OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 83-614

TITLE SECURITIES INDUSTRY ASSOCIATION, Petitioner v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ET AL.

PLACE Washington, D. C.

DATE April 24, 1984

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IN THE SUPREME COURT OF THE UNITED STATES

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SECURITIES INDUSTRY ASSOCIATION :

Petitioner :

v. : No. 83-614

BOARD OF GOVERNORS OF THE :

FEDERAL RESERVE SYSTEM, ET AL. :

- -x

Washington, D.C.

Tuesday, April 24, 1984

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 12:59 o'clock p.m.

APPEARANCES:

JAMES B. WEIDNER, New York, New York; on behalf of the petitioners.

CARTER G. PHILLIPS, ESQ., Office of the Solicitor General, Department of Justice, Washingtn, D.C.; on behalf of Respondent.

C O N T E N T S

PROCEEDINGS

CHIEF JUSTICE BURGER: We will hear arguments next in Securities Industry Association against the Board of Governors of the Federal Reserve.

Mr. Weidner, you may proceed whenever you are ready.

ORAL ARGUMENT OF JAMES B. WEIDNER, ESQ.

ON BEHALF OF THE PETITIONER

MR. WEIDNER: Mr. Chief Justice, may it please the Court. This case involves an admittedly unprecedented order of the Federal Reserve Board, reversing 50 years of administrative understanding, and industry understanding permitting bank affiliates, for the first time in half a century --

QUESTION: How can it be unprecedented if you reverse something?

MR. WEIDNER: Unprecedented in terms of reversing the understanding, but not unprecedented in terms of reversing a prior administrative ruling.

Involved are two statutes fundamental to the governing of the banking industry, and financial services industry in this country, the Bank Holding Company Act and the Glass-Steagall Act. In this case, directly contrary to congressional intent, in our view, the Board of Governors, affirmed by the Second Circuit, turned two narrow exceptions in the statutes into broad authorizations instead. We believe that the decision below should be reversed for two reasons.

First, the Bank Holding Company Act requires that any bank affiliate, which is not a bank, be involved in a business that is so closely related to banking as to be a proper incident thereto. That has been interpreted and requires that that business be closely related in the sense of being -- of having a direct and significant connection to banking, and not similar -- not simply being related to it in the sense of being functionally similar, which is what the Board found.

Secondly, we believe that the Glass-Steagall Act prevents any affiliation of a bank with an entity that is principally engaged in the public securities business, and that is the business in which the affiliate here involved is here involved.

Briefly, the facts are these: In early 1982, the BankAmerica Corporation, owner of BankAmerica, one of the largest banks in the world, applied to the Federal Reserve Board for permission to acquire the Charles Schwab Corporation. Schwab is the owner of one of the largest, if not the largest discount brokers in the United States.

The SIA, our client, opposed the application and requested a hearing. The Federal Reserve Board ordered a hearing before an Administrative Law Judge. The Law Judge ruled in favor of the proposed acquisition. The Second Circuit affirmed.

If I may, let me first address the Bank Holding Company Act. That Act was passed in 1956 to further the basic congressional purpose of separating banking from commerce in general. By that Act, Congress said that banks will not evade that separation through the structure of a bank holding company, and said that a bank holding company could not acquire a non-banking subsidiary unless -- a very narrow exception -- that subsidiary's business was so closely related to the business of banking to be a proper incident thereto.

The Board of Governors interpreted that statute for the next decade as requiring a direct and significant connection between the proposed activity of the subsidiary and the activity of the bank holding company itself.

In 1969, the Board asked Congress to amend the statute to loosen up the standard. They found it to be too restrictive. What they proposed was that the closely related standard be changed to read "functionally related," and that the phase "the business of" be deleted from the phrase "closely related to the business of banking."

The House and the Senate both passed bills, which in fact did substitute "functionally related" for "closely related," but there were significant differences between those bills. One of the most significant differences was that the House said: We will put functionally related in, but we are also going to have what became known as a laundry list of prohibited activities that in no case will be deemed closely related to banking.

The result was a conference committee, of course, and what can only be described as a legislative Donnybrook. Clearly there was a battle in the Conference Committee as to which view would prevail. In fact, the compromise was reached only after a virtual stalemate. The obvious deal that was cut was this:

The Conference agreed to leave out "the business of" from the "business of banking," but in return for that, and in return for the House members deleting their laundry list of prohibited activities, the proposed functionally related test was out and the original "closely related" language was left in the statute.

A review of the legislative history makes clear -- It is a little bit difficult to discern all of the ramifications of what happened, but one thing, I believe, is absolutely clear from the legislative history, and that is that Congress did not substitute "functionally related" for "closely related" in the statute.

The Congressional Report -- The Conference Committee Report makes clear that the Board was given greater flexibility in the sense that by deleting "the business of" from the statute, no longer did a connection a connection have to be shown between the specific holding company and the proposed activity, but that a direct and significant connection continued to be required between banking in general and the proposed activity. That is the connection that could not be found here.

