After Natwest: Are Camp "Subtle Hazards" and "Union of Powers" Analyses Dead?

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Congress enacted the Glass-Steagall Act (Glass-Steagall or the Act) in the wake of the 1929 stock market crash to restore public confidence in the banking system. The Act prohibits commercial bank involvement in certain types of investment banking activities and prohibits the involvement of securities firms in commercial banking. The Act also prohibits a bank affiliate's involvement in certain investment banking activities, but limits this latter prohibition to affiliations with entities "principally engaged" in the prohibited activities. Finally, the Act prohibits corporate director interlocks between corporations "primarily engaged" in certain investment banking activities and member banks.

This wall between commercial and investment banking has recently come...
under fire as the financial markets invent financing instruments never contemplated by the Congress in 1933 and many commercial banks express concerns about their competitiveness with securities firms within the constraints of Glass-Steagall. As banks have gained momentum in their push for banking reform, members of Congress have responded with a legislative proposal to break down the Glass-Steagall wall between commercial and investment banking. Although the stock market tail spin of “Black Monday” temporarily may have dampened legislative efforts to repeal Glass-Steagall, the Board of Governors of the Federal Reserve (Board), and the federal courts continue to narrow the scope of Glass-Steagall. However, this narrowing potentially undermines the condition upon which the courts first agreed to defer to agency regulation. Historically, the courts have de-

9. Golembe, supra note 6, at 15.


ferred to agency determinations involving Glass-Steagall activities. The courts have based this deference on an implicit view that Glass-Steagall serves both a prohibitory and a regulatory function. The courts have recognized the agency's superior ability to protect against the express hazards inherent in investment banking activities as well as the subtle hazards Congress sought to avoid.

In Securities Industry Association v. Board of Governors of the Federal Reserve System (*NatWest*), however, the United States Court of Appeals for the District of Columbia Circuit deviated from the Supreme Court's precedents when it attempted to demonstrate the superfluity of subtle hazards analysis in cases where the Board determines that the applicable Glass-Steagall Act provisions do not expressly prohibit the proposed activity. This rationale limits the scope of prohibited activities to those expressly identified in the Glass-Steagall Act which Congress enacted over fifty years ago, notwithstanding the Supreme Court's encapsulation of the legislative history of the Glass-Steagall Act under the rubric of hazards and subtle hazards. *NatWest* construes section 20 of the Act to prohibit bank affiliates only from engaging principally in the underwriting of securities. In strictly construing section 20, the court ignored the possibility that the combination of activities covered by the *NatWest* application would fail to satisfy section 20 if the subsidiary's activities were examined under the "subtle hazards" test. The *NatWest* court argued that an activity "closely related" to banking, because it is a traditional fiduciary function of bank trust departments, cannot implicate any subtle hazards.

This Note will review the case law preceding the *NatWest* decision which established the subtle hazards analysis for Glass-Steagall cases. It will assess the analytical success of the *NatWest* court's attempt to justify substantial deference to agency decisions in Glass-Steagall cases under a standard that diminishes the importance of subtle hazards. This Note will conclude that the standard adopted in *NatWest* undermines prior Supreme Court use of subtle hazards analysis to expand the Act into a regulatory context at the same time that Congress considers incorporating a regulatory approach into its proposals to reform Glass-Steagall.

15. See infra notes 23, 56, 64-75, 97-108, and accompanying text.
18. *Id.* at 813-17 & n.8.
19. *Id.* at 813-14.
20. *Id.* at 813-17.
21. *Id.* at 817.
I. REGULATORY APPLICATION OF GLASS-STEAGALL

A. The Subtle Hazards of Glass-Steagall, Union of Powers, and Deference to Administrative Regulation

The Supreme Court, in *Investment Company Institute v. Camp*, first articulated the principle that the great weight normally given to "any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute" should be rejected when that agency fails to "search for the meaning and intent of Congress." The Court refused to defer substantially to a regulation involving sections 16 and 21 of the Glass-Steagall Act which the Office of the Comptroller of the Currency (the OCC) promulgated without any accompanying rationale as to the meaning and intent of Congress. The Court independently examined the legislative history using subtle hazards analysis as a conceptual framework to articulate the congressional concerns behind the Act. In doing so, the court defined the parameters of agency discretion by isolating the hazards and subtle hazards of investment banking that Congress sought to avoid in commercial banking. These subtle hazards focused upon conflict of interest and unsound banking practices which the public and Congress had linked to the 1929 crash.

The "principal hazard" Congress originally sought to avert by enacting the Glass-Steagall Act consisted of the "obvious danger that a bank might invest its own assets in... imprudent" securities. Upon a thorough review of the legislative history, the Supreme Court identified other "subtle hazards" Congress had sought to avoid by erecting a wall between commercial banking and investment banking. These subtle hazards include: (1) the impairment of public confidence in the bank, essential to its solvency, when its securities affiliate fared badly; (2) the "temptation to shore up the affiliate through unsound loans or other aid"; (3) "the pressure to sell a particular investment and to make the affiliate successful [creating] a risk

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23. *Id.* at 627-28.
25. *Id.* § 378.
27. *Id.* at 627-34.
28. *Id.*
29. *Id.*
30. *Id.* at 630.
31. *Id.* at 630-35.
32. *Id.* at 631 (citing *Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 20, 237, 1063 (1931)).
33. *Id.*
that the bank would make its credit facilities more freely available" or "make unsound loans . . . [to] companies in whose . . . securities the affiliate has invested"; (4) the chance that "bank depositors might suffer losses on investments they purchased in reliance on the relationship between the bank and its affiliate"; (5) the temptation "to make loans to customers with the expectation that the loan would facilitate the purchase of stocks and securities"; (6) "the conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice." The Camp Court articulated these examples of subtle hazards under the broader subtle hazard that "the promotional needs of investment banking might lead commercial banks to lend their reputation for prudence and restraint to the enterprise of selling particular stocks and securities."  

In light of this intent, the Court held that the OCC regulation's authorization of commercial bank sponsorship of a commingled managing agency account or mutual fund violated sections 16 and 21 of Glass-Steagall. The Court reasoned that the activity implicated some of the hazards and subtle hazards of investment banking that Congress intended to prevent by enacting Glass-Steagall. Although the pertinent statutory provisions did not expressly prohibit bank sponsorship of mutual funds, the Court concluded that efforts to sell participation in such a fund constituted sale of a security within the purview of Glass-Steagall.  

The Camp Court premised its subtle hazards analysis on union of powers analysis when it recognized that activities that individually raise no hazards

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34. *Id.* (citing *Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 20, 237, 1063 (1931)).
35. *Id.* (citing 77 CONG. REC. 4028 (1931) (statement of Rep. Fish)).
36. *Id.* at 632 (citing S. REP. No. 77, 73d Cong., 1st Sess. 9-10 (1931)).
37. *Id.* at 633 (citing 75 CONG. REC. 9912 (1931) (statement of Sen. Bulkley)).
38. *Id.* at 632 (citing 75 CONG. REC. 9912 (1931) (statement of Sen. Bulkley)).
39. The Court defined a mutual fund as an open-end investment company. *Id.* at 625 n.11.
42. *Id.* at 634-38.
of investment banking could violate Glass-Steagall precepts when combined. The Court applied its union of powers analysis to prohibit bank sponsorship of the commingled managing agency account. The Court reasoned that, although the commingled managing agency accounts consisted of two separate, permissible components—commingled trust funds and the bank acting as managing agent—the Glass-Steagall Act prohibited their joinder in the operation of the fund.\(^4\) The Court stated that this union of powers gave "birth to an investment fund whose activities [were] of a different character," \(^4^4\) "in direct competition with the mutual fund industry." \(^4^5\) This activity, tantamount to operation of a mutual fund, essentially required the bank to act as investment advisor to an open-end investment company. The combination of sale of commercial trust funds with a managing agent power implicated the subtle hazards of investment banking even though neither of the individual services would do so. Thus, an activity not expressly prohibited by the literal language of the Glass-Steagall Act implicated subtle hazards and required regulation or prohibition.

B. The Subtle Hazards of Investment Advisory Services Within the Framework of the Bank Holding Company Act

The Camp Court introduced the union of powers framework for subtle hazards analysis in circumstances involving bank powers under the Glass-Steagall Act. However, the statutory structure of the Bank Holding Company Act of 1956 (BHCA)\(^4^6\) expressly incorporated an analogous frame-

\(^4^3\) Id. at 624-25.

\(^4^4\) Id.

\(^4^5\) Id. The dissent in Camp completely rejected the "union of powers" framework for subtle hazards analysis, along with subtle hazards analysis itself. It argued that Glass-Steagall prohibited commercial bank involvement in investment banking; the commingled managing agency account constituted a "traditional fiduciary function" of bank trust departments. Therefore, the consideration of subtle hazards erroneously extended the scope of Glass-Steagall prohibitions to traditional commercial bank functions Congress never intended to prohibit. Id. at 643-45 (Blackmun, J., dissenting).

