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1. Report of the Committee on Banking and Currency -- Senate Report No. 1455, 73rd Congress, page 155. Statement of the Committee. -

"The primary function of commercial banking is to furnish short-term credits for financing the production and distribution of consumable goods. ... Such loans should be self-liquidating. A sharp line of demarcation should exist between the function of the commercial banker and the investment banker."

2. Statement of Winthrop W. Aldrich before the Senate Investigating Committee -- Hearings of Senate Committee on Banking and Currency, part 8, pages 3977-3979. -

" ... Commercial banking and investment banking are two fields of activity esentially different in nature. I came to believe that while it was essential that there should be coordination between these two types of banking, such coordination could best be protected from abuse, and thus enhancedin usefulness, through absolute separation of interest between the two fields. ... The commercial bank's credit function is very definitely governed by its responsibility to meet its deposit liabilities on demand. It must not seek excessive profits by taking undue credit risks, and it cannot wisely tie up its funds in long-term credits however safe they may be. ... The investment banker also renders necessary and effective service ... by meeting long-term needs, providing funds for plant and equipment, or for permanent working capital. He does and should take speculative risks of a sort unsuitable to the commercial bank ... He takes the risk that the public may not readily absorb the new securities which he brings out and that his own capital may be tied up for a long period of time. This last distinction between investment and commercial banking emphasizes the wisdom of the legislation forbidding investment bankers from taking deposits."

3. Senate Committee on Banking and Currency, 73rd Congress. -- Report No. 77 (reporting the Glass-Steagall Bill), page 8. Statement of the Committee. -

"The outstanding development in the commercial banking system during the prepanic period was the appearance of excessive security loans, and of overinvestment in securities of all kinds. The effects of this situation in changing the whole character of the banking problem can hardly be overemphasized. National banks were never intended to undertake investment banking business on a large scale, and the whole tenor of legislation and administrative rulings concerning them has been away from recognition of such a growth in the direction of investment banking as legitimate. Nevertheless it has continued; and a very fruitful cause of bank failures, especially within the past three years, has been the fact that the funds of various institutions have been so extensively 'tied up' in long-term investments."

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4. Congressional Record, May 10, 1932, page 9909. Speech by Senator Bulkley.--

"Banks may at present (1932) be engaged in the securities business either in their own name or through the medium of an affiliate. In either event it will only be the larger ones that are active in originating and underwriting. The smaller ones will be active only in retailing. ...

Banks which have gone into origination do so on a more comprehensive and omniverous scale than the older unincorporated houses of issue. The latter specialize more selectively not only as to the kind of business but as to the particular corporations and the size of transactions they undertook to finance.

(page 9910) Among the things that led American banks into the securities business, one of the most important appears to have been the correspondent relationship. ... Metropolitan banks found themselves between their country correspondents who wanted securities and their customer corporations who wanted long-term financing. The one afforded distribution and the other supply ... In the beginning the tendency probably was for the banks simply to take larger and larger shares in underwritings and in distribution; but as they did so, they were able to exact more and more commission and eventually, if they chose, they were able to invade the field of origination themselves and integrate all the securities functions.

(page 9911) The English banks of deposit have kept themselves strictly clear of the investment-securities business, while the big German banks, on the other hand, have not hesitated to make substantial investments of their own funds in promotions and refinancings with a view to public distribution at such time as might be convenient. In banking literature there are arguments both ways. It seems, however, that the English banking situation has been maintained in a more satisfactory and creditable manner than the German, and that whatever we may learn from comparison of English and German banking should lead us to prefer the English practice, under which commercial banking is strictly segregated from the origination and underwriting of capital issues.

(Senator Bulkley then discusses the process of a large bank building up a securities department having heavy fixed expenses and then finding it necessary to discover new issues to sell without due regard to the soundness of the issues in order to meet these fixed costs.)

While the banks competed with each other in the business of finding and distributing issues of investment securities, yet they had at all times one great common interest -- none of these profits could be made unless the condition of the securities market was such as to assure the absorption of securities. Most of the banks, certainly all the great ones, were interested, therefore, in a good market for capital securities. ... Can there be any doubt that in order to maintain the market conditions

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which would absorb the great production of capital securities and produce the big profits for the affiliates and bond departments, commercial banks went astray by encouraging an overdevelopment of collateral-security loans? Is it not fair to attribute the vast development of loans on collateral security at least in part to the necessity for keeping up a market condition capable of absorbing capital issues? It does not matter whether this motive was deliberate or subconscious; the fact remains that the banks generally were involved in it ...