The specific business that is at issue is execution of securities trade for the public. That is a business that banks have not been in for the last 50 years. It was not on the basis that banks generally have been in the business that the Board found, or could find this acquisition to be permissible. Instead, the Board found it permissible because, in its view, the activities involved here were functionally similar to other activities performed by banks, so that at least some banks were well-equipped to perform them.

I suggest what has happened is that the Board -- This is not a mere matter of interpretation. The Board has in fact put back in the statute exactly the language that the Congress refused to accept. We have a Board, in effect, amendment of statute directly contrary to legislative intent. It is not simply that it is contrary to legislative intent, but I suggest, if anything, "functionally similar" is even broader than "functionally related."

For example, if all that is necessary to be shown is that the bank, or at least some banks have the capacity to perform some activity and, therefore, it is closely related. Banks have the capacity and do execute wire transfers. Then why couldn't it be argued that they should be able to go into the telecommunications business, and that is not a farfetched example.

The American Bankers Association -- this is in our brief -- has in fact asked the Federal Reserve Board to approve, as a bank affiliate activity, telecommunication services. It seems to me that the next thing we are going to hear is that because banks have dispensed toaster and calculators to get depositors to put money in the bank, then they can go into the retail toaster business. In a more serious vein, I really do believe that this is virtually a limitless standard.

The Board has pointed to this Court's decision in what we have called ICI-2 as authority for its standard. But the fact it, the activity involved there, investment advice to a closed and mutual fund, was an activity that banks had done for 50 years. Indeed, this Court specifically said that in looking at future applications, the Board was to assure that the bank affiliate did not exceed bank's traditional fiduciary functions.

In this case, however, there is no doubt that securities execution is not a traditional banking function.

QUESTION: Although it is for customers.

MR. WEIDNER: I am sorry.

QUESTION: It certainly is for customers of the bank.

MR. WEIDNER: Securities execution?

QUESTION: Sure.

MR. WEIDNER: No, Justice O'Connor, I don't believe that it is. To the extent that banks have had an involvement in "brokerage" through the years, their involvement has simply been to accommodate orders of bank customers to sell stock or securities. But in doing that, they have uniformly forwarded the orders to brokers for execution.

There is a significant difference here because a broker who executes a trade puts his net capital on the line every time he does that. In other words, whether it is one time a day or 100,000 times a day, each time that trade executed that broker has got to come up with the securities or cash to make good in the trade. If his customer doesn't have it, the broker has got to come up with the money or the securities.

It is for that reason -- Turning to Glass-Steagall just for a moment, because I think it does respond to your question, although it is not in the Bank Holding Company Act. The Glass-Steagall Act was amended, and I will return to this, to limit bank securities activities to purchasing and selling, without recourse upon the order and for the account of customers.

The question is what does "without reccurse" mean? This Court addressed -- In its technical sense, it means without endorsement or guarantee. But this Court that specific requirement in the Awotin case, and expressly flatly held that without recourse, in this context, in this statute, its predecessor, is not limited solely to endorsement and guarantee because it would make any sense in terms of trading and securities, which are not typically endorsed or guaranteed. Certainly stock is not endorsed or guaranteed. It said it had a broader meaning.

Then the question is, what is the analogous liability that a broker might face to a third party, if it is not endorsement or guarantee? The analogous liability is exactly the risk of customer fails. The broker has got to come up with the securities or stock to the third person if his customer doesn't. It is exactly that kind of liability which we believe Congress expressly legislated against in the Glass-Steagall Act.

The way that a bank or a broker can accomplish avoiding that liability, and many brokers do, is acting as a forwarding broker, that is to say, the broker gets a securities order, forwards it to an executing broker on a so-called fully disclosed basis -- that is disclosing the name of the customer to the executing broker -- who then deals directly with the customer, account statements, confirmations, and the like. There is no recourse against the bank.

In fact, I should point out -- this is something that has happened since our reply brief was filed on the same day -- the Comptroller of Currency, in a proposed rulemaking reported at 49 Federal Register

15089, has proposed regulations to deal with bank securities activities.

One of the things that the Comptroller said in that regulation a week ago was that no bank will conduct a securities business in-house, except on a fully disclosed basis, that is to say, forwarding the orders to brokers for execution, which is what banks have done on an incidental accommodation basis for years, and that, I suggest, is what the Comptroller understands "without recourse" means in the statute.

To return to where we started, no, I don't believe that banks have been in the business of executing securities orders for the public at any point until they were allowed to be affiliated with Schwab only two years ago.

QUESTION: Are you saying under the new proposed regulation that the activity considered here would be made invalid?

MR. WEIDNER: It could be performed, but only in a separate subsidiary. The bank itself could not perform it, that is correct.

If I may turn --

QUESTION: This case involves a separate subsidiary, does it not?