\(^4^6\) 12 U.S.C. § 1843(c)(8) (1982). The differing treatment of banks and bank affiliates afforded by the Glass-Steagall Act further clarifies the relationship between the BHCA and the Glass-Steagall Act. For example, § 16 of the Glass-Steagall Act, which pertains to banks, prohibits banks from engaging in underwriting. 12 U.S.C. § 24(Seventh) (1982 & Supp. IV 1986); see also Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 58-59 & n.24 (1981). In contrast, § 20 of the Act, pertaining to "affiliates," prohibits these bank affiliates from being "engaged principally" in underwriting. 12 U.S.C. § 377 (1982 & Supp. IV 1986). The qualified nature of the prohibition against bank affiliate underwriting in the Glass-Steagall Act partially explains the need for the BHCA: "Part of the motivation underlying the requirement that bank holding companies divest themselves of nonbanking interests was the desire to provide a measure of regulation missing from the Glass-Steagall Act." Investment Co. Inst., 450 U.S. at 69. However, this intent behind the BHCA cannot at all be construed to limit the "engaged principally" qualification against prohibition in § 20 of the
work for regulating bank holding companies. For example, Congress intended the BHCA "to maintain and . . . strengthen Glass-Steagall's restrictions on the relationship between commercial and investment banking."47 Although the BHCA generally seeks to limit banks to banking and to keep banks separate from commercial businesses,48 section 4(c)(8)49 constitutes an exception to this overall purpose. This provision permits bank holding companies to hold shares of any company engaged in activities that the Board determines are (1) closely related to banking and (2) "a proper incident thereto."50 The two tests are independently and conjunctively applied: an activity closely related to banking may not necessarily constitute a proper incident to banking. Thus, Federal Reserve Board determinations of whether an activity "closely related to banking" also constitutes a "proper incident thereto" requires consideration of whether the risks of unsound banking practices outweigh the activity's "benefits to the public."51

Consideration of unsound banking practices necessarily includes a consideration of Glass-Steagall policies. Thus, in Board of Governors of the Federal Reserve System v. Investment Company Institute,52 the Supreme Court expressly incorporated the subtle hazards analysis into the proper incident to banking test.53 Investment Company Institute arose from a challenge to a proposed Board regulation that allowed bank holding companies and subsidiaries to provide investment advisory services to closed-end investment companies.54 The Board regulation at issue did not address investment advice to open-end investment companies. Further, as in Camp, the express statutory language of the Glass-Steagall Act neither prohibited nor regulated the pro-

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50. Id. A bank holding company may acquire "shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." Id. In determining whether an activity is a proper incident, the Board is to "consider whether its performance by an affiliate of a holding company can reasonably be expected to provide benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." Id.
51. Id.
53. Id. at 55-59, 64, 68.
vision by banks or affiliates of investment advisory services to closed-end investment companies. Yet, the Court found that the provision of investment advisory services in both contexts implicated the subtle hazards Congress sought to avoid with Glass-Steagall. However, in Investment Company Institute, unlike Camp, the Court held regulation of these hazards to be adequate. The Court based its conclusion on three reasons.

First, there exist fewer hazards and subtle hazards associated with investment advice provided to the closed-end investment companies at issue in Investment Company Institute as compared to the number of subtle hazards associated with providing investment advice to open-end investment companies as in Camp. For example, the bank sponsoring the mutual fund in Camp underwrote the stock of the open-end investment company. In contrast, the bank in Investment Company Institute would neither underwrite nor sell the stock of its closed-end investment company. Advisors to closed-end investment companies managed to avoid the subtle hazards of underwriting by not realizing an increase in their advisory fees as the result of sales of company shares. In contrast, the fees of advisors to mutual funds increased through the sale of company shares, providing an incentive to the bank or its holding company to engage in promotional activities.

Second, unlike Camp, which dealt mainly with a bank’s management of an open-end investment company under section 16 of the Glass-Steagall Act, the Court resolved Investment Company Institute in the context of a bank holding company and a section 4(c)(8) affiliate providing investment advisory services to a closed-end investment company under section 20 of Glass-Steagall. Whereas section 16 prohibited bank activities that implicated the subtle hazards of investment banking, section 20 merely prohibited bank holding companies and their affiliates from being principally engaged in activities that implicated the subtle hazards of investment banking. Thus, section 20 permitted greater involvement in investment banking activities by affiliates than section 16 allowed banks. Subtly hazardous activities

56. 450 U.S. at 65-68.
57. Id. at 66-67.
58. Id. at 65-66 (comparing the Investment Company Institute situation with that in Camp).
59. Id. at 66-67.
60. Id. at 67 & n.40.
61. Id. at 67.
63. 450 U.S. at 48-50.
64. Id. at 60-61 & n.26.
65. Id. at 58 & n.24.
by bank holding companies and subsidiaries appear more amenable to regulation because of the principally engaged limitation of section 20, while similar activities by banks seem subject to outright prohibition. However, this merely facilitates an overall ad hoc explanation of the outcome in Investment Company Institute, if the analytical role of subtle hazards analysis is ignored. The fact that Investment Company Institute was decided within a BHCA context does not fully explain how the Court came to its decision. This is because the fact that an entity is a bank holding company as opposed to a bank does not aid a determination of when to regulate as opposed to when to prohibit. Instead, subtle hazards analysis appears to have been the means by which the Court determined when the “principally engaged” threshold was crossed.66

Specifically, the Investment Company Institute Court limited its holding to the proposition that the Board regulation authorizing investment advisory services to closed-end investment companies constituted an activity closely related to banking, because the investment advisory services constituted “traditional fiduciary functions” of bank trust departments.67 The Court implicitly articulated the major premise of the Camp union of powers approach when it affirmed that traditional fiduciary functions closely related to banking could, in fact, implicate subtle hazards when later evaluated under a proper incident to banking analysis.68 This independence between the closely related to banking and proper incident to banking tests of the BHCA logically incorporated the union of powers framework for subtle hazards analysis into a bank holding company context. The application of subtle hazards analysis in the bank holding company context extended court deference to the Board’s regulations under section 4(c)(8) proper incident to banking analysis.69

Third, the Court, citing Camp, deferred to the Board’s interpretive ruling on its regulation because the Board addressed the subtle hazards that Congress intended to avoid with the Glass-Steagall prohibitions.70 For example, the Board imposed restrictions on a bank’s extension of credit to an investment company to which it provided investment advisory services.71 In addition, the Board’s interpretive ruling restricted the bank from providing depositors’ names to the investment company.72 This restriction avoided the

66. Id. at 65-68.
67. Id. at 55-58.
68. Id. at 57-59.
69. Id. at 68.
70. Id.
71. Id. at 67.
72. Id. at 67 n.39.
hazard associated with a bank failing to render impartial advice because it promotes its fund.\textsuperscript{73} Further restrictions imposed by the Board ranged from prohibitions on a bank acting as investment advisor to any investment company with a similar name to prohibitions against locating the investment company offices with those of the bank in the same building.\textsuperscript{74} The Board implemented these restrictions to prevent the public from connecting the fortunes of the investment company with the soundness of the bank.\textsuperscript{75}

Furthermore, the Court deferred to the Board regulations under the BHCA as “a preliminary authorization of such services, rather than approval of any specific advisory relationship.”\textsuperscript{76} The Court expressly assumed that only the first prong of the section 4(c)(8) test under the BHCA was at issue. Under this prong, the Court held that the investment advisory services in a closed-end investment context were closely related to banking because they were similar to the “traditional fiduciary functions of banks.”\textsuperscript{77} However, the Court explicitly left open the issue as to whether such services would constitute a proper incident to banking under the second prong of section 4(c)(8).\textsuperscript{78} In fact, the Court further premised its deference on the assumption that the Board would continue to review specific applications under the second prong to assure that proposed investment advisory services within specific factual circumstances did not conflict with the policies of the Glass-Steagall Act.\textsuperscript{79} In other words, this part of the \textit{Investment Company Institute} holding limited its deference to the proposition that the investment advisory services at issue were closely related to banking under the first prong. It did not presume that such activities would never fail the second prong by violating the Glass-Steagall Act in specific situations.

