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# *National Association of Securities Dealers, Inc. v. SEC* -- National Banks May Sell Mutual Funds

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# CASES NOTED

## NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. v. SEC—NATIONAL BANKS MAY SELL MUTUAL FUNDS

The Comptroller of the Currency issued revised Regulation 9,[1] authorizing the commingling of managing agency accounts[2] by national banks under their fiduciary powers. The First National City Bank submitted the first proposal for such an account, and it was approved by the Comptroller. In addition, the Federal Reserve System ruled that the proposed arrangement would not violate section 32 of the Banking Act of 1933.[3]

The Investment Company Institute (ICI)[4] filed suit against the Comptroller and the First National City Bank in United States District Court[5] seeking a declaratory judgment to invalidate the provisions in Regulation 9 which authorized the commingling of the managing agency accounts under fiduciary powers of national banks. The district court concluded that ICI had standing to sue the Comptroller and found in favor of ICI on several grounds: (1) the commingled managing agency account involves the contractual principal-agent relationship and is not a fiduciary activity within the purview of Section 92a of the Federal Reserve Act;[6] (2) the issuance of "units of participation" to investors in the account involved the Bank in the business of dealing in securities for its own account in violation of sections 16[7] and 21[8] of the Glass-Steagall Act; and (3) the relation between the Bank and the account

1. 12 C.F.R. § 9.18 (1963).

2. By commingling managing agency accounts, national banks can create the functional equivalent of an open-end mutual fund. An open-end mutual fund continuously issues shares which are redeemable upon presentation by the shareholder to the extent of his proportionate share of the company's current net assets or the cash equivalent thereof. This redeemability feature distinguishes the open-end mutual fund from the closed-end investment company.

3. 12 C.F.R. § 218.11 (1963). The Banking Act is found in its original form in 48 Stat. 684 (1933).

4. The Investment Company Institute is a trade association of the mutual fund industry composed of 159 registered, open-end management investment companies, underwriters, and investment advisors to those companies.

5. Investment Company Institute v. Camp, 274 F. Supp. 624 (D.D.C. 1967).

6. 76 Stat. 668 (1962), 12 U.S.C. § 92a (1964) authorizes the Comptroller to grant national banks "the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics or in any other fiduciary capacity in which State banks . . . are permitted to act under the law of the State in which the national bank is located."

7. 48 Stat. 184 (1933), *as amended* 12 U.S.C. § 24 (1964) provides in part that a national bank shall not underwrite any issues of securities or stock.

8. 48 Stat. 189 (1933), *as amended* 49 Stat. 707 (1935), 12 U.S.C. § 378 (1964) makes it unlawful for any firm that is engaged in the business of issuing, selling, or underwriting securities to engage in the business of receiving deposits.

was an affiliation or interlocking directorate between a bank and an organization principally engaged in the securities business in violation of sections 20[9] and 32[10] of the Glass-Steagall Act.

The First National City Bank filed an application with the Securities and Exchange Commission to register the proposed account as a diversified open-end management investment company under the Investment Company Act of 1940.[11] The Bank requested that it be exempted from various provisions of the Investment Company Act (which prohibit bank domination of an investment company) because the Comptroller required that the Bank maintain effective control of the account in order to comply with the banking laws.[12] The SEC, over the objection of the National Association of Securities Dealers, maintained that even a specific prohibition against bank domination of an investment company does not preclude an exemption pursuant to section 6(c).[13] Accordingly, it granted the exemptions, concluding that the risks of conflict of interest would be adequately controlled by those provisions of the Investment Company Act which remained applicable, supplemented by the Comptroller's regulations, and that the exemptions would permit the establishment of a new and desirable investment medium.[14]

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9. 48 Stat. 188 (1933), *as amended* 49 Stat. 704, 707 (1935), 12 U.S.C. § 377 (1964) makes it unlawful for a member bank of the Federal Reserve System to be an affiliate of any organization engaged principally in "the issue, flotation, underwriting, public sale, or distribution" of securities.