MR. WEIDNER: This clearly does involve a separate subsidiary, that is right, but in terms of viewing --

QUESTION: So the new regulation would not counteract this particular situation?

MR. WEIDNER: No, it would not, and I didn't mean to imply that it would. If I did, I certainly didn't mean to. It had direct relevance because a question, turning now to the Glass-Steagall Act, is exactly what did Congress mean to prohibit in that Act. In our view, without going to the background of the Glass-Steagall Act, of course, it was a reaction to the crash of '29 and the economic chaos and bank failures that followed.

In our view, Congres meant to prevent banks from doing certain securities activities entirely, and from affiliating with entities who are principally in those securities activities. The question, then, is what were banks prohibited from doing and how does that relate to their affiliates.

Perhaps I could step back just brief to 1927, because the story really start there with the McFadden Act. In 1927, Congress passed the McFadden Act, which for the first time authorized banks to deal in securities. Significantly, it authorized banks to deal only in investment securities, that is, low risk debt securities.

At no point had Congress authorized banks to deal in stock. The only thing that banks were doing at that time was, on an informal basis, accommodating customers who may have inherited some stock, or whatever, by passing along those orders to a broker for execution.

By 1933, after the chaos had occurred, Congress, in effect, realized that it had made a mistake, and in the Glass-Steagall Act withdrew the securities powers that it had granted in the McFadden Act of 1927, and said that banks shall not deal in investmetn securities, except to the limited extent of purchasing and selling, without reccurse, upon the order and for the account of their customers.

I won't return to "without recourse," but it seems to us from the face of it that it is clear that that language meant that a customer -- that a bank was merely to pass a customer's orders along for execution. But there really can't be much doubt about what was done, in our view, because immediately after the Glass-Steagall Act passed, the Comptroller of Currency, who is responsible, of course, for all national banks, said: Look, wait a minute. I think that you may have gone too far, because if you read that proviso, the exception to dealing literally, it says that a bank may accommodate only orders in investment securities, not stock, and said the Comptroller, that is pretty important in rural areas where a bank may be the only financial institution in miles. There isn't a brokerage house on the corner. Won't you clarify your intent, in effect, he said, and make it clear that banks can continue to accommodate on this informal basis orders and stock, as well.

He proposed legislation. In 1934, both the House and Senate passed bills that incorporated it, but it floundered on the last day of the session. The Comptroller then issued a rulemaking interpretation that said, in effect, in my view Congress didn't mean to prevent accommodating orders on stock. I am going to permit it and return to Congress, in effect, next year to get it expressly permitted. But, said the Comptroller in that ruling, this does not mean banks may do a brokerage business.

That was in July 1934. In August, I believe it was, or September 1934, the Federal Reserve Board ruled similarly and specifically quoted the Comptroller's language.

In 1934, the Comptroller did return to Congress, testified that in his view this was necessary to expand this exception, and made clear that it was only on an accommodation basis, and convinced Congress to expand the statute to include purchasing and selling, without recourse, on the orders, securities and stock.

Under this Court's precedent, in Zuber against Allen, it seems to me that that history itself should be controlling, if there were ambiguity, we dont' think there is, as to what Congress intended in the exception in Section 16 for accommodating stock orders.

The Comptroller proposed the legislation. He testified directly before the Congressional Committees that were considering it, what his view was, and Congress enacted what he proposed.

The respondents say, wait a minute, in 1933, the Congressional Reports that accompanied the initial Glass-Steagall Act said, "Banks shall be permitted, to the same extent heretofore, to deal in securities," therefore that shows that they were permitted to be public stockbrokers. But let's look at what happened. Banks had not been permitted prior to 1933 to broker stock, or prior to any date to broker stock. They had been permitted only to deal in investment securities.

The Comptroller made that clear, he made clear what he had in mind, that is an accommodation provision limitation during 1934 and 1935.

The '35 Amendment that added stock -- expanded the exception to add stock, was specifically characterized as a technical amendment intended to make no substantive changes in the law.

If respondents are correct that what Congress intended to do was to permit banks to be public stock brokers, it would necessarily mean that in 1935, when Congress passed a technical, non-substantive amendment to a statute, the Glass-Steagall Act, otherwise meant broadly to prohibit securities activities for banks, it authorized, for the only time in 200 years, banks to become public stockbrokers. I suggest that simply doesn't make common sense, let alone legislative history sense.

QUESTION: I thought that we were dealing here with a bank affiliate, not the bank itself. I also thought that the prohibition in Section 16, on its face, applied to banks and not the affiliates.

MR. WEIDNER: Justice O'Connor, we clearly are dealing with a bank affiliate, and let me turn to Section 20, which deals specifically with them.

Let me say this that in our view the structure and the history of the Glass-Steagall make it clear that what Congress had in mind was, given -- remember that when this was passed, given the crash and the 2,000 banks that failed in the interim, to get banks out of the securities business, and it did it by prohibiting certain activities entirely for banks, and prohibiting them principally for their affiliates.

