THE COMMERCIAL BANK TRUST DEPARTMENT AND THE "WALL"*

EDWARD S. HERMAN**
CARL F. SAFANDA***

INTRODUCTION

A traditional goal of commercial banks has been the efficient utilization of bank personnel and internally generated information to further the interests of the institution as a whole. Toward this end, information has flowed along well-established lines of communication between the commercial department of a bank and the bank's trust department for their mutual benefit. Confidential information received by the commercial banking department functioning as a creditor has been included in this internal flow, and has sometimes proved valuable to the trust department in making investment decisions. During the past decade, however, emerging judicial interpretation of the securities laws relating to the improper use of "inside information" has raised a serious threat to these interdepartmental banking relationships. More than that, it has placed the banks in a dilemma: use by the trust department of confidential information generated by the commercial department may give rise to liability for violation of insider rules; failure to use such information may subject the bank to liability as a negligent fiduciary or at least place the bank in an awkward position vis-à-vis its trust customers.[1]

In response to this dilemma, many banks have attempted to establish a "wall" between the commercial and trust departments so as to cut off some or all information flows. The success of this response to the problem depends largely upon the nature of the previously existing reationships between trust and commercial departments, and the capacity and willingness of banks to alter them. This article, then,

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** Professor of Finance, Wharton School of Finance and Commerce, University of Pennsylvania. A.B., 1945, M.A., 1948, University of Pennsylvania; Ph.D., 1953, University of California, Berkeley.

*** A.B., 1964, Northwestern University; J.D., 1967, University of Illinois; M.B.A., 1969, University of Pennsylvania; associate, Hudson & Wilf, Philadelphia, Pennsylvania. The author is a former Fellow of the Center for the Study of Financial Institutions of the University of Pennsylvania Law School.

1 See, e.g., Trading in Penn Central Stock: Financial Institutions and Privileged Information, Staff of House Comm. on Banking and Currency, 92d Cong., 1st Sess., Report on the Penn Central Failure and the Role of Financial Institutions, pt. V, at 313 (1971).

begins with a consideration of the legal and historical background of information flows between bank departments. The next section considers the legal problems created for banks by the new and changing status of "insiders." The balance of the article utilizes interview data and historical materials to analyze the business and structural factors that have influenced the development and effectiveness of bank walls and to appraise the present state of wall construction in trust banks. The article concludes with a brief analysis of some major policy options and proposals for dealing with some of the problems that the wall has not yet resolved.

I. The Potential Conflict in Legal Duties of Bank Trustees

A. *Traditional Patterns of Information Flows and the Law*

In the years preceding the rise of the "insider" problem and the potential liabilities associated with the possession and use of privileged information, it was an established and unquestioned practice for a bank to make unrestricted internal use of information generated by all of the activities in which the bank was engaged. A strong link, based upon long-standing and deeply rooted business practices that originated in the bank's profit interest, existed between the commercial and trust departments. Such a relationship accorded with generally accepted trust law principles, which required a trustee to keep informed and to be in a position to act if an investment became imprudent.[2] Indeed, one of the original arguments for association of trust and commercial banking functions was to secure to the former "better investment facilities and a stronger group of directors, and the valuable information and help which can be obtained from other departments of a bank."[3] For example, the publicly-made explanation of—and justification for—the absorption of Equitable Trust and Interstate Trust by Chase National Bank in 1930 emphasized that

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[2] G. Bogert, Law of Trusts 284-85 (4th ed. 1963). See In re First Nat'l Bank, 25 N.Y.S.2d 221 (Sup. Ct. 1941); In re Buckelew's Estate, 128 N.J. Eq. 81, 13 A.2d 855 (Prerog. Ct. 1940); Tannenbaum v. Seacoast Trust Co. 125 N.J. Eq. 360, 5 A.2d 778 (Ct. Err. App. 1939); In re Clark's Will, 257 N.Y. 132, 177 N.E. 397 (1931); In re Stark's Estate, 15 N.Y.S. 729 (Sur. Ct. 1891). A trustee is generally held responsible for knowledge of relevant facts readily ascertainable at the time of his action or failure to act. People's State Bank & Trust Co. v. Wade, 269 Ky. 89, 106 S.W.2d 74 (1937); In re Cowles' Will, 22 App. Div. 2d 365, 255 N.Y.S.2d 160 (1965); In re Weinz' Will, 59 N.Y.S.2d 576 (Sur. Ct. 1945).

Although citation to general trust law principles is helpful, the authors recognize that such broad rules are difficult to apply in the absence of a specific factual context. Each case involving the duties and responsibilities of a trustee must turn on its own peculiar facts and circumstances. In re First Nat'l Bank, 25 N.Y.S.2d 221, 229 (Sup Ct. 1941).