10. 48 Stat. 194 (1933), *as amended* 49 Stat. 709 (1935), 12 U.S.C. § 78 (1964) prohibits a director, officer, or employee of a member bank from serving in a similar capacity with an organization "primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds or other similar activities."

11. 54 Stat. 789 (1940), *as amended* 15 U.S.C. § 80(a)(1)(52) (1958), *as amended* 15 U.S.C. § 80(a)(2)(39) (Supp. V, 1964).

12. The principal exemptions sought were from sections 10(b)(3), 10(c), and 10(d)(2) of the Act. Section 10(b)(3) provides that an investment company shall not have an investment banker as a member of its board unless a majority of the board are not investment bankers. Section 10(c) provides that an investment company may not have a majority of the board who are directors or officers of any one bank. Section 10(d)(2) requires that the investment advisor be engaged principally in the business of rendering investment supervisory services. The SEC granted the exemptions from sections 10(c) and 10(b)(3) but refused to grant an exemption from section 10(d)(2). This arrangement permits no more than 60% of the directors of the account to be affiliated with the bank.

13. Section 6(c) provides that the SEC may exempt any person from any provision of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and purposes fairly intended by the policy and provisions of the Act."

14. A good discussion of the events involved in the instant case is provided in the concurring opinion of Bazelon, C.J., National Ass'n of Securities Dealers, Inc. v. SEC, 420 F.2d 83, 85-95 (D.C. Cir. 1969). In addition, the order of the SEC which is the subject of one of these appeals has been reviewed in several legal periodicals. *See* Lehr, *The Affiliation of Commercial Bank and Mutual Fund Personnel*, 10 ST. LOUIS L.J. 190 (1965); Comment, *Of Banks and Mutual Funds: The Collective Investment Trust*, 20 SW. L.J. 334 (1966); Comment, *Banks, Trusts and Investment Companies: The Commingled Investment Fund*, 115 U. PA. L. REV. 1276 (1967); Comment, *Regulation of Bank-Operated Collective Funds—Judicial or Legislative Resolution of an Administrative Controversy?*, 73 YALE L.J. 1249 (1964).

The Court of Appeals consolidated the petition of the National Association of Securities Dealers[15] for review of the SEC order[16] and the appeal of the judgment and order of the district court in *Investment Co. Institute v. Camp.*[17] Reversing the district court decision in the latter case and affirming the order of the SEC, the court *held*: The actions taken by the Securities and Exchange Commission and the Comptroller are fully consonant with the statutes committed to their regulatory jurisdiction. *National Association of Securities Dealers, Inc. v. Securities and Exchange Commission*, 420 F.2d 83 (D.C. Cir. 1969).[18]

## I. THE BACKGROUND OF THE CASE

In 1962, the authority to permit national banks to act as trustees and in other fiduciary capacities and to regulate their exercise of such powers was transferred from the Board of Governors of the Federal Reserve System to the Comptroller.[19] The Comptroller, who clearly believed that the only restriction on bank services should be a concern for risks to the solvency of the banks, immediately opened the door to diversification by national banks.[20] In April 1963, the Comptroller issued revised Regulation 9 authorizing the commingling of managing agency accounts under the fiduciary powers of national banks.[21]

Prior to 1963, many national banks offered managing agency accounts which provided investment advisory service to individual cus-

15. The National Association of Securities Dealers is a trade association representing about 3,700 registered brokers or securities dealers.

16. First National City Bank, SEC Investment Company Act Release No. 4538 (March 9, 1966).

17. 274 F. Supp. 624 (D.D.C. 1967).

18. *Vacating* National Association of Security Dealers, Inc. v. SEC, 36 U.S.L.W. 2312 (D.C. Cir. Nov. 21, 1967) upon an *en banke* rehearing.