There is no history, although this is in effect what we believe the Board and the Second Circuit have held, no history, legislative or statutory, that suggests that the Board has discretion to authorize bank affiliates to engage principally in what banks can't engage in at all. That we believe is what has happened.

I might contrast Section 20 with Section 32 that has to do with interlocks. Section 20 has to do with bank affiliations. Section 32 did vest the Board with exemptive authority over certain circumstances.

Let me turn to Section 20. As I said, that statute -- that section has to do with bank affiliations, part of the Glass-Steagall Act, and provides that a bank may not be affiliated with any entity "engaged principally in the issue, floatation, underwriting, public sale, distribution," and so on. I will come back to the language.

In our view, that language covers the waterfront in terms of activities, including public brokerage. It says, "public sale." It is a remedial statute. The statute should be construed broadly, and indeed every time this Court has assessed the Glass-Steagall Act, it has said that its provisions are indeed to be read as remedial provisions, broadly.

What the government -- the respondents say is, now wait, public brokerage wasn't covered by that because -- Let me turn to the Second Circuit first. The Second Circuit said, it is not covered because the terms apply only to principal activities, as opposed to agency activities.

Underwriting, for example, they said, is a principal activity, and so on, so brokerage is out. But the fact is that underwriting certainly encompasses, and the Board doesn't dispute, best effort underwriting. That is an agency, not a principal activity. And there is no reason why a public sale couldn't equally well be an agency as well as a principal activity.

The Board, apparently recognizing the problem in the Second Circuit opinion in that respect, doesn't support it here. They have a different view. Their view is that those terms concern themselves only with new issues of stock or the introduction of large blocks of stock to the public. In other words, public offerings.

The problem with that interpretation is what they are saying in essence is that it covers only primary distributions of stock -- the first time stock is made available to the public. If that is the case, they have just eliminated half of the securities industry from the statute. The entire secondary market where stocks are traded once they are out in public hands.

If that is the case, and that is necessarily what they are saying, that means not only could bank affiliates principally be stockbrokers, but they could be dealers, that is, trading for their own account. They can even be market-makers. Even the Federal Reserve Board has said in its amended Reg Y that dealing is not a permitted activity.

One further thing, I think, bears upon Section 20 to contrast it with Section 32, the interlock provision, which as of 1935 used the same phrase as Section 20. Its predecessor language -- the predecessor in '32 as enacted in 1933 -- said, purchasing, selling, and negotiating, not issuance, floatation, and so on. That amendment was also a technical, non-substantive amendment.

If, as the Board says, the statutory phrase now means only underwriting, then necessarily Section 32 must have meant the same thing in 1933 when it was initially passed. Then the statute falls apart, because Section 16, which we talked about before relating to agency activities, uses the terms "purchasing and selling," clearly relating to agency activity.

In other words, I think if you look at the statute as a whole, there is only one construction that makes sense and it makes sense in terms of the general congressional intent as well, that is, and if I may let me read Section 20 in its entirety, "May not affiliate with an entity principally engaged in the issue, floatation, underwriting, public sale, or distribution at wholesale or retail, or through syndicate participation of stocks, bonds, debentures, notes, or other securities."

I suggest that what Congress had in mind was covering the waterfront. It meant to prevent principal engaging at all activities, whether they are principal or agent, in all markets, whether primary or secondary, and in all securities, whether they are equity or debt. I think any other construction of that statutory phrase throws this language out of kilter and, I respectfully suggest, out the window.

In summary, we believe that the Federal Reserve Board, affirmed by the Second Circuit, was incorrect. Schwab is unquestionably principally engaged in the execution of securities trades for the public, the public securities brokerage business.

They have reached that conclusion by turning very narrow exceptions, "closely related" in the Bank Holding Company Act, "purchase and sale" in the Glass-Steagall Act, into broad authorizations instead, never intended by Congress. In effect, they are trying to turn the clock back to 1927, when Congress had permitted -- even further, to permit dealings in stock.

I suggest that if the clock is to be turned back, that is a policy decision of enormous consequences that should be addressed by Congress only, and in fact Congress is right now looking in an omnibus fashion to the financial services industry to see if and, if so, how that industry should be restructured.

I believe the decision below should be reversed.

CHIEF JUSTICE BURGER: Mr. Phillips.

ORAL ARGUMENT OF CARTER G. PHILLIPS, ESQ.

ON BEHALF OF RESPONDENT

MR. PHILLIPS: Mr. Chief Justice, and may it please the Court.

At issue in this case is the Federal Reserve Board's determination, made on the basis of an exhaustive administrative record, that the business of executing securities transactions on exchanges is closely related to banking as to be a proper incident thereto, and that such brokerage activities are not prohibited to bank holding companies or their subsidiaries by the Glass-Steagall Act.

In that regard, it is probably worthwhile to emphasize once more, as Justice O'Connor did with her question, to remember that this case concerns only a bank holding company and its subsidiary. It does not involve the bank and, therefore, precisely what banks are permitted to do, and have engaged in, in the past is not directly controlling on the outcome of this case.

