memorandum refuting an SEC staff position that a bank must register as a broker-dealer if it offers nondiscretionary investment agency services.[64]

These issues were addressed in the SEC's initial regulations implementing Title II.[65] In particular, the SEC agreed that banks are exempt from broker-dealer registration when they act as trustees for 401(k) and IRA accounts[66] and, while not agreeing that custodial services are exempt under the statute, adopted a regulatory exemption allowing small banks to perform custodial functions for such accounts.[67] The SEC also exempted banks from the "chiefly compensated" test when they act as indenture trustees, and clarified the circumstances under which bank investment agency accounts are exempt.[68]

The SEC's treatment of these issues did not fully resolve our concerns, and indeed created some new ones, but we had the opportunity to further address the scope of Title II during the public comment period on the regulation. Among other things, we asked the SEC to interpret the sweep exemption to allow banks to sweep customer deposits into money market mutual funds and to exempt

---

[63] *See* Letter from Melanie L. Fein, Esq., representing Federated Investors, Inc., to Robert L. D. Colby, Deputy Dir., and Catherine McGuire, Assoc. Dir. and Chief Counsel, Div. of Mkt. Regulation, Sec. & Exch. Comm'n (Mar. 14, 2001) (on file with the Annual Review of Banking & Financial Law).

[64] *See* Letter from Melanie L. Fein, Esq., representing Federated Investors, Inc., to Robert L. D. Colby, Deputy Dir., and Catherine McGuire, Assoc. Dir. and Chief Counsel, Div. of Mkt. Regulation, Sec. & Exch. Comm'n (Mar. 7, 2001) (on file with the Annual Review of Banking & Financial Law).

[65] Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934; Exchange Act Release No. 44,291, 66 Fed. Reg. 27,760 (May 18, 2001).

[66] Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 66 Fed. Reg. at 27,768.

[67] Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 66 Fed. Reg. at 27,781-83.

[68] Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 66 Fed. Reg. at 27,767.

banks when they effect securities transactions for escrow and similar agency accounts.[69] We also asked the SEC to exempt banks from the "chiefly compensated" test with respect to certain employee benefit plan accounts where the bank receives all of its compensation in the form of mutual fund service fees.[70]

The SEC responded favorably to our suggestions in proposed Regulation B, issued in June 2004.[71] Among other things, the SEC proposed an exemption under which a bank may effect transactions in money market mutual funds for fiduciary, escrow, and other agency accounts without being required to register as a broker-dealer.[72] The SEC also created a special exemption for banks effecting securities transactions for certain employee benefit plans.[73]

While further refinement of certain provisions in Regulation B still is needed, we are confident that the SEC's staff will make appropriate adjustments to the point where the regulation ultimately will become workable.

The banking industry and its regulators have complained that Regulation B, even with the favorable changes made to date, would impose an unnecessary compliance burden on banks.[74] The burden in this case appears to be a predictable outcome of statutory language that was agreed to by banking industry lobbyists during negotiations on Title II, apparently without fully considering the consequences. Hopefully, the burden will be minimized as the SEC refines Regulation B to address industry concerns.

The SEC's deliberative proceedings on Title II demonstrate that the agency is prepared to work with the banking industry on a cooperative basis to make the regulation workable, consistent with

---

[69] *See* Letter from Melanie L. Fein, Esq., representing Federated Investors, Inc., to Robert L. D. Colby, Deputy Dir., and Catherine McGuire, Assoc. Dir. and Chief Counsel, Div. of Mkt. Regulation, Sec. & Exch. Comm'n (Nov. 19, 2002) (on file with the Annual Review of Banking & Financial Law).

[70] *See* Letter from Melanie L. Fein, Esq., representing Federated Investors, Inc., to Robert L. D. Colby, Deputy Dir., and Catherine McGuire, Assoc. Dir. and Chief Counsel, Div. of Mkt. Regulation, Sec. & Exch. Comm'n (Feb. 25, 2002) (on file with the Annual Review of Banking & Financial Law).

[71] Exchange Act Release No. 49,879, 69 Fed. Reg. 39,682 (June 30, 2004).

[72] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. pt. 242.776).

[73] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004) (to be codified at 17 C.F.R. pt. 242.770).

[74] *See*, Letter from Alan Greenspan to the SEC, *supra* note 3 (and other letters posted on the SEC's web site at http://www.sec.gov/rules/proposed/s72604.shtml).

investor protection considerations. The SEC has repeatedly invited banks and other interested parties to meet with it and submit written information describing the impact of Title II and alternative proposals on bank activities.[75] The SEC has also stated that, once a regulation is adopted, it will afford banks at least a one year grace period to come into compliance.[76]

Any idea of implementing Title II through draconian enforcement tactics is not evident in the SEC's actions to date. Rather, the agency has fulfilled its role as the functional regulator of bank securities activities by proceeding judiciously in addressing bank concerns in a responsible way consistent with the investor protection objectives of the securities laws. Had there been evidence of fraudulent practices or other violations of the securities laws by banks, the SEC might not have proceeded at such an accommodating pace.

V. Conclusion

The controversy over the functional regulation provisions in Title II reflects fundamental difficulties in the application of the securities laws to banks. Apart from convoluted and uncertain statutory language in Title II, interagency philosophical differences and lack of Congressional support have vexed the implementation process. Unhappy with the prospect of SEC regulation, banks have dragged out the process for six years, fighting the SEC at every pass with the federal banking agencies as their henchmen.

The SEC can no longer delay implementing Title II without appearing to be reneging on the task. While investors do not appear to have suffered any harm in the absence of an SEC rule implementing Title II, continued uncertainty regarding the scope of the exemptions in Title II is not in the long-term interests of banks or their customers. If nothing else, banks would benefit from a regulation clearly delineating the scope of activities they may safely

---

[75] *See*, *e.g.*, Catherine McGuire, Chief Counsel, Div. of Mkt. Regulation, Sec. & Exch. Comm'n, Remarks Before the Bank Insurance Securities Association (Oct. 8, 2003).
[76] Regulation B, 69 Fed. Reg. 39,682 (proposed June 30, 2004).

conduct without being found to be engaged in unlawful brokerage activities.[77]

In the absence of any indication that Congress is willing to rewrite Title II, banks and their regulators must accept the reality that the SEC is now the functional regulator of bank securities activities, and the SEC must begin to perform that role or else lose credibility.

Banks and federal banking regulators should strive to work diligently with the SEC to ensure that the SEC understands the concerns unique to banks and implements the law in a way that minimizes disruption to traditional banking activities. Likewise, continued regulatory openness at the SEC will encourage banks to maintain an ongoing dialogue in order to help the SEC better fulfill its role as a functional regulator of banks in furtherance of the investor protection goals of the securities laws. Greater harmony in the regulation of bank securities activities will benefit all concerned, most importantly bank customers and the investing public.[78]

---

[77] A bank could face litigation not only from the SEC but from private litigants, and the penalties for operating as an unregistered broker-dealer are severe.

[78] After this article was written, the Senate Committee on Banking, Housing and Urban Affairs approved the "Financial Services Regulatory Relief Act of 2006" on May 4, 2006. Financial Services Regulatory Relief Act of 2006, http://banking.senate.gov/_files/ACF2.pdf (last visited May 19, 2006). Section 101 of the bill requires the SEC to adopt a regulation to define the term "broker" as it pertains to banks in the Securities Exchange Act of 1934. Prior to issuing a final rule, the SEC is required by the bill to "consult with and seek the concurrence of" the federal banking agencies.