\textbf{C. Subtle Hazards Applied to Discount Brokerage Services Within the Framework of the Bank Holding Company Act}

More recent decisions of the Supreme Court retain the subtle hazards framework for Glass-Steagall regulation. The Court’s decision in \textit{Securities Industry Association v. Board of Governors of the Federal Reserve System (Schwab)}\textsuperscript{80} accords with the subtle hazards and substantial deference framework of \textit{Investment Company Institute} and \textit{Camp. Schwab} arose out of a

\textsuperscript{73} Id.
\textsuperscript{74} Id.
\textsuperscript{75} Id.
\textsuperscript{76} Id. at 57-58, 64, 68.
\textsuperscript{77} Id. at 57-58.
\textsuperscript{78} Id.
\textsuperscript{79} Id.
securities industry challenge to Bank America Corporation's proposed acquisition of Charles Schwab & Company, a discount brokerage business.\textsuperscript{81} The Supreme Court held that section 20 of Glass-Steagall permitted the acquisition because brokerage services fell outside of the definition of a public sale of securities prohibited by section 20.\textsuperscript{82} The Court also held that brokerage services alone implicated none of the subtle hazards recognized in \textit{Camp}.\textsuperscript{83} The Court expressly premised its holding on the exclusion of investment advisory services from the discount brokerage services at issue.\textsuperscript{84}

Even though the bulk of the \textit{Schwab} opinion concerned the construction of "public sale," the holding relied on both the public sale analysis and the subtle hazards analysis. In the public sale analysis, the Court construed public sale as underwriting and not as encompassing the discount brokerage services at issue.\textsuperscript{85} In fact, the Court limited the meaning of all of the terms of prohibition in section 20 to underwriting for the purposes of deciding the facts of the case. Both the public sale analysis and subtle hazards analysis gave independent support to the holding.\textsuperscript{86} Thus, the Court's determination that the acquisition implicated none of the subtle hazards had little to do with the meaning of public sale under section 20. Rather, the Court reasoned that discount brokerage services did not implicate any of the subtle hazards of underwriting because of the nature of each service.\textsuperscript{87} For example, the profits for discount brokerage services depended exclusively on the volume of shares rather than the sale of any particular securities, as they would in underwriting.\textsuperscript{88}

The Court's decision also implicitly recognized that some activities not technically considered to be underwriting could raise the spectre of subtle hazards.\textsuperscript{89} For example, the Court described best efforts underwriting as not

\begin{itemize}
\item \textsuperscript{81} \textit{Id.} at 209.
\item \textsuperscript{82} \textit{Id.} at 217-20.
\item \textsuperscript{83} \textit{Id.} at 220-21 (citing Investment Co. Inst. v. Camp, 401 U.S. 617, 634 (1971)).
\item \textsuperscript{84} \textit{Id.} 12 C.F.R. § 225.25(b)(15) (1987) documents this limitation pursuant to the § 4(c)(8) exception to the BHCA in a regulatory provision reflecting the \textit{Schwab} holding. 12 C.F.R. § 225.25(b)(15) (1987).
\item \textsuperscript{85} \textit{Schwab}, 468 U.S. at 217.
\item \textsuperscript{86} \textit{Id.} at 217 & n.16, 220-21.
\item \textsuperscript{87} \textit{Id.} at 220-21.
\item \textsuperscript{88} \textit{Id.}
\item \textsuperscript{89} \textit{Id.} at 217 n.17. The opinion stated that:
\begin{quote}
[i]n the typical distribution of securities, an underwriter purchases securities from an issuer, frequently in association with other underwriters. The distribution of these securities to the public may be effected by the underwriters alone, or in conjunction with a group of dealers who also purchase and sell the particular issue of securities as principals. Underwriters also may distribute securities under a "best efforts" agreement pursuant to which large blocks of specific issues of securities are offered to the public by the investment banker as agent for the issuer. A "best efforts" distribution
\end{quote}
\end{itemize}
technically constituting an underwriting. Because Schwab's business did not include best efforts distribution, the Court left open the issue of whether section 20 prohibited best efforts underwriting. Consequently, Schwab left open a number of logical possibilities for the Court in the future. The Court could broaden the definition of public sale to include activities such as best efforts underwriting. Alternatively, the Court could limit the definition of public sale to firm commitment underwriting, as it did in Schwab. More importantly, the Court did not exclude other alternatives. Thus, a best efforts distribution plan might not be a public sale but still could be prohibited or regulated by section 20 under subtle hazards.

The Court's articulation of substantial deference gives further credence to such a possibility. The Schwab Court expressed the foundation for its substantial deference to the Board's decision to authorize a bank holding company to acquire a nonbanking affiliate engaged principally in discount brokerage services pursuant to the section 4(c)(8) exception of the BHCA, citing Camp and Investment Company Institute as authorities. The Court would defer to the Board if the Board made a reasonable construction of the statutory language and complied with the legislative intent of the Glass-Steagall Act. Camp and Investment Company Institute defined subtle hazards as the test for compliance with the Glass-Steagall legislative intent. Thus, the Schwab Court's subtle hazards analysis corresponds to the test for consistency with the legislative intent behind the Glass-Steagall Act. On the other hand, the Schwab Court's public sale analysis corresponds to the reasonable construction of the statutory language component of substantial deference. Consequently, the Court's independent and conjunctive use of public sale analysis and subtle hazards analysis logically follows from its grounds for substantial deference. Insofar as this test is conjunctive and not

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90. Schwab, 468 U.S. at 217 n.17.
91. Id.
92. Insofar as the Court left open the issue of whether § 20 prohibited best efforts underwriting because Schwab's business did not include best efforts distribution, logically the Court could also have left open the issue of whether § 20 prohibited firm underwriting plans because Schwab's business did not include any firm commitment underwriting plans.
93. Schwab, 468 U.S. at 217 n.16.
94. Id.
95. Id.
disjunctive, any activity that did not constitute underwriting and was not expressly prohibited by the Act could nonetheless be regulated or prohibited if it failed to comply with the legislative intent of the Act by implicating a subtle hazard.

D. Prohibition Versus Regulation Under Glass-Steagall

The conjunction of the public sale analysis and the subtle hazards analysis leads to four theoretical classifications of cases. The first case is when the activity at issue does not constitute a technical underwriting and no subtle hazards exist. A second case is when the activity at issue does not constitute a technical underwriting yet subtle hazards exist. The third case is when the activity at issue constitutes a technical underwriting and no subtle hazards exist. The fourth case is when the activity at issue constitutes a technical underwriting and subtle hazards exist as well.

The unique nature of section 20 within the Glass-Steagall pantheon further complicates these hypothetical classifications of cases. The Court in Investment Company Institute noted that subtly hazardous activities by bank holding companies and their subsidiaries are more amenable to regulation under section 20, while section 16 absolutely prohibits similar activities by banks. This apparent dichotomy occurs because section 20 limits its prohibitions to cases where the affiliate engages principally in underwriting, whereas section 16 contains no such limitation. Thus, each of these four major hypothetical fact patterns results in both a regulatory and a prohibitory outcome, thereby doubling the total number of hypothetical classifications of cases.

Schwab clearly disposed of one of the fact patterns and its dual results. The activity at issue in Schwab was not a technical underwriting, no subtle hazards existed, and the activity was regulated pursuant to section 4(c)(8) of the BHCA. In addition, the Court rejected prohibition under the circumstances.

In Investment Company Institute, the Court did not construe public sale, but if it had, the Court would not have classified the investment advisory services at issue as underwriting. In fact, the absence or mitigation of the subtle hazards of underwriting distinguished the permissible investment advisory services to closed-end investment companies upheld by the Court in Investment Company Institute and the prohibited investment advisory serv-

97. 450 U.S. at 58 n.24, 60 n.26, 65-68.
98. Id.
100. Id.
ices to open-end investment companies rejected by the Court in *Camp*. The investment advisory services in *Investment Company Institute* were not underwriting because they failed to implicate the subtle hazards of underwriting to the same degree as implicated in *Camp*. Therefore, *Investment Company Institute* would fit into the classification where the activity at issue does not constitute a technical underwriting, subtle hazards exist, and regulation occurs. However, dicta in *Investment Company Institute* did not foreclose outright prohibition under similar circumstances if there are sufficient subtle hazards to exceed the principally engaged in underwriting threshold. Conversely, *Camp* fits within the classification where the activity at issue is not a technical underwriting, subtle hazards are present, and the activity at issue is prohibited. The separately legal activities of “com[ming][ing] trust funds on the one hand, and act[ing] as a managing agent on the other” implicated subtle hazards when combined into an activity tantamount to a mutual fund. Thus, *Investment Company Institute* and *Camp* cover the factual circumstances where subtle hazards are dispositive to regulation or prohibition.