19. Act of Sept. 28, 1962, 76 Stat. 668, 12 U.S.C. § 92a (1964).

20. Since 1962, national banks have rapidly expanded their services to include:
(1) Electronic data processing;
(2) Subsidiary corporations;
(3) Leasing of personal property;
(4) Capital notes;
(5) Credit cards;
(6) Insurance agencies;
(7) Travel agencies; and
(8) Off-premises activities.
Many competitors have sought to enjoin these services as ultra vires. Their attempts have generally been impeded by a morass of legal problems, particularly the lack of standing to sue the Comptroller. *See, e.g.*, Arnold Tours, Inc. v. Camp, 408 F.2d 1147 (1st Cir. 1969); Saxon v. Georgia Ass'n of Independent Ins. Agents, 399 F.2d 1010 (5th Cir. 1968); Port of N.Y. Authority v. Baker, Watts & Co., 392 F.2d 497 (D.C. Cir. 1968); Association of Data Processing Serv. Org. v. Camp, 279 F. Supp. 675 (D. Minn. 1968), *appeal docketed*, No. 19,218, 8th Cir., Feb. 23, 1968. The legal limits to the expansion of national bank services are today unresolved, and scholarly opinion is mixed concerning appropriate boundaries. *See* Beatty, *What are the Legal Limits to the Expansion of National Bank Services?*, 86 BANKING L.J. 3 (1969); Kirst, *Diversification of National Banks*, 21 STAN. L. REV. 650 (1969).

21. 12 C.F.R. § 9.18 (1963).

tomers, but the minimum account economically feasible for a bank to manage was generally in excess of $100,000.[22] By commingling funds the banks could offer their services to smaller investors and create the functional equivalent of an open-end mutual fund.

The SEC claimed that such accounts would involve the sale of securities and subject the bank to the securities laws.[23] The banking interests protested the SEC regulation, claiming that existing bank regulations were sufficient and dual regulation created an unnecessary and impractical burden.

Through the efforts of the banking lobby, supported by the Comptroller,[24] several bills began to appear in Congress which would exempt banks' commingled agency accounts from regulation by the SEC.

The First National City Bank adopted a different approach, yielding to SEC control, but seeking exemptions from provisions in the Investment Company Act.[25] The SEC sensed the potential success of impending legislation freeing the banks from much needed SEC regulation[26] and granted the necessary exemptions,[27] despite the opposition of the mutual fund industry.[28] The day following the SEC ruling, the Comptroller wrote to Senator Robertson, Chairman of the Senate Committee on Banking and Currency, to withdraw his support for the McIntyre Bill,[29] effectively killing that legislation.[30]

The mutual fund industry then brought these actions to prevent the implementation by the First National City Bank of the proposed account.

The court of appeals[31] rendered a very brief per curiam decision. Although a majority of the court had reservations about standing,[32] the doubts were resolved in favor of reaching the merits to conclude that both the Comptroller and the SEC acted within their authority. Chief Judge Bazelon explained the reasoning of the court in a concurring opin-

22. *Hearings on S. 2704 Before a Subcomm. of the Sen. Comm. on Banking and Currency*, 89th Cong., 2d Sess., at 65 (1966) (hereinafter cited as 1966 *Hearings*).

23. Statement of Manuel F. Cohen, 1966 *Hearings* at 180-86.

24. Letter from James J. Saxon to Senator Robertson, Jan. 20, 1964, 110 CONG. REC. 832 (1964).

25. *Application of First Nat'l City Bank to the SEC*, August 23, 1965, 1966 *Hearings* at 180-86.

26. Statement of Manuel F. Cohen, 1966 *Hearings* at 180-86.

27. First National City Bank, SEC Investment Company Act Release No. 4538 (March 9, 1966), CCH FED. SEC. L. REP. 77, 332.

28. Opposition to the Bank's application at the SEC hearing was led by the Investment Company Institute, the National Association of Securities Dealers, Inc., and the Association of Mutual Fund Plan Sponsors, Inc.

29. S. 2704, 89th Cong., 2d Sess. (1966). This bill would have exempted bank collective investment funds from the application of the securities laws.

30. N.Y. Times, Mar. 12, 1966, at 30, col. 5.

31. The court consisted of Bazelon, C.J., Berger, J. (now Chief Justice of the Supreme Court of the United States) and Miller, J.

