United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

January 30, 1987

The Honorable Paul A. Volcker
Chairman
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Chairman Volcker:

In your testimony before the Committee on January 21, 1987, you stated that the Board will act soon on applications by Citicorp and other bank holding companies to underwrite municipal revenue bonds, commercial paper, mortgage-backed securities, and securities representing an interest in consumer debt, pursuant to section 4(c)(8) of the Bank Holding Company Act ("BHC Act").

I write to state my conviction that the Board lacks authority to approve those applications.

The applicants each control a bank that is a member of the Federal Reserve System. Accordingly, section 20 of the Glass-Steagall Act prohibits the applicants from controlling any company "engaged principally in the issue, flotation, underwriting, public sale, or distribution . . . of stocks, bonds, debentures, notes or other securities." The applicants contend that that prohibition would not encompass a company that would underwrite the securities in question as long as the company were principally engaged in other activities, which--according to the applicants --could include underwriting eligible securities. (By "eligible securities," I mean securities of the types that member banks are allowed to underwrite pursuant to sections 16 and 21 of the Glass-Steagall Act; by "ineligible securities," I mean all other securities.)

The clear and overriding intent of the Congress in enacting the Glass-Steagall Act was to prohibit banks from underwriting ineligible securities, whether directly or through affiliates. That intent was well understood in 1933, and no one doubted that the Act carried it into effect. Banks promptly divested or dissolved their security affiliates; no bank attempted to continue underwriting securities through an affiliate on the theory that the affiliate was not principally engaged in underwriting.

The applications at issue here fly in the face of that Congressional intent. They would allow the applicants to make a regular and (in both relative and absolute terms) a substantial business of underwriting ineligible securities. Even if the Board imposed percentage limitations such as those in Bankers Trust New York Corporation (Dec. 24, 1986), I

believe that approval of the applications would contravene the intent of section 20 and render that section a toothless tiger. "To say that a securities firm ranking [as the applicants would] among the leading investment bankers of the country with respect to . . . . [the securities in question] . . . should be held beyond the scope of the statute is," in the Board's own words, "to say that Congress enacted a statute with the intention that it would apply to no one"--or at least not to large banking organizations. Board of Governors v. Agnew, 329 U.S. 441, 451 (1947) (Rutledge, J., dissenting) (quoting from the Board's discussion of "primarily engaged" in section 32 of the Glass-Steagall Act).

By its own terms, section 20 prohibits the applicants from controlling any company that is principally engaged in underwriting "securities." The section provides no exception for underwriting eligible securities; it applies to all securities, whether eligible or ineligible. Thus, in determining whether a company is principally engaged in underwriting or other activities proscribed by section 20, the company's eligible securities activities count toward the numerator of proscribed activities, and not merely toward the denominator of total activities. The affiliate's eligible securities activities cannot be used as a springboard for underwriting ineligible securities.

Finally, I believe that the Board lacks authority under section 4(c)(8) of the BHC Act to approve the activities in question. The Congress adopted that Act on the assumption--then universally accepted--that the Glass-Steagall Act prohibits affiliates of member banks from underwriting securities. The Congress never intended to give the Board authority to permit such underwriting. Neither the original BHC Act nor any amendment to that Act modified the prohibitions of section 20. On the contrary, the BHC Act was intended "to maintain and even to strengthen Glass-Steagall's restrictions on the relationship between commercial and investment banking." Board of Governors v. Investment Company Institute, 450 U.S. 46, 69 (1981). The Board itself has recognized that the Bank Holding Company Act Amendments of 1970, which framed the current "public benefits" test of section 4(c)(8), were not intended to weaken Glass-Steagall prohibitions. 12 C.F.R. sec. 225.125(b). Thus, in my view, section 4(c)(8) does not authorize the Board to re-weigh the public benefits and the possible adverse effects of underwriting securities; the Congress rendered its own definitive judgment on those issues in 1933. See Investment Company Institute v. Camp, 401 U.S. 617, 630 (1971); Securities Industry Association v. Board of Governors, 468 U.S. 137, 147-48, 153 (1984).

There is ample evidence that my view of Congressional intent is supported by the entire Congress. As recently as 1984, the Senate passed a bill (S. 2851) specifically authorizing bank holding companies to underwrite and deal in three of the four kinds of securities now being considered by the Board. There were many arguments as to whether bank holding companies should or should not be granted such authority. But at no time did anyone advance the theory that the Board already had authority to allow such

underwriting. Because the Board lacked such authority, the Senate moved to change the law.

Over the years, I have supported allowing bank holding companies to engage in the securities activities now being considered by the Board. Nonetheless, allowing bank holding companies to engage in those activities has raised substantial policy issues of great concern to members of Congress. Even though I personally favor changing the law to allow those powers, approval of the applications would involve a major reversal of policy that can only be effected by the Congress. Until the Congress changes the law, the Board lacks authority to permit the activities in question. Accordingly, I urge that the applications be denied.

Sincerely,

William Proxmire
Chairman