This leaves the classifications where the activity at issue constitutes a technical underwriting. The Supreme Court in *Securities Industry Association v. Board of Governors of the Federal Reserve System (Bankers Trust I)* disposed of the issue of Glass-Steagall prohibition in contrast to regulation in an analogous context. It rejected a regulatory approach giving substantial discretion to the Federal Reserve Board where the statutory language of

101. 450 U.S. at 65-68.
102. *Id.* at 57-58.
104. 468 U.S. 137 (1984). The issue before the Court in *Bankers Trust I* concerned the Federal Reserve Board’s determination that a bank’s offering for sale of third-party commercial paper was not a security within the meaning of § 21. The Court disagreed, holding that commercial paper does constitute a “security” under § 21. *Id.* at 160. The Court also remanded for a finding whether the bank’s sale of third-party commercial paper does constitute underwriting. *Id.* Two years later, in *Securities Indus. Ass’n v. Board of Governors of the Fed. Reserve Sys. (Bankers Trust II)*, 807 F.2d 1052 (D.C. Cir.), *cert. denied*, 55 U.S.L.W. 3853 (U.S. June 22, 1987), the Court of Appeals for the District of Columbia Circuit reversed the district court finding on remand from the Court that the bank’s activity constituted underwriting subject to prohibition by § 21 of the Glass-Steagall Act, principally because Glass-Steagall only prohibited public offerings and not private placements. *Id.* at 1052. Thus, the principal issue on appeal concerned whether the underwriting activities at issue were subject to Glass-Steagall prohibitions. Judge Bork used subtle hazards analysis to construe the scope of the statutory language prohibiting underwriting insofar as the activity at issue clearly constituted a form of underwriting. *Id.* at 1069. In other words, Judge Bork did not use subtle hazards analysis expansively as a basis for regulating an activity that did not constitute underwriting. *Id.* Rather, he used subtle hazards analysis to narrow the scope of the express prohibitions of the Act that would appear to cover the activities at issue. See infra text accompanying notes 125-33.
Glass-Steagall expressly prohibited the activity at issue.\textsuperscript{105} While the issue before the Court in \textit{Bankers Trust I} dealt with construing commercial paper as a security within the meaning of section 21 of the Glass-Steagall Act,\textsuperscript{106} its rationale suggests that the four remaining classifications of potential cases can be collapsed into one category. Where the activity at issue is a technical underwriting, it is prohibited, not regulated, irrespective of subtle hazards analysis.\textsuperscript{107} Subtle hazards analysis is merely a means of statutory construction in the \textit{Bankers Trust I} context. Incidentally, there is no reason to extend the \textit{Bankers Trust I} rule into the classifications governed by \textit{Camp, Investment Company Institute}, and \textit{Schwab}, where the activities at issue were not technical underwritings and where subtle hazards analysis was indeed dispositive to the outcome. Limiting \textit{Bankers Trust I} in this manner is further supported by the fact that \textit{Camp} expressly viewed Glass-Steagall as a regulatory statute\textsuperscript{108} and introduced subtle hazards in this context. Viewed in this light, \textit{Camp} and \textit{Investment Company Institute} are properly seen as expansive applications of Glass-Steagall based on the subtle hazards policy concerns behind the Act. Because the literal language of the Act essentially prohibits underwriting, regulation or prohibition of an activity not constituting underwriting which nonetheless implicates subtle hazards falls within the \textit{Investment Company Institute} or \textit{Camp} authorities. On the other hand, prohibition of underwriting, notwithstanding subtle hazards, falls within the dictum of the \textit{Bankers Trust I} view of Glass-Steagall.

\textbf{E. Subtle Hazards and Glass-Steagall Legislative Reform}

The most recent legislative effort to repeal or reform Glass-Steagall focused \textit{principally} on overturning the Glass-Steagall Act within the circumstances covered by the \textit{Bankers Trust I} holding.\textsuperscript{109} The proposed reform efforts would opt for regulation instead of prohibition where the activity at issue constitutes an underwriting. However, the reform would prohibit underwriting activity where subtle hazards exist. This would eliminate the \textit{Bankers Trust I} absolute prohibition rule, by turning the decision to regulate or prohibit on the avoidance of subtle hazards.\textsuperscript{110} Furthermore, this should not affect the analytical foundations of the \textit{Camp} and \textit{Investment Company}...

\textsuperscript{105} \textit{Bankers Trust I}, 468 U.S. at 147-48.
\textsuperscript{106} \textit{Id.} at 140-41.
\textsuperscript{107} See infra text accompanying notes 165-66.
\textsuperscript{109} \textit{Draft Financial Modernization Act}, supra note 11.
\textsuperscript{110} \textit{Id.}; see also \textit{S. REP. NO. 100-305, 100th CONG., 2D SESS., 2-3, 17-18, 22, 28-29, 49-53, 121-22, 127-28, 130 (1988)} (various government officials discussing the use of “firewalls” to avoid subtle hazards).
Institute category of cases where regulation or prohibition turns on subtle hazards analysis.

Senator Proxmire's bill proposes to repeal Glass-Steagall's outright prohibitions on bank involvement in the underwriting of securities with a general authorization for bank holding companies to acquire securities affiliates. However, the bill makes this general authorization with a number of restrictions or "firewalls". This bill premises these firewalls on a desire to avoid subtle hazards. For example, one may argue that the bill's restrictions on the extension of credit by the bank holding company or bank affiliates to the securities affiliate seek to avoid the subtle hazard of shoring up the affiliate through unsound loans. One may also assert that the bill limits a bank holding company's extension of credit for the purposes of purchasing securities distributed or underwritten by its securities affiliate to avoid the subtle hazard inherent when banks "make loans to customers with the expectation that the loan [will] facilitate the purchase of stocks and securities." The same subtle hazard apparently underlies the restrictions against the securities affiliate providing customer information to the bank.

The bill also restricts a bank's investment advice involving securities underwritten by its securities affiliate. The restriction requires a bank to notify customers of the underwriting relationship of its securities affiliate. The bill premises this restriction on subtle hazard concerns with a "conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice." In addition, the bill prohibits interlocking directorates between a bank holding company and any affiliate bank. Furthermore, the bill requires disclosure of information to prevent conflicts of interest, as required by the Federal Reserve Board of Governors. The bill grounds both of these firewalls on a desire to avoid all of the conflicts of interest. Such concerns also include the subtle hazard of the bank making "its credit facilities more freely available" or making "unsound loans . . . [to] companies in whose . . . securities the

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111. See Draft Financial Modernization Act, supra note 11, § 102, at 2-13.
112. Id. at 5.
114. Draft Financial Modernization Act, supra note 11, at 6; Camp, 401 U.S. at 632 (citing S. Rep. No. 77, 73d Cong., 1st Sess. 9-10 (1931)).
115. Draft Financial Modernization Act, supra note 11, at 8.
116. Id.
118. Draft Financial Modernization Act, supra note 11, at 8.
affiliate has invested."119 The bill, one may also reason, premises the restriction against a bank providing customer information to its securities affiliate120 on avoiding the subtle hazard that "bank depositors might suffer losses on investments they purchased in reliance on the relationship between the bank and its affiliate."121

Finally, one may assume the bill bases its requirement to disclose "that the securities affiliate is not a bank"122 on avoiding the subtle hazard of impaired public confidence in the bank when its securities affiliate fares badly.123 Thus, the bill deals with virtually every subtle hazard in one way or another by the firewalls proposed in the bill, notwithstanding the view that it is purely an effort to repeal Glass-Steagall.124 An application of the above classification scheme to Senator Proxmire's bill reveals an interesting shift in focus from the broad prohibitions in the Glass-Steagall act to a more directed focus on specific firewalls meant to avoid subtle hazards. Consequently, in an era of Glass-Steagall reform in the legislative branch, the policy concerns captured by subtle hazards analysis may have become the more meaningful way of analyzing issues.

II. SUBTLE HAZARDS CHALLENGED

It is with the above discussion in mind that a contrary trend concerning Glass-Steagall analysis has emerged in the courts. In Securities Industry Association v. Board of Governors of the Federal Reserve System (Bankers Trust II),125 the United States Court of Appeals for the District of Columbia Circuit made the first challenge to the Camp, Investment Company Institute, and Schwab two-pronged formulation of the basis for substantial deference to Federal Reserve Board Glass-Steagall decisions in a section 16 context dealing with banks.126 In dictum, the Bankers Trust II court reasoned that the Supreme Court had never held that Glass-Steagall permitted or prohibited any particular banking practice based solely on subtle hazards.127 The

120. DRAFT FINANCIAL MODERNIZATION ACT, supra note 11, at 8.
121. Camp, 401 U.S. at 631 & n.24 (citing 77 CONG. REC. 4028 (1931) (statement of Rep. Fish)).
122. DRAFT FINANCIAL MODERNIZATION ACT, supra note 11, at 7.
123. Camp, 401 U.S. at 631 (citing Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency, 71 Cong., 3d Sess. 20, 237, 1063 (1931)).
124. DRAFT FINANCIAL MODERNIZATION ACT, supra note 11, at 5-8; see also supra text accompanying notes 30-38.
126. Id.; see also supra text accompanying notes 94-105.
127. 807 F.2d at 1069. The court's factual premise is worthy of challenge. In Camp, the Supreme Court prohibited bank sponsorship of mutual fund-like accounts principally based on
Bankers Trust II court further reasoned that avoidance of subtle hazards by regulation without necessarily "totally obliterat[ing] . . . [them] suffices." Therefore, although the court found that a subtle hazard existed, it still gave substantial deference to the Board's approval of Bankers Trust's (a bank) proposed placement of commercial paper issued by third parties.

The court based its decision on Chevron v. Natural Resources Defense Council, Inc. and Investment Company Institute v. Conover, which deferred to administrative decisions, in the absence of a clearly defined congressional intent. The Bankers Trust II court questioned the validity of the Camp formulation of subtle hazards because the Camp Court established the subtle hazards standard in the absence of any formulation by the responsible regulatory agency. Thus, Bankers Trust II blazed the trail for the subse-
sequent challenge to the subtle hazards analysis component of substantial deference.