32. The court originally dismissed this matter for lack of standing on the part of the petitioners. 36 U.S.L.W. 2312 (D.C. Cir. Nov. 21, 1967) upon an *en banke* rehearing. Upon rehearing that decision was vacated by the decision under discussion in this note.

ion, and Judge Berger discussed the doubts as to standing in a second concurring opinion in which he was joined by Judge Miller.

## II. SUBSTANTIVE HOLDINGS

The court deliberately avoided invading the authority of the regulatory agencies and involving itself in a determination of economic policy.[33] Judge Bazelon, in explaining the validity of the account under the banking and securities laws, reiterated the positions of the appropriate regulatory agencies. The court found as follows:

(1) The difference between the traditional trust relationships and the principal-agent relationship involved in the account does not alter the fiduciary character of the duties owed to investors, and therefore the account is a fiduciary activity within the purview of § 92a of the Federal Reserve Act;[34]

(2) The sections of the Glass-Steagall Act[35] which prohibit banks from dealing in securities for its own account were only intended to preclude the bank from risking its own assets in securities and do not prohibit the purchase of securities for the account of others as would be done under the account;

(3) The account is merely a department of the bank[36] except for the purposes of the Investment Company Act (which prohibits bank control of investment companies). Accordingly, the account does not violate the provisions of the Glass-Steagall Act[37] forbidding bank affiliation with an organization which is principally engaged in securities dealings; and

(4) The SEC has the power under the Investment Company Act to grant exemptions from any of its provisions.

(5) The provisions of the Investment Company Act which remain applicable, supplemented by the Comptroller's regulations, adequately protect against the four areas of possible conflict of interest cited by opponents of the account. These include:

(a) retention of substantial cash deposits for the account in the bank;

(b) use of account investments to shore up bank loans;

(c) purchase for the account of securities underwritten by the bank; and

(d) allocation of brokerage to existing or potential bank customers.

33. *See* L. JAFFE, JUDICIAL CONTROL OF ADMINISTRATIVE ACTION (1965); Saferstein, *Nonreviewability: A Functional Analysis of "Committed to Agency Discretion,"* 82 HARV. L. REV. 367 (1968). For cases concerning standards for judicial review of the Comptroller's determinations, see Warren Bank v. Camp, 396 F.2d 52 (6th Cir. 1968); Security Bank v. Saxon, 298 F. Supp. 991 (E.D. Mich. 1968).

34. *See* note 6 *supra*.

35. *See* notes 7 and 8 *supra*.

36. This "single entity" theory was promulgated as a regulation by the Federal Reserve Board, 12 C.F.R. § 218.111 (1967).

37. *See* notes 9 and 10 *supra*.

## III. Standing

The effect of this decision is to allow the governmental regulatory agencies tremendous freedom in interpreting the banking and securities laws. Despite its holding that the trade associations have standing to sue the SEC and the Comptroller,[38] the court does little to restrain the activities of these regulatory agencies.

The finding that the ICI had standing to sue the Comptroller is so cloaked in ambiguous terminology that its value as precedent for further actions against the Comptroller is severely limited. While both concurring opinions find that the ICI had standing, their approaches to this conclusion represent opposite poles of the spectrum of judicial philosophy. Moreover, either approach could provide a cornerstone for the future development of the uncertain law of standing.

Judge Bazelon analyzed the cases granting competitors standing to sue the Comptroller and concurred with the results achieved, but attempted to base the granting of standing on a more realistic foundation than the reasoning of prior cases. In those cases, which granted standing, the courts found in certain provisions of the banking laws an implied intent of Congress to protect insurance agents and data processing companies from bank competition. Noting that Congress in writing the banking laws was not concerned with aggrieved non-bank competitors, but rather with protecting banks and their depositors' fortunes, Judge Bazelon wrote:

> I agree that the insurance agents and the data processors in these two cases did have standing, but I am not persuaded that the specific provisions relied upon by the courts were intended to create protected classes of competitors any more than the Glass-Steagall Act was intended to benefit mutual funds or investment bankers.[39]

He reasoned that since "the cases denying standing to competitors are governed by (1) considerations of separation of powers, and (2) a desire to limit actions against the government, rather than by rigid abstract rules,"[40] it should not be necessary to find that Congress intended to protect the particular plaintiff in order to grant standing. Rather, where there was a proper plaintiff (one who is actually aggrieved and is an appropriate party to vindicate the public interest) and a proper legal issue (*i.e.*, statutory construction as opposed to constitutional propriety of legislation or government spending), it should be sufficient to find that Congress did not intend to protect the administrative rulings from judicial review.