(page 9912) ... There is another phase of the situation which cannot but have some effect upon the people's confidence in banks. The investment-security business is attended with certain risks. Market conditions may change after the making of a commitment in such a way as to cause considerable loss to an underwriter ... and although such a loss would possibly not result in any substantial impairment of the resources of the banking institution, ... there can be no doubt that the whole transaction tends to discredit the bank and impair the confidence of its depositors.

The banker ought to be regarded as the financial confidant and mentor of his depositors. ... Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits.

Take the other side of the picture: a corporation, having carried its account with a bank, having borrowed from that bank for its ordinary commercial requirements, is confronted with the question of raising long-time funds by the issuance of securities. If it is to have the advice of its banker untainted by the prospect of obtaining an originating or underwriting profit we must keep the banks out of the investment security business ... If the public is to be protected against the possibility of bad bank loans being set up into bond issues to be sold to savings depositors of the same banks without the exacting scrutiny of an independent underwriter interested primarily in the soundness of the securities he is about to sell we must prohibit the banks from engaging in the security business. If we are to keep banks from being tempted to make security loans in order to help make a market or to finance the purchase of securities on which the lending bank is making an originating or underwriting commission, we must keep banks out of the investment security business.

(page 9913) Throughout the development of investment securities affiliates and the development of the investment security business directly through the bond departments of banks, there have been banks which have remained free from this operation. A notable case is that of the Central

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Hanover Trust Company of New York, which for years has publicly stressed the fact that they had no securities company, and, consequently, 'nothing to sell'."

5. Congressional Record, May 22, 1933, page 3954. Extension of remarks by Representative Bacon on the Glass-Steagall Bill. Summary by Representative Bacon of arguments for and against the divorce of investment banking and securities affiliates.

Arguments in favor of separation. -

"Prior to the World War and the Liberty Loan drives, in which commercial banks assisted, the securities business was largely conducted by private banks and investment houses. Then a few security affiliates were established for selling bankers acceptances and covering issues. These rapidly grew and built up elaborate and expensive sales organizations which, to sustain themselves, entered more and more into the business of industrial long-term financing. First primarily concerned with selling these securities, their needs for more merchandise led them to participate in, underwrite, or originate a growing proportion of them. The more they sold, the more new issues they wanted to handle. And as this growth continued, the more bank credit they were forced to make available for the purchase of new securities.

The unhealthy inflation of bank credit ... was the result of a vicious circle. Nearly every line of industry was overcapitalized with new security issues. New investments had to be sold. Credit had to be extended freely to permit the purchase of these. This credit was applied to sustaining and increasing stock market prices.

In the era of high-pressure investment sales many unsound issues were offered and many found their way into the portfolios of the smaller banks ... Metropolitan banks held their correspondents in a condition of involuntary servitude and ... coerced them into buying securities ...

Thus when stock exchange values shrank ... thousands of small banks took large losses on their securities and were caught with frozen loans on unsalable collateral. ... This situation, it is asserted, indicates that the remedy which will prevent its recurrence must be measures to keep commercial banks out of investment business. ... Had private banks and investment houses -- which are the logical medium for long-term financing -- not had this competition, they would have handled large issues on their merits and the market would have been conditioned by credit policies consistent with sound commercial banking.

(Mr. Bacon then summarizes part of the speech of Senator Bulkley of a year before, of which extracts have been given above.)

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(page 3955) Bank credit is a controlling factor in the business life of the Nation, and should be conditioned by the needs of commerce, industry, and agriculture. Heretofore, with banks interested in the securities market, speculation has exerted an undue influence upon the control of credit."

(Mr. Bacon quotes Winthrop Aldrich as favoring certain measures to make more effective the operation of commercial banking from the business of dealing in securities. These include (1) no corporation or partnership should be permitted to accept deposits without being subject to the same regulations as commercial banks; (2) no corporation dealing in securities should be permitted to take any deposits at all.)