The decision by the United States Court of Appeals for the District of Columbia Circuit in *NatWest* represented a significant break from prior precedent, not only because of its holding, but also because of the court's rationale. The *NatWest* court ignored the *Camp* union of powers premise to its subtle hazards analysis and undermined the independence of subtle hazards analysis from the *Schwab* public sale analysis of section 20. If followed in future cases, it has the potential to fundamentally change the nature of the relationship between the Glass-Steagall Act and BHCA.

*NatWest* applied to the Board for approval of an affiliate arrangement for providing investment advisory and brokerage services under section 4(c)(8) extensive review of the legislative history of the Glass-Steagall Act to formulate the subtle hazards standard. See *Camp*, 401 U.S. at 629-35.


135. *NatWest* applied to the Federal Reserve Board of Governors in August 1985, pursuant to § 4(c)(8) of the BHCA and § 225.23(a)(3) of regulation Y, for approval of the provision of investment advisory and brokerage services by a newly formed affiliate (the CSC), limited to institutional as opposed to retail customers. 12 U.S.C. § 1843(c)(8) (1982); 12 C.F.R. § 225.23(a)(3) (1987); Federal Reserve Board of Governors Press Release (Oct. 23, 1985).

*NatWest*'s application limited the CSC's brokerage activities to those of an agent “solely for the account of customers” and further stated that *NatWest* would “not . . . bear the financial risk” as an underwriter in the securities “it brokers or recommends.” *Id.* at 2. In addition, *NatWest*'s application provided that a portion of the CSC's investment advisory services qualify under § 2(a)(20) of the Investment Company Act of 1940. *Id.* at 1 (citing Investment Company Act of 1940, 15 U.S.C. § 80-2(20) (1982)). The definition of investment adviser in § 2(a)(20) follows:

(20) “Investment adviser” of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company, and (B) any other person who pursuant to contract with a person described in clause (A) of this paragraph regularly performs substantially all of the duties undertaken by such person described in said clause (A); but does not include (i) a person whose advise is furnished solely through uniform publications distributed to subscribers thereto, (ii) a person who furnishes only statistical and other factual information, advice regarding economic factors and trends, or advice as to occasional transactions in specific securities, but without generally furnishing advice or making recommendations regarding the purchase or sale of securities, (iii) a company furnishing such services at cost to one or more investment companies, insurance companies, or other financial institutions, (iv) any person, the character and amount of whose compensation for such services must be approved by a court, or (v) such other persons as the Commission may by rules and regulations or order determine not to be within the intent of this definition.

NatWest's application included many provisions clearly designed to avoid the hazards or subtle hazards of investment banking identified by the Supreme Court in *Camp*. Relying, in part, on these restrictions, the Board approved NatWest's application, while challenging the need for subtle hazards analysis. The Securities Industry Association (SIA)
petitioned for review of the Board's decision, challenging the approval under section 20 of the Glass-Steagall Act. The United States Court of Appeals for the District of Columbia Circuit denied the petition, giving substantial deference to the Board's decision.

The *NatWest* court exclusively grounded this deference upon its finding that the Board properly construed the meaning of public sale under section 20. The *NatWest* court did not premise this deference on the reasonableness of the Board's subtle hazards analysis. Instead, the court extended the logic of the Board's criticism of subtle hazards analysis and attempted to supply an alternative to a subtle hazards-based substantial deference, relying on dicta from *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* Under the court's rationale, one might assume that Congress did not intend to regulate any activity not falling within the literal definition of public sale in section 20. In *Chevron*, the Supreme Court held that courts must

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91. The Board reasoned that no violation of §§ 20 and 32 of the Glass-Steagall Act resulted from the formation of CSC by NatWest because the combination of investment advice and brokerage services did not constitute a public sale. *Id.* at 592-94. The Board based this conclusion on the fact that the term “public sale” in § 20 prohibits underwriting only. *Id.* Thus, brokerage and investment advisory services are not underwriting. *Id.* at 592.

The Board also questioned the logic of engaging in a subtle hazards analysis “where the activity is permissible under the literal terms of the statute.” *Id.* at 594. The Board ignored the union of powers rationale of *Camp* by focusing principally on the *Schwab* Court's use of subtle hazards analysis. As an example of a situation where the Supreme Court “has not relied on the possibility of ‘subtle hazards’ as determinative of the legality of a particular activity,” the Board again used *Schwab*. *Id.* Furthermore, the Board relied upon its earlier rationale that the proposed activities at issue were “not a public sale” as a principal reason why no subtle hazards were in fact implicated. *Id.* For example, since CSC would act “solely as agent” and not as an underwriter, its activities would not implicate any subtle hazards. *Id.* The Board reasoned that no difference existed between the discount broker in *Schwab* and the broker providing investment advice in *NatWest* in terms of their relative subtle hazards. *Id.* According to the Board, “virtually all of the potential hazards cited by the SIA” might potentially arise when a banking organization provides investment advice alone. *Id.* Finally, the Board assumed that *Investment Co. Inst.* stood for the proposition that “the provision of investment advice to an investment company does not violate the Glass-Steagall Act ... provided that the bank [providing these services] does not underwrite any issue of securities or purchase any securities of the investment company.” *Id.* at 592. In other words, the Board determined that whether or not investment advice involves underwriting, the activity expressly prohibited by the literal terms of § 20 represents the only qualifier on the legality of the independent provision of investment advisory services under Glass-Steagall. Even so, the Board expressly recognized subtle hazards analysis in its determination as the basis for the Board’s regulation of activities permissible under the terms of the Act. *Id.* at 595.

140. *NatWest*, 821 F.2d at 813.
141. *Id.* at 813-15.
142. *Id.* at 813.
defer where Congress failed to express an intent toward a particular construction and the administrative agency based its determination upon a reasonable policy.\textsuperscript{144}

The \textit{NatWest} court questioned the need for a subtle hazards analysis where the express statutory language of Glass-Steagall failed to prohibit the activity at issue.\textsuperscript{145} Furthermore, the court assumed the nonexistence of subtle hazards in any activity other than underwriting as a premise in a number of areas critical to its rationale.\textsuperscript{146} For example, the court reasoned that no salesman's stake existed in the sale of particular securities by County Services Corporation (CSC) because CSC maintained no relationship with any issuer of securities.\textsuperscript{147} The court also found no difference between discount brokerage services and full scale brokerage services that include investment advisory services to institutional customers.\textsuperscript{148} In support of this, the court determined that because \textit{Schwab} found no subtle hazards to discount brokerage services,\textsuperscript{149} it was dispositive.\textsuperscript{150} This was largely because the factual circumstances of both \textit{Schwab} and \textit{NatWest} excluded any underwriting activities.\textsuperscript{151} Finally, the court reasoned that activities sanctioned when separately conducted must also be sanctioned when combined in a union of powers.\textsuperscript{152} Thus, because section 20 failed to prohibit the separate provision of investment advisory services in \textit{Investment Company Institute} and the separate provision of discount brokerage services in \textit{Schwab}, no prohibition could exist from the union of these powers.\textsuperscript{153} Through this latter finding the \textit{NatWest} court implicitly rejected the union of powers premise of the \textit{Camp} decision.

Thus, the \textit{NatWest} court's rationale served to reframe the Glass-Steagall analysis of bank holding company activities. Under this view, the courts need not determine whether the union of powers\textsuperscript{154} implicates any subtle hazards because \textit{NatWest} essentially displaces subtle hazards analysis with the statutory construction of public sale. Thus, under the court's rationale, the issue becomes one of whether the union of these powers constitutes un-

\begin{thebibliography}{150}
\bibitem{NatWest} Id. at 816 n.8.
\bibitem{Id} Id. at 813-17.
\bibitem{Id} Id. at 816-17.
\bibitem{Id} Id.
\bibitem{NatWest} NatWest, 821 F.2d at 817.
\bibitem{Schwab} NatWest, 821 F.2d at 813-14.
\bibitem{Id} Id. at 814.
\end{thebibliography}
derwriting. The court reasoned that because underwriting constituted either purchasing securities from an issuer, or acting as the agent of an issuer, the combination of investment advice with brokerage services fell outside of the activities regulated by section 20. Thus, the NatWest court's rationale assumes that no subtle hazards arise when brokerage services and investment advisory services are combined because brokerage services and investment advisory services do not individually constitute underwriting. In other words, the court's rationale assumes that the subtle hazards of investment banking exist only in association with firm commitment underwriting.

The NatWest opinion provided two additional reasons for ignoring subtle hazards in assessing the permissibility of bank holding company activity. First, Judge Bork cited Investment Company Institute to support the proposition that no significant difference exists between investment advisory services and the traditional fiduciary functions of banks. To the court, any holding that found the combination of investment advisory and brokerage services activities to implicate subtle hazards would render unlawful investment advisory activities, including those traditionally performed by bank trust departments. Thus, Judge Bork found illegitimate any application of subtle hazards that would invalidate traditional bank services. Second, the court found no implication of subtle hazards by the addition of investment advisory services to brokerage services because CSC received commissions only on transactions executed, regardless of the investment advice provided. Therefore, according to the court, CSC's profits depended solely on the volume of shares traded and not on the sale of particular securities. Although Judge Bork rejected the use of subtle hazards analysis, he grudgingly applied it and found it nondispositive because the subtle hazards associated with a salesman's stake were not present.