Contrary to petitioner's general assertion --

QUESTION: Is that the same inquiry under the Bank Holding Company Act?

MR. PHILLIPS: Is what, I am sorry, I don't understand.

QUESTION: What did you just say?

MR. PHILLIPS: What I am suggesting is that the question of what a bank may do under Section 16 does not control what a bank holding company or its subsidiaries can do under Section 20. There is very different language.

QUESTION: It is not supposed to engage in non-banking activities, is it?

MR. PHILLIPS: Under the Bank -- Yes, it -- well, it has to be an activity that is closely related to banking, but it doesn't have to be an activity that is banking. Indeed, this Court said as much in the ICI II decision.

QUESTION: You think that it doesn't have to be an activity that a bank ever engaged in?

MR. PHILLIPS: It may not have to be an activity that it is precisely engaged in, no. But I think that if it is so closely related to banking that a bank would be perfectly well suited to engage in that form of activity that that would be fine. Especially if, as in this case, the reason why banks are not engaged in that activity are not so much dependent on the law as they are on the financial events that gave rise to the problem in the first instance.

I think that it is important to understand what the Board did here to place it in context. In the 1970s, the Securities and Exchange Commission unfixed the fees that brokers charge -- can charge on their -- for executing transactions on the stock exchanges. This pro-consumer decision led directly to the creation a new form of financial opportunity from this discount brokerage, a firm such as Schwab emerged. Prior to that time, it was generally not possible to offer fewer services for a lesser fee.

In the early 1980s, BankAmerica, realizing what an opportunity this presented, made an application to the Federal Reserve Board to acquire the Charles Schwab Discount Brokerage firm. The Board published notice of the proposed acquisition and solicited comments from the public.

You may regard it as probably worthwhile, and this will also reemphasize again that this case involves bank holding companies. It is important to note that the Securities and Exchange Commission expressly passed judgment on this particular issue, and did not oppose the acquisition of Schwab by BankAmerica's Holding Company.

QUESTION: Neither did the Comptroller.

MR. PHILLIPS: The Comptroller did not oppose either. In fact, the Comptroller very favorously affirmed that decision, frankly.

It is common for the Board to issue a 4(c)(8) order based solely on these sorts of written comment, but in this case they went the extra step and set the matter down for an extensive hearing in order to examine this new form of commercial opportunity.

First the Administrative Law Judge, and then the Board, thoroughly analyzed the history of brokerage activities undertaken by banks, compared them with the specific business of Schwab. Both the Administrative Law Judge and the Board invoked the standards that had been applied for the last ten years regarding what is closely related to business, those standards coming in the D.C. Circuit's 1975 Courier case. Both found that banks generally provide services that are operationally and functionally so similar to the proposed services as to equip them particularly well to provide that service. Both the Administrative Law Judge and the Board then engaged in the proper incident analysis and concluded that the public benefits greatly outweighed any detriments that might arise.

It is our view that procedurally and substantively, the Board's action were precisely what Congress envisioned when it rejected the House's attempt to narrowly constrain the Board's discretion in dealing with the what is closely related to banking by bank holding companies. That determination is left to the experience and the expertise of the Federal Reserve Board, and tt has made a judgment in this case as to what businesses can properly be integrated under the umbrella of a bank holding company. This Court has consistently said that it would respect that kind of judgment made in this complex financial arena.

Petitioners challenge that the Board's decision is based solely on a semantics fortuity. Congress, in 1970, did reject a mere functional relationship test. This Court has already recognized that the purpose of that change is very vague, and it is not clear precisely intended by its actions in 1970. From this, petitioner infers that the Board is precluded from ever analyzing these problems in terms of functional relationships.

The problem with the argument is that the decision in this case did not turn on mere functional relationship. The Board found that banks have traditionally purchased and sold securities as agent for their customers. In over-the-counter markets, the Board found that banks oftentimes perform the entire function of the purchase and sale of securities.

QUESTION: Do you think that they have often acted exactly like a broker?

MR. PHILLIPS: That is precisely what the finding of the Administrative Law Judge were, that they have the same computer operations, they have the same training personnel, and they engage in exactly the same kinds of judgments.

QUESTION: What about with the same legal effect?

MR. PHILLIPS: In terms of -- In terms of effecting a purchase and sale of security, there is no difference.

With regard to the "without recourse" issue that the petitioner places so much emphasis on, it seems to us quite clear that the Congress did not intent to preclude banks from transmitting brokerage exchange -- brokerage transactions in a way that they had to designate who the customer was in order to avoid liability of the bank.

As far as we know, banks have historically collected large quantities of orders and just shipped them off, without setting out exactly who the customers are.

QUESTION: You don't think they have always -- You don't think that they have always submitted them to a broker?

MR. PHILLIPS: On the exchanges, they have always transmitted them to a broker.