[3] Remington, Trust Business of Tomorrow, 67 Trust Companies 677 (1938).

"[t]he extensive information and wide experience of the bank as a whole will be available to the executive officers of the trust department . . . ."[4]

Major banks traditionally buttressed their efforts to secure new trust business with the argument that their commercial officers' knowledge of their extensive clientele could be expected to contribute to the investment performance of the trust department. Bank directors, although ostensibly chosen only to exercise their independent judgment, were expected to function as sophisticated informants as well. From an early date, it was anticipated that bank directors who had close associations with other institutions could be helpful not only in cementing harmonious relations between the bank and those institutions, but also because the knowledge they acquired from the latter often proved useful in their capacities as bank directors.[5] Directors on the board's trust committee were selected both on the basis of their ability to discriminate properly between investments and reduce the chance of loss to a minimum and because in the daily conduct of their affairs within the city they were likely to receive the latest information affecting the value of securities held by the bank.[6] Such selection practices were important in an age of limited professional sources of information and slow dissemination of knowledge. They were also important because of the frequent use, in securities markets, of manipulative practices deliberately intended to mislead the unwary. Referring to the necessity for piercing through such deceptive devices, one early treatise on trust companies noted that stock ticker information must be

> supplemented by "inside information," for stock quotations by themselves may prove anything but safe guides. The operations of a bull or bear pool may give the market a fictitious appearance, and a "wash sale" may fix the quotation in

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4 Chase National Bank to Provide Superior Type of Trust Service Upon Consummation of Merger, 50 Trust Companies 765 (1930) (quoting press release of merging banks).

5 Affiliations Between National Bank and Trust Company Interests, 3 Trust Companies 864-65 (1906).

6 Vierling, Investment of Trust Funds by Trust Companies, Proceedings of the Trust Company Section, American Bankers' Association 117 (1898).

One of the requisites for a functional trust committee of the board of directors was that it be comprised of individuals knowledgeable in matters relevant to the trust department:

> The head of a Trust Department would seek, for instance, a director especially qualified in regard to real estate matters; likewise a representative especially familiar with securities; one especially familiar with manufacturing and industrial problems; and finally one or more especially familiar with Law pertaining to trust administration and property rights and problems.

Freiberger, What the Trust Department Expects of Directors, 68 Trusts and Estates 225 (1939).

> order to regulate loaning values, when to find a real purchaser the limit would have to be dropped many points.[7]

The lower-level committee structure of the bank was also designed to facilitate the flow of information. At the trust investment committee level, for example, participation by both commercial and trust officers was often thought to have special benefit for the trust department:

> The Trust Investment Committee affords an excellent opportunity for a close tie with the commercial department of the bank [and] it is well to have one or more commercial officers included in the membership . . . . They bring to the Committee knowledge of the bank's commercial loans and investments in its own portfolio which is valuable on many occasions. This benefit could well be reversed by having the chairman of the committee, who normally would head the investment division of the trust department, meet occasionally with the loaning officers of the bank to keep them informed regarding investment policies. Such meetings could well follow field trips for the study of particular industries, or at periods when changing conditions alter investment procedure in any respect.[8]

Trust officers were sometimes encouraged to "sit in" on loan meetings,[9] and in many cases credit department memos were regularly sent to the trust department.[10]

Early trust law assumed that the special skills, knowledge, and contacts of the bank, as of other professional trustees, would be put to use for the benefit of its trust beneficiaries. In the words of one court:

> [A] great trust company, having at its command special knowledge of market and financial conditions and an organization skilled in the investment of funds, must, in the exercise of ordinary care, bring to the management of estates entrusted to its care this specialized knowledge and experi-

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7 F. B. Kirkbridge, J. E. Sterrett and H. P. Willis, The Modern Trust Company 121 (6th ed. 1925).

8 Statement of Clarence R. Chaney, Vice Chairman of the Board, Northwestern National Bank of Minneapolis, quoted in Trust Service for Commercial Customers, 88 Trusts and Estates 365 (1949).

9 Cocke, Practical Program for Bank-Trust Cooperation, 90 Trusts and Estates 748 (1951). The article also describes the practice of having all trust officers meet weekly with senior executives and senior lending officers of the bank so that the trust officers might "obtain outside points of view on the management of estates entrusted to their care." Id. at 750.