Finally, the NatWest court rejected the SIA argument that Bankers Trust I required prohibition of CSC's activities, because the Glass-Steagall Act was

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156. NatWest, 821 F.2d at 814.
157. Id.
158. This is because the District of Columbia Circuit presumed not to deal with best efforts underwriting. Id. at 814 n.7.
159. Id. at 817-18 (citing Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46, 63 (1981)).
160. Id. at 817.
161. Id.
162. Id.
163. Id.
164. Id.
not a regulatory statute. Judge Bork found the facts of NatWest more comparable with the facts of Investment Company Institute than with those in Bankers Trust I where the activity at issue was expressly within the "literal language of the statute." Thus, in both Investment Company Institute and NatWest, the statute did not expressly prohibit the activities at issue. Therefore, the activities at issue in NatWest and Investment Company Institute were more amenable to regulation and not subject to the Bankers Trust I rule.

III. ARE THE DISPOSITIVE FACTS OF INVESTMENT COMPANY INSTITUTE, SCHWAB AND NATWEST REALLY IDENTICAL?

A. Substantial Deference

This Note does not question the reasonableness of the Federal Reserve Board of Governors' construction of public sale in section 20 of the Act in NatWest, particularly because the Supreme Court settled this construction in Schwab. This Note focuses on the problems with the NatWest court's attempt to ground its substantial deference exclusively on the construction of public sale. Apparently, the NatWest court assumed that the construction of public sale in section 20 was dispositive as to the outcome of its subtle hazards analysis. This approach apparently views subtle hazards analysis as superfluous.

The Supreme Court has not yet expressly overturned subtle hazards analysis. Under precedent existing prior to NatWest, courts must base substantial deference to Board determinations upon the two-pronged analysis of the Camp to Schwab cases. First, the Board must reasonably construe the pertinent Glass-Steagall provision. Schwab limits the prohibitions of section 20 to firm commitment underwriting and leaves open the possibility of

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165. Id. at 818 (citing Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys. (Bankers Trust I), 468 U.S. 117, 137 (1984)).
166. Id.
167. Id.
169. 821 F.2d at 813-14.
171. 821 F.2d at 813.
172. Id. at 816-18.
173. Id.
175. Schwab, 468 U.S. at 217.
best efforts underwriting.\textsuperscript{176} Second, the Board must reasonably apply a subtle hazards analysis in support of its regulation of the activity under Glass-Steagall.\textsuperscript{177}

However, the NatWest court essentially extends the logic of Bankers Trust II \textsuperscript{178} and the Board’s reasoning in its NatWest decision\textsuperscript{179} when it expressly assumes that courts may ground substantial deference exclusively on reasonable construction of the meaning of public sale in section 20\textsuperscript{180} and when it later reasons that NatWest’s proposed activities do not implicate subtle hazards because these activities are not the public sale prohibited in section 20.\textsuperscript{181} Bankers Trust II questioned the weight accorded to the Camp subtle hazards and the sufficiency of subtle hazards as a condition for permitting or prohibiting any activities under the Glass-Steagall Act.\textsuperscript{182} Likewise, the Board in National Westminster Bank, PLC, argued that subtle hazards have never determined the legality of an activity not expressly prohibited by the literal terms of the Glass-Steagall Act.\textsuperscript{183} However, the fact that an activity is not defined expressly within a reasonable construction of the literal terms of prohibition of the Act has never by itself caused the Supreme Court to hold that Glass-Steagall permits the activity.\textsuperscript{184} The Court has held that grounds for substantial deference are conjunctive, not disjunctive, including: (1) reasonable construction of statutory terms and (2) subtle hazards analysis as to the congressional intent.\textsuperscript{185} Furthermore, the Supreme Court deferred to Board regulation of investment advisory services in Investment Company Institute under the rubric of subtle hazards analysis without determining whether or not the Act expressly prohibited investment advisory services.\textsuperscript{186}

The Court has also assumed that there are subtle hazards to activities that are not underwriting.\textsuperscript{187} In Schwab, the Court accepted the possibility that

\textsuperscript{176} Id. at 217-19.

\textsuperscript{177} Id. at 217; Investment Co. Inst., 450 U.S. at 68; Camp, 401 U.S. at 627-28.


\textsuperscript{181} Id. at 817.

\textsuperscript{182} 807 F.2d at 1069.


\textsuperscript{185} Schwab, 468 U.S. at 217.

\textsuperscript{186} 450 U.S. at 60.

\textsuperscript{187} Id. at 65-68.
an activity, not technically an underwriting, could nonetheless implicate the subtle hazards of underwriting.\textsuperscript{188} Therefore, the fact that subtle hazards is not a sufficient condition for legality of a particular activity\textsuperscript{189} does not mean that it is not a necessary condition for legality. The Board and Supreme Court have either prohibited or regulated investment advisory services in different contexts based upon the subtle hazards implicated by the proposed services at issue.\textsuperscript{190} This regulation or prohibition has occurred notwithstanding the determination that investment advisory services may not necessarily constitute the underwriting of securities. Therefore, it is erroneous under present law for the \textit{NatWest} court to ground its substantial deference on only the first prong of the substantial deference test.\textsuperscript{191}

\textbf{B. Investment Advisory Services}

Judge Bork oversimplified \textit{Investment Company Institute} when he asserted the legality of the separate provision of investment advisory services\textsuperscript{192} under section 20. \textit{Investment Company Institute} does not stand for the proposition that the independent provision of investment advice is not prohibited by section 20\textsuperscript{193} because investment advice does not constitute the public sale\textsuperscript{194} of securities. \textit{Investment Company Institute} did not construe public sale when it engaged in subtle hazards analysis of a Federal Reserve Board regulation.\textsuperscript{195} Rather, \textit{Investment Company Institute} assumed that in some cases the Glass-Steagall Act may prohibit the individual provision of investment advice.\textsuperscript{196} For example, the Glass-Steagall Act arguably prohibits investment advice of bank holding companies and their affiliates to mutual

\textsuperscript{188} 468 U.S. at 217 n.17.
\textsuperscript{190} \textit{Investment Co. Inst.}, 450 U.S. at 66-68.
\textsuperscript{191} 821 F.2d at 813.
\textsuperscript{192} \textit{Id.} at 813-14 (discussing the \textit{Investment Co. Inst.} case).
\textsuperscript{193} 450 U.S. at 46.
\textsuperscript{194} \textit{But see NatWest}, 821 F.2d at 813-14.
\textsuperscript{195} 450 U.S. at 66-69.
\textsuperscript{196} \textit{Id.} at 65-66.
funds (open-end investment companies) for two reasons. First, the Board regulation at issue in *Investment Company Institute* limited itself to investment advisory services in the closed-end investment company context. Second, *Camp* rejected the OCC regulation sanctioning bank operation of an activity tantamount to an open-end investment company. The *Investment Company Institute* Court distinguished its upholding of the Board regulation from *Camp* on the basis that subtle hazards associated with a bank’s investment advisory services in an open-end investment company context were absent when an affiliate limited its investment advisory services to the closed-end investment company context.

The *Investment Company Institute* Court reasoned that investment advisors to closed-end investment companies are not principally engaged in the underwriting of securities because the activity implicates none of the subtle hazards or policies behind section 20. Principally, the advisory fee earned by the “adviser to a closed-end company increases only if the value of the investment portfolio increases” whereas the “fee of the adviser to a mutual fund increases both with the increase in value of the investment portfolio and through the sale of the company’s shares.” Therefore, “[t]he advisory fee earned by the bank would provide little incentive to the bank or its holding company to engage in promotional activities” when limited to the closed-end investment company context. Thus, the implication remained that investment advisory services provided under some other arrangement, such as investment advisors to open-end investment companies, could in fact exceed the principally engaged threshold and, thereby, fall within the prohibition of section 20.