QUESTION: They won't have to now, will they?

MR. PHILLIPS: No, Your Honor, they won't have to now.

QUESTION: That is somewhat of a change, isn't it?

MR. PHILLIPS: It is true that it is somewhat of a change with regard to the exchanges, but the basic -- but the bottomline is that it is still an activity.

This Court's inquiry should be limited to the issue of whether or not the Board has stated a connection between the proposed activity and what banks traditionally do, and whether it is rational to conclude that that connection is a close one.

QUESTION: I thought our inquiry would be whether what the Board did is contrary to what Congress intended to do by the relevant statutes.

MR. PHILLIPS: Of course, that is the ultimate inquiry, but Congress -- Congress delegated to the Board discretion to make judgments, to employ its expertise in deciding what activities are closely related to banking.

QUESTION: You wouldn't suggest that the Board could authorize a bank to engage in underwriting, would you?

MR. PHILLIPS: No, Your Honor, of course, not.

QUESTION: The argument right here is that Congress didn't intend a bank to engage in brokering.

MR. PHILLIPS: But there is not one work in the legislative history to suggest that Congress had any concern about mere brokerage activities by banks. The entire debates in 1933 and again in 1956 relate to the problems of market, market collapse of large issues of securities.

There is no reference in any of that history to the mere execution of a brokerage transaction, and there is no reason for any concern, because did not fail in the late 1920s and 1930s -- in the early 1930s because they executed transactions on securities exchanges.

Banks failed because they engaged in investment banking practices where purchased large quantities of securities and those securities went back. That is precisely what Congress prohibited, not anything related to the simple execution of transactions. Indeed, Congress expressly allows banks, under Section 16, to purchase and sell securities as agents for their customers.

Under the Glass-Steagall Act, it seems to us that, notwithstanding petitioner's repeated reliance on Section 16, that the only relevant provision is Section 20. Section 16, by its terms, relates only to national banks. Section 21, also relied upon by petition, only relates to the receipt of deposits, and it is undisputed that Schwab nor BankAmerica do not receive deposits, and neither has the bank.

Therefore, it makes meaningless, the plain meaning role, to argue, as petitioner does, that the restrictions imposed under those provisions should be borrowed and applied willy-nilly to the activities of a bank holding company that has its own specific set or provisions to deal with.

And that provision of Section 20 -- Section 20, by its terms, prohibits bank affiliates from underwriting, distributing, issuing, publicly selling, or floating blocks of securities. That is not an across-the-board condemnation of all securities activities. That is a condemnation of public marketing activities.

If Congress had intended to preclude bank affiliates from engaging in brokerage activities, it would surely have said that brokerage activities are not permissible, or at least it would have used the term "purchase and sale of securities as agent," just the commonly understood definition of brokerage functions.

Congress did none of those things. Instead, it drafted the language in a way that makes it unmistakably clear that it is intended to deal solely with underwriting. This Court recognized as much in the Agnew decision. In characterizing the meaning of the identical language in Section 32 of the Act, this Court repeatedly described it as involving nothing but underwriting.

Similarly, that interpretation of Section 32, as not embracing brokerage -- mere brokerage activity, was adopted by the Federal Reserve Board in the 1930s and has remained unchanged since that time.

QUESTION: Mr. Phillips, are you aware of any bank, other than J. P. Morgan, which at the time of the adoption of the Glass-Steagall Act, actually had a seat on the exchange and kept it?

MR. PHILLIPS: My understanding is that there were six banks at that time --

QUESTION: Six.

MR. PHILLIPS: -- that maintained seats on the exchanges. The reason, of course --

QUESTION: Did they continue to keep their seats, other than Morgan, and use them to execute orders for customers?

MR. PHILLIPS: Unfortunately, the record doesn't reflect what those banks did, because that didn't seem to be a major issue in the administrative process. But we do know, in the New York Times Articles that discussed those investments, those banking operations that went to commercial banking as opposed to investment banking, that they prominently stated that they were keeping their seats on the exchanges, and one can only assume that they would have only made that a matter of serious concern if they planned to use those seats.

So as far as we know, some banks did undertake to act in that way.

QUESTION: And were not challenged under Section 16 by the Comptroller, or anyone else for executing orders?

MR. PHILLIPS: As far as we know there was never any challenge, and petitioner has not presented us with any evidence to indicate that there has ever been any challenge.

QUESTION: Under the Comptroller's ruling, until lately, a bank couldn't do this itself, could it?

MR. PHILLIPS: Yes, Your Honor, that is correct. Until 1957, it could only do it without profit. Then after -- and then most recently now, it can do it in any situation.

QUESTION: That ruling was rather old, wasn't it?

MR. PHILLIPS: That ruling did derive initially from the immediate aftermath of the Glass-Steagall Act.

QUESTION: When did the Comptroller overturn that decision?

MR. PHILLIPS: He began to erode that decision in 1957, soon after the Bank Holding Company Act.