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38. *See* note 18 *supra*.
39. National Association of Securities Dealers, Inc. v. SEC, 420 F.2d 83, 99 (D.C. Cir. 1969).
40. *Id.* at 97.

Judge Burger, writing for himself and Judge Miller, sought to restrict standing based upon "unlawful competition" to situations where competition has been prohibited to protect those parties already pursuing some activity, thereby excluding situations where "competition per se is not proscribed but the very product which constitutes the competition is in itself illegal."[41] In his opinion, this latter form of unlawful competition "finds no support in a close analysis of the myriad cases reviewing the prerequisites to standing, is a misrepresentation of the conceptual genesis of the theory of unlawful competition, and cannot support a claim of standing."[42] The reason that illegal conduct producing competition cannot support a claim of standing, he argues, is that, in determining standing, attention must be focused upon the party seeking to get his complaint before the court and not upon the issues he seeks to have adjudicated. After noting that the ICI had failed to establish its "own status as intended statutory beneficiar[y] of a freedom from competition by national banks,"[43] he, nonetheless, agrees that the ICI has standing because of "the need for judicial examination of the important questions raised."[44]

Judge Burger's startling conclusion, which is completely contrary to the argument developed in his opinion, demonstrates the validity of Judge Bazelon's premise that "to do justice to the subtleties of standing as an element of justiciability" one must "acknowledge that cases denying standing to competitors are governed by (1) considerations of separation of powers, and (2) a desire to limit actions against the government, *rather than by rigid abstract rules* . . . ."[45] The body of Burger's opinion, however, representing the views of a majority of this court, demonstrates a tenacious desire to cling to those rigid abstract rules.

Even after finding standing based upon little more than "the need for judicial examination of the important questions raised,"[46] however, the court properly refrained from any attempt to usurp administrative functions.

The court and the regulatory agencies agreed that bank control of mutual funds would create *potential* conflicts of interest. They approved of the fund nevertheless, reasoning that the potential for abuse was no greater than that which already exists in bank control of commingled trust accounts of the traditional variety.[47] The court properly refused to analyze the economic, political and social impact of permitting national

41. *Id.* at 102.
42. *Id.* at 102.
43. *Id.* at 105.
44. *Id.* at 108.
45. *Id.* at 97 (emphasis added).
46. *Id.* at 108.
47. Common trust funds used for the administration of personal trusts and fiduciary accounts for which the bank may be serving as trustee, executor, administrator, or guardian have been regulated by a federal bank supervisory agency since 1937. These pooled funds are specifically exempted in the provisions of the Investment Company Act of 1940.

banks to enhance their power through the domination of the practical equivalent of mutual funds.

## IV. POLICY

The determination of the limits to be placed on bank control of commerce and industry is essentially an economic policy determination better suited for Congress than the courts.

No attempt is made here to suggest limitations that should be imposed upon bank control of industrial or commercial corporations or even to argue that the present regulation of bank activity is insufficient. It is Congressional reluctance to investigate the increasing influence of banks on the economy that this writer believes warrants criticism.