The Court in *Investment Company Institute* did not make much of the fact that the investment advisory services involved a bank holding company context as compared with the bank context of *Camp*. The Court distinguished the cases based on their subtle hazards analyses and not on the difference between bank holding company and bank regulation under the Act. At the least, Judge Bork’s interpretation of *Investment Company Institute* is subject to question when he asserts that it stands for the proposition that investment advice in all contexts is permissible. The most Judge Bork can

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197. *Id.*
198. *Id.* at 49-51, 65-68.
200. 450 U.S. at 65-68.
201. *Id.* at 67 & n.40 (emphasis added).
202. *Id.* (emphasis added).
203. *Id.*
204. *Id.* at 65-68.
205. Securities Indus. Ass’n v. Board of Governors of Fed. Reserve Sys. (NatWest), 821
assert is that the Court has not yet rendered a holding on investment advisory services to open-end investment companies in a bank holding company act context. However, given the readiness of the Court to apply subtle hazards analysis freely in the bank holding context from Investment Company Institute to Schwab, the more reasonable textual reading of Investment Company Institute may be the limited one of this Note. Thus, Investment Company Institute is insufficient authority to support CSC's investment advisory services, even when separated from brokerage services, because the investment advisory services in NatWest are not limited to the closed-end investment company circumstances governed by the Investment Company Institute holding.206

C. “Closely Related” to Banking and “Subtle Hazards” Analyses

Judge Bork also used the Investment Company Institute analysis of investment advisory services to state that combined brokerage and investment advisory services do not differ significantly from the “traditional fiduciary functions” of banks.207 From this he concluded, first, that combined brokerage and investment advisory services were not the public sale of securities prohibited by section 20. Second, he concluded that combined brokerage and investment advisory services did not implicate any subtle hazards.209 In Investment Company Institute, the Court argued that the services of investment advice were not “significantly different from the traditional fiduciary” functions of banks for the purposes of finding investment advisory services as closely related to banking210 in a section 4(c)(8) context.211 The fact that investment advice closely relates to banking does not necessarily mean that

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208. NatWest, 821 F.2d at 814.
209. Id. at 817. Of course, this second argument is from Justice Blackmun’s uncited dissent in Investment Co. Inst. v. Camp, 401 U.S. 617, 644-45 (1971) (Blackmun, J., dissenting). Judge Bork did not give credit to Justice Blackmun for this argument. Instead, the District of Columbia Circuit in NatWest cited the dicta in Investment Co. Inst. NatWest, 821 F.2d at 817-18 (citing Investment Co. Inst., 450 U.S. at 63). However, the applicability of Justice Blackmun’s rationale to a bank holding company or affiliate context is questionable insofar as he framed his dissent in the context of activities proposed for banks. Camp, 401 U.S. at 644-45 (Blackmun, J., dissenting). The argument is certainly stronger in the context of comparing services proposed for banks than it would be in the NatWest context of services proposed for bank holding companies and affiliates. See supra note 45 and accompanying text.
210. 450 U.S. at 55-58.
section 20 always authorizes investment advice by a bank. Nor does this
negate the existence of any subtle hazards when investment advisory services
combine with brokerage services. Consequently, the Investment Company
Institute Court further stated that even though investment advice is closely
related to banking in satisfaction of the two-part section 4(c)(8) test, the
Board would have to evaluate each application to determine if the proposed
activity constituted a "proper incident to banking." This independent ex-
amination would assure that an affiliate "does not exceed the bounds of
traditional fiduciary functions of managing customer accounts." Judge
Bork's interpretation of Investment Company Institute implied there was no
need for this second step of analysis. He assumed from the close relationship
of investment advisory services and brokerage services to banking, that an
affiliate engaged in these services would never "exceed the bounds of tradi-
tional fiduciary functions." In other words, he collapsed the closely re-
lated to banking and proper incident to banking tests when he interpreted
Investment Company Institute in this manner. While there are indeed simi-
larities between the Glass-Steagall Act and the BHCA, it is unprecedented
and confusing for the NatWest court to transport the Investment Company
Institute Court's closely related to banking analysis under the BHCA to re-
solve Glass-Steagall issues such as the existence or nonexistence of subtle
hazards. The Court in Investment Company Institute considered Glass-Steag-
gall concerns to be unresolved by the closely related to banking analysis in
support of the Board regulation. It viewed the regulation upheld by the
closely related test as merely a preliminary authorization subject to subse-
quent proper incident to banking analysis. The Investment Company In-
stitute Court expressly contemplated Glass-Steagall and subtle hazards
challenges as inherent in the "proper incident to banking" determinations of
the Board.

Furthermore, the Board and the Supreme Court have found subtle
hazards where an activity is closely related to banking. The Board's miti-
gation, through regulation, of the hazards in Investment Company Institute
does not disprove their existence. Likewise, the Camp Court majority

213. Id. at 817.
214. 450 U.S. at 57.
215. Id. at 57-58.
217. 450 U.S. at 57.
218. Id. at 64.
219. Id. at 57-58, 64, 68.
220. Id. at 67.
221. Id. at 67 n.39.
found subtle hazards in the management of mutual fund accounts by a bank, a service described by the *Camp* dissent as a traditional fiduciary function of banks. Thus, it is erroneous for Judge Bork to argue that traditional fiduciary functions of banks or activities closely related to banking by definition raise no subtle hazards.

D. NatWest and Schwab

Judge Bork reasoned that *Schwab* was dispositive of *NatWest*. He frequently used *Schwab* as a rationale for the nonexistence of subtle hazards in CSC's proposed activities. *Schwab* certainly was dispositive as to the reasonableness of the Board's construction of public sale in section 20, but it did not dispose of the outcome of the *NatWest* subtle hazards analysis, particularly because *Schwab* only considered discount brokerage services and not the subtle hazards of investment advisory services.

*Schwab* construed all of the terms of prohibition in section 20 to limit them to firm-commitment underwriting. However, the case expressly left open the issue of the status of best efforts underwriting in section 20. If the *Schwab* construction of public sale indeed disposed of subtle hazards in *NatWest*, then only firm commitment, and perhaps best efforts, underwriting would ever implicate any subtle hazards. This would ignore the fact that *Schwab* engaged in subtle hazards analysis even though it accepted that *Schwab* would not underwrite securities.

Judge Bork managed to analyze the outcome of subtle hazards analysis in *NatWest* as virtually identical to *Schwab* by introducing a new argument for the absence of subtle hazards. The discount brokerage subsidiary in *Schwab* did not underwrite. CSC in *NatWest* did not underwrite. Thus, the

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224. Id. at 817.
225. Id. at 813-14.
226. But see id. at 817 (stating *Schwab* "is dispositive with respect to the nonexistence of any 'subtle hazards'").
230. 821 F.2d at 817.
231. 468 U.S. at 220-21.
232. Id. at 217.
233. 821 F.2d at 814, 817.
common denominator in the different factual circumstances of these cases was the absence of any relationship between Schwab or CSC on the one hand, and any issuer of securities, on the other. The next step implicit in Judge Bork’s analysis reveals the danger of making inductive generalizations from one particular. There were no subtle hazards in Schwab; therefore, Judge Bork might argue, there were no subtle hazards in NatWest. This conclusion is implicit in Bork’s argument that the absence of a relationship with an issuer negates a particular subtle hazard.

A review of the Camp Court’s discussion of subtle hazards does not support such a simple formula. How can one a priori assume that “the conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice” will only occur in a firm underwriting context? The Continental Illinois National Bank bail-out of its subsidiary in the wake of the October 1987 stock market crash clearly undermines the notion that banks will only “shore up . . . [their] affiliate[s] with unsound loans” in a firm underwriting context. The investment advisory services in Investment Company Institute did not constitute underwriting. Yet the investment advisory activities at issue in Investment Company Institute implicated subtle hazards avoidable by regulatory restrictions promulgated within the framework of the BHCA. Therefore, underwriting is not the exclusive cause of all the subtle hazards of investment banking. In sum, the NatWest reduction of the subtle hazards of Camp to this single test is highly questionable in the absence of any technical study, testimony, or legislative history to support such a reduction.

1. Is Best Efforts Underwriting an Open Issue?

The absence of a relationship with an issuer cannot be a reason for the absence of subtle hazards in NatWest if the legality of best efforts underwriting is truly left an open issue. On the one hand, the NatWest court presumed not to articulate any dictum on the legality of “best efforts underwriting” by CSC, particularly because the Schwab Court had expressly left the door open to challenging the legality of best efforts underwriting. On the other
hand, it reasoned that CSC's activities would not implicate the subtle hazards of a salesman's stake in the sale of particular securities because "CSC [would] have no relationship with any issuer." Judge Bork also reasoned that there would be "no relationship with the issuer" because CSC would act neither as a firm commitment nor a best efforts underwriter.

This results in an inconsistency within Judge Bork's opinion. On the one hand, the logic of NatWest entails that best efforts underwriting implicates the subtle hazards of underwriting because best efforts underwriting by definition involves a relationship with an issuer. On the other hand, the NatWest opinion purported to leave open the issue as to the legality of best efforts underwriting. If best efforts underwriting is later held to be legal in section 20 contexts, then the absence of a relationship with an issuer cannot be a reason for the absence of a salesman's stake in the sale of particular securities.

2. Relationship with Issuer in NatWest

Another inconsistency in Judge Bork's opinion concerned his assertion that "CSC will have no relationship with any issuer." This is one of the principal reasons he advanced in support of his rationale that CSC's proposed activities did not implicate the subtle hazards of underwriting. Judge Bork's assertion is belied by the Federal Reserve Board's regulation of the relationship between CSC and any "member of the NatWest Group" that is a "counterparty (as principal)" to a securities transaction brokered by CSC.