QUESTION: When did he specifically overturn that prior ruling?

MR. PHILLIPS: In 1982, I believe it was. At that time, he explained that it was his view that the earlier interpretation was not predicated on anything in the language of Section 16, but appeared by all accounts to be nothing more than a very conservative reaction to the problems of problem failures.

QUESTION: He didn't need to admit that he was wrong, in the first place, it is just that either his prior ruling -- either one of them, his prior ruling or this one, were correct.

MR. PHILLIPS: True, they both can be regarded -- They both unquestionably reasonable interpretations of the plain meaning of the language.

In deciding which of the provisions to apply in this case, this Court has twice rejected efforts to incorporate standards from one section in Glass-Steagall and apply to other activities. In Agnew, this Court concluded that different qualifying phrases used in the provisions mark a distinction this Court should not obliterate.

Similarly, in ICI II, the Court held that the Act's structure reveals that congressional intent to treat banks separately from their affiliate and to impose a less stringent standard on bank holding companies. Adherence to those principles requires the conclusion that this case can and should be resolved completely by reference to Section 20 of the Glass-Steagall Act.

By strongly urging the Court to limits its inquiry to Section 20, we do not, however, mean to imply that we shy away from scrutiny by this Court under Sections 16 or 21, by their terms they simply do not apply. But if, as petitioner seems all too often to assume, this case involved a national bank, our submission would be no different.

Like their affiliates, national banks are prohibited from underwriting securities, but they are expressly authorized, as one of their many delegated powers, to purchase and sell securities on behalf of their customers as agent, and not for their own accounts. In other words, banks would appear to be able to serve as a broker.

This grant of power was intended in 1933 to ratify preexisting practices of banks, and as we explained in some detail in our brief, it is clear that banks did engage in the purchase and sale of stock, and other securities, for customers prior to that time, and that is all that Congress meant to ratify.

The division Congress made in the Glass-Steagall Act was between investment banking activities that carry a tremendous risk of loss if the market shifts. It did not intend to illuminate the rather minimal potential for liability, or was not worried about the potential -- minimal potential liability of a broker having to cover for a customer who happens to place an order.

It may be, as petitioner suggested today, that brokerage firms place their entire assets at their disposal when they execute an order, but the record in this case reflects that less than 1 percent of all of the transactions executed by the Schwab brokerage firm -- less than 1 percent involves situations where the customer fails to satisfy his own order or his own request. Accordingly, this is not a significant problem, and it is certainly not a problem Congress made any specific reference in anything in 1933 or 1935.

Congress could not foresee in 1933 the discount brokerage activities would some day be profitable. It seems to us quite clear from the language that it adopted, allowing for agency actions on the part of bank in executing -- in the purchase and sale of securities that it would clearly have upheld and permitted the banks to engage in the kinds of activities that Schwab undertakes here.

It seems to us that that interpretation, as I just mentioned to Justice White, is a reasonable one, and that is where this Court's inquiry should stop. So long as the Comptroller's newest interpretation is reasonable, it is entitled to deference by this Court.

Petitioner conjures up the horrors of the bank failures of the 1930s and hints that the Board's decision here is based on arguments presented in connection with the regulatory and legislative decisions of the mid-1920s that led to that financial disaster. But the Federal Reserve Board has not turned the clock back to 1927, nor created an environment of serious bank failure.

The Board has instead adjusted to the financial events of the 1970s and the 1980s, and acting faithfully to the congressional scheme created to allow substantial, but not unbridled, expansion of the business of banking. It has presented a thorough and reasonable explanation for its approval of BankAmerica's application in this case.

It is petitioner and the securities firms whom it represents who seek to stop the financial clock from moving beyond the events of the 1970s, when that industry as so structured that competition was severely limited, and the only role for a bank on the exchanges was to serve as an intermediary between the bank's customer and the broker, with the latter receiving the fee, but without any risk of competition.

Those times are gone, and the securities industry must recognize that banks, and of particular significance to this case, bank holding companies and their affiliates are legitimate competitors in that discrete area of securities activity concerning the purchase and sale of stock as agent.

This change is not the product of regulatory fiat, but rather a reasonable application of the plain meaning of the statutes Congress adopted, and empowered the Board to use its expertise to enforce. It is, therefore, not the Board's action that "should be legislated by Congress," as petitioner puts it, but rather petitioner's efforts to overturn the orderly decision of the Board that should be submitted to Congress for reevaluation.

The Administrative Law Judge, the Federal Reserve Board, and the Second Circuit have all unanimously and correctly held that the discount brokerage activities are a legitimate part of the business of banking, which Congress did not intend to prohibit by Glass-Steagall. Accordingly, the judgment of the Court of Appeals should be affirmed.

CHIEF JUSTICE BURGER: Mr. Weidner, do you have anything further?

REBUTTAL ORAL ARGUMENT BY JAMES B. WEIDNER, ESQ.