The reactions to the efforts of Representative Wright Patman[48] to initiate thorough investigations have been shamefully inadequate. A study conducted in response to the efforts of Representative Patman[49] compared the stockholdings of trust departments of 49 commercial banks (four to six in each of ten metropolitan areas) with "The Fortune Directory of 500" largest U.S. corporations (which accounted for 70.5% of all industrial profits during the year surveyed, 1966) and found, among other things, that:

> There are 176 separate instances involving 147 companies in which these 49 banks hold 5 percent (determined by the subcommittee to be the figure which generally indicated a bank might have substantial influence or control over a corporation) or more of the common stock of an individual company. . . . These banks hold a total of 768 interlocking directorships with 286 of the 500 largest industrial corporations. . . .[50]

As startling as these statistics may seem, they prompted no immediate response from Congress. Instead, the Senate extended for one year the time in which the SEC is to study and make a report to Congress on institutional investing practices in the securities market.[51]

After pointing to numerous illegal bank-lobbying practices, Representative Patman noted that five lobbyists, registered for The American Bankers Association, reported spending only $190 to lobby during the first six months of 1969, "a period of an extremely heavy run of banking legislation in the Congress."[52] The House Banking and Currency Committee voted to block Chairman Patman from starting an investigation of the banking lobby.[53]

48. (D. Texas), Chairman of the House Committee on Banking and Currency.
49. STAFF OF THE SUBCOMM. ON DOMESTIC FINANCE, HOUSE COMM. ON BANKING AND CURRENCY, 90TH CONG., 2D SESS. REPORT ON COMMERCIAL BANKS AND THEIR TRUST ACTIVITIES: EMERGING INFLUENCE ON THE AMERICAN ECONOMY (1968).
50. *Id.* at 3.
51. S. REP. No. 206, 91st Cong., 1st Sess. 1 (1969).
52. WEEKLY REPORT, CONG. Q. 1814 (September 26, 1969).
53. *Id.*

Today, the flagrant abuses arising from the one-bank holding companies have attracted the concern of Congress. While these abuses must be rectified, legislation in this field will not eliminate the need to reevaluate all bank control of industry. The words of President Nixon contained in a message accompanying his proposal to regulate one-bank holding companies apply to all bank control of commerce and industry: "Left unchecked, the trend toward combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. . . ."[54]

By acceding to the discretion of the respective governmental regulatory agencies, the court in the instant case has increased the urgency for congressional action.

ALLEN FULLER

## NONJOINDER OF HUSBAND IN WIFE'S DEED: APPLICABILITY OF ESTOPPEL

Real property was conveyed to the coplaintiff, a married woman, who twice conveyed by deed this same tract of land without the joinder of her husband as required by statute.[1] The first deed, wherein the words

54. 5 WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS No. 13, 61 (1969).

1. FLA. STAT. § 693.01 (1967): "Any married woman owning real property may sell, convey or mortgage it as she might do if she were not married, provided her husband join in such sale, conveyance or mortgage."

FLA. STAT. § 708.04 (1967): "The husband and wife shall join in all sales, transfers and conveyances of the property of the wife, other than personal property and choses in action."

FLA. STAT. § 708.08 (1967):

> Every married woman is hereby empowered to take charge of, and manage and control her separate property, to contract and to be contracted with, to sue and be sued, and to sell, convey, transfer, mortgage, use and pledge her property, real and personal, and to make, execute and deliver instruments and documents of every character, without restraint, without the joinder or consent of her husband, in all respects as fully as if she were unmarried. Every married woman, without the joinder or consent of her husband, shall have and may exercise all rights and powers with respect to her separate property, income and earnings, and may enter into, obligate herself to perform, and enforce contracts or undertakings to the same extent and in like manner as if she were unmarried; provided, however, that no deed, mortgage or other instrument conveying or encumbering real property owned by a married woman shall be valid without the joinder of her husband; provided, further, that any claim or judgment against any married woman shall not be a claim or lien against such married woman's inchoate right of dower in her husband's separate property.

The purpose of having the husband join is said to be primarily for the protective benefit of the wife and secondarily for the welfare of the husband by preventing the wife, without his consent, from conveying real property which would be detrimental to the welfare of their mutual marital interest. *See In re* Jensch, 134 So.2d 285 (Fla. 2d Dist. 1961).

Serious doubts as to the constitutionality of these statutes are raised by FLA. CONST. art. X, § 5, *as amended* in 1968:

> There shall be no distinction between married women and married men in