When the Federal Reserve Board imposed additional restrictions on NatWest's application, which required that CSC inform its customers and obtain their consent to any brokerage transaction within this relationship, the Federal Reserve Board implicitly recognized several aspects of this relationship. First, the potential existed for imputation of relationships between other NatWest affiliates and issuers to CSC. Second, this relationship required additional restrictions to avoid implication of subtle hazards. In this case, the subtle hazards might consist of having a promotional interest, which "conflicted" with CSC's provision of "disinterested investment ad-

241. NatWest, 821 F.2d at 817.
242. Id. at 814.
243. Id. at 814, 817.
244. Id. at 817.
245. Id. at 812 n.4.
246. Id.
service.” If CSC were to have a “promotional interest” in the sale of securities by virtue of its investment advisory services, then Judge Bork’s premise, that only underwriting implicates “subtle hazards,” would prove clearly unfounded.

3. Schwab Holding Limitations

Even if the premise were true that “CSC will have no relationship with any issuer,” the conclusion that this necessarily negates any subtle hazards associated with NatWest having a salesman’s stake in the sale of particular securities does not automatically follow. Even if “the decision in Schwab [were] dispositive with respect to the nonexistence of any ‘subtle hazards,’” the purported absence of any relationship between CSC and any issuer by itself, would not sufficiently dispose of any subtle hazards. The Supreme Court in Schwab reasoned that trading “only as an agent” did not implicate the subtle hazards of underwriting because an agent’s “assets are not subject to the vagueries of the securities market.” In Schwab, the Court used trading “only as an agent” of a customer merely as a description of the discount brokerage services at issue. This is functionally equivalent to the NatWest phraseology of having no “relationship with any issuer.” The Schwab Court did not use this description of the discount brokerage services at issue as a reason for denying the existence of any subtle hazards. The Schwab Court’s express limitation of its holding to discount brokerage services, exclusive of investment advisory services, is consistent with this interpretation. Furthermore, if trading only as an agent explained the absence of subtle hazards in Schwab, then Judge Bork is correct that subtle hazards analysis is superfluous; but the Schwab Court did not overturn subtle hazards analysis. The Court did not hold that trading as an agent in all contexts never implicates any subtle hazards. Instead, the real reason the Court found discount brokerage services (or trading only as an agent) not to implicate subtle hazards was that the broker’s profits did not vary with the performance of particular securities. When Judge Bork

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248. NatWest, 821 F.2d at 817.
249. Id.
251. Id.
252. 821 F.2d at 814, 817.
254. Id. at 221.
255. Id. at 220-21.
256. Id. at 220.
used brokerage services as a talisman to automatically negate the subtle hazards previously identified with investment advisory services, he begged the question whether anything implicates a subtle hazard when it is combined with brokerage services. The NatWest court did not support its assumption that subtle hazards analysis would not distinguish discount brokerage services and combined brokerage and advisory services. The absence of a relationship with any issuer does not explain why NatWest does not implicate the promotional incentives of investment banking.

4. NatWest's Profits and Subtle Hazards

The NatWest court attempted to buttress the argument that subtle hazards only result from underwriting with the real reason the Schwab Court found no subtle hazards for discount brokerage services: "Schwab's profits" depended "solely on the volume of shares" it traded "and not on the purchase or sale of particular securities." Thus, in NatWest, Judge Bork appeared to make the same analysis when he stated that "CSC's profits will depend on the volume of shares it trades and not on the sale of particular securities . . . because CSC will receive a commission only on transactions it executes, regardless of whether CSC advised the customer to purchase the security or whether the customer followed that advice." Essentially, Judge Bork stated that all of CSC's profits will result from its brokerage services, and none of CSC's profits will result from its investment advisory services, because CSC's profits result solely from commissions on brokerage transactions.

First, Judge Bork ignored the Investment Company Institute distinction between investment advisory services in the closed-end investment company and open-end investment company contexts with respect to this subtle hazard: "the fee of the advisor to a mutual fund [open-end investment company] increases with . . . the sale of the company's shares" whereas the "advisory fee . . . to a closed-end investment company increases only if the value of the investment portfolio increases." Instead of arguing that Schwab completely disposed of this subtle hazard in NatWest, the court

258. 821 F.2d at 815-18.
259. Id. at 817.
260. 468 U.S. at 220.
261. 821 F.2d at 817.
should have used the Investment Company Institute distinction to question the assumption of the Board that this particular subtle hazard did not arise in NatWest. This is particularly the case because the NatWest application for investment advisory services did not limit the affiliate to the closed-end investment company activity of the Investment Company Institute holding.\textsuperscript{263}

Second, the assumption that the factual context of brokerage plus investment advisory services in NatWest was the same as the discount brokerage services in Schwab was questionable from another standpoint. If, in fact, CSC's profits result exclusively from its brokerage commissions and not from its investment advisory services, then CSC would not qualify as an investment advisor under section 2(a)(20) of the Investment Company Act.\textsuperscript{264} Section 2(a)(20)(iii) specifically excludes from its definition of investment advisor any "company furnishing such services at cost."\textsuperscript{265} However, NatWest's application stated that CSC would act as an investment adviser under section 2(a)(20).\textsuperscript{266} Therefore, CSC would indeed profit from its investment advisory services, exclusive of its brokerage services. In addition, the notion that CSC's profits or financial incentives resulted only from brokerage services\textsuperscript{267} was further belied by the fact that "CSC would charge separate fees for investment advice and brokerage services upon request of a customer."\textsuperscript{268} To argue that the billing practice of combining these fees coordinated the facts of NatWest with the facts of Schwab would argue form over substance.

E. Union of Powers and Subtle Hazards Analyses

The Camp Court specifically introduced subtle hazards analysis in a union of powers context, where separately legal activities were found to nonetheless become illegal when combined because their combination implicated subtle hazards.\textsuperscript{269} Therefore, when the NatWest court first argued that separately legal activities, such as investment advisory services and brokerage services, remained legal when combined together, it assumed that no subtle hazards existed. If the NatWest court truly adhered to the substance and not merely the form of Camp to Schwab subtle hazards analysis, it could not

\textsuperscript{263} NatWest, 821 F.2d at 813-14, 817.
\textsuperscript{265} Id.; see also supra note 135 and accompanying text.
\textsuperscript{266} NatWest, 821 F.2d at 811 & n.3.
\textsuperscript{268} NatWest, 821 F.2d at 812; see also National Westminster Bank PLC, 72 Fed. Res. Bull. at 585.
expressly deny, as it did, the Camp Court’s union of powers premise for its introduction of subtle hazards analysis. The union of powers rationale and subtle hazards analysis were so inherently linked together that, to ignore union of powers while purporting to engage in subtle hazards analysis, and then to later deny the viability of subtle hazards analysis, engaged in a circular argument against the viability of both. NatWest essentially assumed that there were no subtle hazards because the union of powers analysis could be ignored; conversely, it also assumed that union of powers analysis could be ignored because there were no subtle hazards to a combination of legal activities. A further inductive leap that such circular reasoning encourages is that the absence of any subtle hazards in the particular union of powers context of NatWest implies that there will never be any subtle hazards in any other union of powers contexts. Thus, by merely inventing new services and combinations of services, the denial of union of powers and subtle hazards would safely limit the scope of Glass-Steagall prohibitions to those services expressly prohibited by the 1933 statute. This in effect would roll back or repeal the Glass-Steagall Act by freezing it in time.

IV. CONCLUSION

While the absolute prohibition of bank holding company involvement in specified securities services under Glass-Steagall may be crumbling away, some form of regulation premised on the policy concerns behind Glass-Steagall should remain. Subtle hazards analysis has formed the rubric for articulating the policy concerns behind the Glass-Steagall Act. Consequently, subtle hazards and union of powers analysis have often served as the vehicles for testing the adequacy of regulatory restrictions premised on Glass-Steagall concerns within the framework of the BHCA. Current legislative reform efforts that would generally authorize the security activities proscribed under the Glass-Steagall Act to bank holding companies have used exceptions, arguably premised on these same subtle hazards, to limit the scope of the proposed general authorization to engage in underwriting.

The NatWest court’s attempt to undermine subtle hazards analysis by fo-

270. NatWest, 821 F.2d at 813-17.
271. Id.
272. However, critical terms of the Glass-Steagall Act are not precise, and, in practice, there is no consensus on exactly what it permits or prohibits, particularly for commercial banks. . . . A number of financial services firms now are able to offer fully integrated commercial and investment banking services by creatively combining products and services.

cusing exclusively on statutory construction of the Glass-Steagall Act is a movement in the wrong direction. The statutory landscape may change, but the policy issues persist. NatWest gets lost in the statutory landscape of the 1933 prohibitory language of the Glass-Steagall Act, while ignoring and distorting the subtle hazards policy issues behind it. The subtle hazards policy concerns are more relevant to the regulatory orientation today than exercises in narrowing or broadening the literal construction of underwriting prohibited by the 1933 Act. Glass-Steagall as a prohibitory mechanism may be dead, but its widow, subtle hazards, remains, even if it changes its name.

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