Arguments opposing separation. -

"The three classes of arguments in opposition are ... (1) that the premises on which the bill was drafted were false and that it is attacking from the wrong direction; (2) that the measures as drafted will be ineffectual anyway and will not achieve their purpose; and (3) that the enactment of the bill is dangerous to the business life of the country.

1. These measures are aimed at the abuses which contributed to the financial debacle but were only symptomatic of a single underlying cause — cheap money and excessive credit. The prevention of this should be the object of legislation and of Federal Reserve policy.

(page 3956) The line of demarcation between commercial and investment banking -- long- and short-term credit -- is not distinct, and they cannot be separated. Frequently their functions are interchangeable, such as, for example, the almost perpetual accommodations sometimes granted by banks to customers in the place of capital issues and such as instances of the conversion of short-term loans into bond issues. Commercial paper is sold in much the same way as investment securities. ...

... Banks with their wide contacts with the public through their correspondents and branches, are the logical medium for selling securities. Investment houses have to resort to the expenses of traveling salesmen and costly branch sales offices. ...

The statement that commercial banks took advantage of their superior opportunities for selling investments by putting low-grade securities on the market is disproven by the fact that surveys show the securities they were responsible for have had better records as to defaults. ...

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Economy in the costs of financing through commercial banks is shown by a survey of the origination of $8,000,000,000 in foreign bonds by commercial banks and investment houses. The spread, in the case of those handled by the latter, was 25 percent greater. Like figures are not available for domestic issues, but would probably indicate an equal saving."

2. (Mr. Bacon outlines various arguments tending to show that the Glass-Steagall bill, including its separation of investment from commercial banking, will not effectually prevent the use of Federal Reserve credit for speculative purposes.)

3. (page 3957). "More serious than its shortcomings are the destructive effects the bill would have upon our financial structure ... Member banks, through their bond departments, or through their affiliates, represent (in May 1933) probably about 50 percent of the machinery for handling securities in this country.

The existence of investment banking without commercial bank credit is impossible unless the financial machinery of the country is completely revolutionized. Investment houses depend for profits upon a rapid capital turnover. They must, therefore, operate on large loans against their security collateral.

Long-term financing of industries is a vital function of the business community. During the decade of 1922-31, $74,000,000,000 of new securities were issued, most of them sound, despite a few abuses. In 1924 the average volume of commercial loans was about $8,000,000,000, while new issues that year aggregated less than $4,000,000,000. In 1929 commercial loans had only grown to $9,000,000,000 — a growth not commensurate with our commercial and industrial expansion — while new issues that year were $10,000,000,000. Banking legislation must face the fact that this form of financing has grown relatively more important and that reform must look to its regulation rather than to turning back and opposing this trend.

The dangers of the Glass bill are shown by an examination of its effect, had it been then in force, upon some of the emergency municipal and utilities transactions of the past 18 months, by which maturing obligations were converted into securities, thus saving several large cities and utilities from disastrous insolvencies. ...

Now, if this section of the bill had been in force, member banks could not have underwritten nor bought for resale any of the utilities issues. And purchases for own account would have been limited to 10 percent of any issue and to 15 percent of capital and 25 percent of surplus

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of the purchasing bank. It is doubtful, however, that the banks would have absorbed these huge issues for their investment accounts.

(page 3958) The aggregate effect of these various restrictions (of the Glass bill) upon member banks will be to drive many of them out of the Federal Reserve System in order to preserve their investment business. ... Strong State nonmember banks with affiliates will have many advantages, among them the ability to afford their customers a complete financial service under one roof; expert advice from their affiliates as to investments and in appraising securities as collateral for loans; source of new business derived from customers of the affiliate. The same advantages largely apply also to banks with highly developed bond departments.

By severing all investment banking from the Federal Reserve we will be cutting it adrift from all control. Investment bankers will be given a monopoly of the kind of financing which ... has grown in importance and is to a measure replacing the use of bank loans in financing industry. The consequences of this would be fraught with danger to the investing public, especially as investment houses, lacking the resources of affiliated banks, will never have equal stability in withstanding heavy losses and continuing service to their clients during critical periods."

Quotation from a campaign statement of President Roosevelt, quoted in the Congressional Record, May 22, 1933, page 3956. -

"Investment banking is a legitimate business. Commercial banking is another wholly separate and distinct legitimate business. Their consolidation and mingling is contrary to public policy."

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