ON BEHALF OF PETITIONER

MR. WEIDNER: If I may, several brief points.

Justice O'Connor, if I could respond briefly to the question of the Morgan Bank and Brown Brothers Harriman.

So far as we know, there are -- there were two banks that were on the exchange, and two kept their seats, but I don't think we can draw from that an inference that it was proper.

First of all, remember the Comptroller specifically prohibited them from engaging in public securities brokerage, so it is unlikely that they did. Second, there is no evidence that they did. Third, there is a perfectly good economic reason why they would have retained their seats, even though they couldn't be public securities brokers, simply this, there are a lot of floor traders, or there were a lot of floor traders who had an exchange seat simply because when there were fixed commissions, if they traded on the floor themselves, they didn't have to pay any commission.

If, as an exchange member, they used the privilege of using a floor broker there, you only have pay 10 percent of the commission. So that, for example, for trust accounts and the like, it would make eminently good sense for Brown Brothers to have someone stay on the exchange when they weren't engaged in the public brokering of securities.

Let me turn then briefly to the Comptroller's recent interpretation or reinterpretation. I suggest that any indication that the Comptroller thought, in 1934 and 1935, he was convincing Congress to allow banks to become public stock brokers, just is simply illogical.

If it is true that it was important that banks, like all other corporations, couldn't be exchange members, only partnerships could be to avoid limited liability, then why was the Comptroller trying to convince Congress to allow banks to become public stock brokers when they couldn't do it?

Well, maybe it was because he wanted them to trade in the over-the-counter market where they don't have to be exchange members. If that was his motive, then why did he issue a regulation immediately after the statute was amended specifically prohibiting them from being public stock brokers. It just doesn't make any sense.

Moreover, something that I didn't mention, but I think bears mention, is in 1934 Congress was considering the Securities and Exchange Act of 1934 to govern public stock brokers. They excepted banks from the definition of broker in the '34. Why would they do that if they thought banks could be public stockbrokers?

QUESTION: What year did you mention?

MR. WEIDNER: 1934, Mr. Chief Justice.

QUESTION: Haven't a lot of financial arrangements changed?

MR. WEIDNER: Since then?

QUESTION: Since then, in the '40.

MR. WEIDNER: They have indeed. Although in this area, the Securities and Exchange Commission has restated its views only within the last six months that in its view, and in our view, the legislative history supports it, as they believe it has, banks were excluded from the brokerage definition in the '34 Act because Congress understood that they could not engage in public stock brokerage because of the Glass-Steagall Act.

QUESTION: What is the SEC's position now on this?

MR. WEIDNER: That they cannct.

QUESTION: On this problem?

MR. WEIDNER: Fxcuse me. That because they have nc jurisdiction over the banking laws, they can't very handily change the banking laws. But they have prcposed a rule that wculd require banks that publicly solicit a brokerage business to register as brokers, because in their view the exception in the statute was never meant to permit banks to be the only brokers that were unregulated by the Securities and Exchange Commissicn.

QUESTION: So you think that it was just a little turf gathering that they supported this application before --

MR. WEIDNER: Justice White, that is one of the things I wanted to mention.

I must say that to say the SEC supported this application is taking a fairly wide literary liberty.

QUESTION: What will happen is that they will have many more applications for licenses.

MR. WEIDNER: It is certainly true that they did not oppose it, but they -- their submission was in about as hedged language as it could be. It said something tc the effect, and this is in the Joint

Appendix on appeal in the Second Circuit, while the spirit, if not the letter of Section 20 would appear to prohibit the banks becoming brokers, nevertheless that is something over which the Federal Reserve Board has jurisdiction.

QUESTION: Did they there say that if this rule is approved, the banks would have to be licensed?

MR. WEIDNER: No, Justice White, they didn't, but I think --

QUESTION: But they now assert it?

MR. WEIDNER: They do.

I think it is helpful to recall that when this proceeding started at the beginning of 1982 there was no bank in the public securities brokerage business. By the end of 1982, every banking authority or financial institutions authority in the country authorized their institutions to go in the business.

Things have changed enormously in the last two years. The SEC is trying to do what it can, but it seems to me that this underscores why a policy decision of this sort should not be done by piecemeal administration.

What has happened is, you have the Federal Reserve Board act, now the SEC has got to react to propose regulations, and then we have the Comptroller reacting to the SEC's reaction. It is a game of administrative billiards, where the next "carem" shot is going tc come from. I'm quite serious.

This is a policy decision of enormous significance, and what we have seen happen is exactly what is going to happen as administrators preempt what should be a congressional and was a congressional judgment, and try to change the congressional intent.

With respectfully request that the decision belcw be reversed.

CHIEF JUSTICE BURGER: Thank you, gentlemen, the case is submitted.

(Whereupon, at 1:49 p.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:

#83-614 - SECURITIES INDUSTRY ASSOCIATION, Petitioner v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ET AL

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BY Diane Hammond

(REPORTER)