10 Wilkinson, Don't Isolate Your Trust Department, 99 Trusts and Estates 576 (1960).

> ence, since an ordinarily prudent man in the exercise of ordinary care would not fail to do this in the management of his own affairs if such advantages were available to him.[11]

Thus, the greater the flow of illuminating information between departments, the better for the bank, since the more informed the trustee's judgment, the less the likelihood of liability for neglect of fiduciary duty. In fact, effective trust administration was considered by some commentators to be possible only where there was effective cooperation between the banking and trust departments.[12] Solicitation of information from "insiders"[13] and reliance upon the judgments of persons close to the insiders were material evidence of the trustee's care and prudence.[14] A New York case involving an attempt by beneficiaries to hold a trust company trustee liable for negligently retaining certain sugar company securities in the trust illustrates the point.[15] The will creating the trust authorized the trustee to continue the decedent's investments "without any personal liability for so doing," and thus the trustee could have been found liable only had it been proved that he had failed to exercise reasonable care. In the court's view:

> It cannot be said that the trustee was negligent in the sense that it was inattentive to its duty, or ignored the question whether a sale of the stocks was advisable or otherwise. The securities of the trust were examined and considered by a committee of the trustee's directors at least once in every six months. This committee was composed of distinguished financiers, members of the New York Stock Exchange, lawyers and others of note in business circles. It was their judgment

[11] Chemical Bank & Trust Co. v. Ott, 248 App. Div. 406, 415, 289 N.Y.S. 228, 237 (1936) (dissenting opinion).

[12] Treman, Need of Close Working Relationship Between Commercial and Trust Departments, 100 Trusts and Estates 1169, 1171 (1961).

[13] Before 1960, no distinction was made between what an insider knew and "inside information." The technical legal definition which has emerged since that time considers "inside information" to be a subset of the category which includes all insider knowledge.

[14] See, e.g., In re Pate's Estate, 84 N.Y.S.2d 853 (Sur. Ct. 1948). The trustee was justified in considering the opinion of the beneficiary, formed through personal contact with certain "insiders." More than that, "it was the duty of the trustee to get as much information on the subject as it could." Id. at 862. Retention of stock by a trustee has been held to be proper where he acted with knowledge that the settlor of the trust, a director of the corporation in question, retained the greater part of his personal holdings, In re First Nat'l Bank, 25 N.Y.S.2d 221 (Sup. Ct. 1941), and also where a director and the treasurer of a corporation had advised their friends to purchase their company's stock, Bowker v. Pierce, 130 Mass. 262 (1881).

In general, the test by which a fiduciary was judged was whether or not he had conscientiously taken advantage of all sources of information reasonably available to him. Matter of McCafferty, 147 Misc. 179, 208 (Sur. Ct. 1933).

[15] In re Clark's Will, 257 N.Y. 132, 177 N.E. 397 (1931).

> that the stock should not be sold. They consulted Henry Clark, a brother of the testator, and first vice-president of [one of the sugar companies whose stock was held] and it was his advice, given as late as 1928, not to sell. They consulted Horace O. Havemeyer and William O. Havemeyer, well-known figures in the sugar trade, and received the same advice.[16]

Thus trustees with access to pertinent information were considered to have a legal duty to gather and use it, and the more responsible and aggressive ones did so until the concept of "insider liability" began to complicate matters. Ironically, what is today designated as "material inside information"[17] was the very type of information which, if available, a prudent trustee was under a duty to consider in making an informed judgment. Now, however, prudent trustees have been confronted with the fact that such important and deeply rooted forms of vigilance may entail their own kinds of liability under rule 10b-5[18] and the body of law developing out of it.

B. *Inside Information and Bank Liability*

The series of "insider" liability cases beginning with *Cady, Roberts*,[19] and continuing to the recent *Investors Management* case,[20] has raised serious problems with respect to traditional relationships and information flows within commercial banks. Bankers, by the nature of their business as lenders, solicit and receive significant financial information from the companies with which they do business.[21] Trading

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16 Id. at 138, 177 N.E. at 399.

17 Material information is information which is essentially extraordinary in nature and is reasonably certain to have a substantial effect on the market price of the security, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir.) (citing 51 Va. L. Rev. 1271, 1289), cert. denied, 394 U.S. 976 (1968), which affects the probable future of the company, or which may affect the desire of investors to buy, hold or sell the company's securities, SEC v. Texas Gulf Sulphur Co., 401 F.2d at 849. In Investors Management Co., SEC Securities Exchange Act Release No. 9267 (July 29, 1971), reprinted in [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,163, the SEC indicated that, in determining whether a particular piece of information met the broad test of materiality, a number of factors were to be considered, including the degree of specificity of the information, the extent to which the information differs from existing public information, and the reliability of the information in light of its nature and source and the circumstances under which it was received. Id. at 80,519.

18 17 C.F.R. § 240.10b-5 (1972).

19 Cady, Roberts & Co., 40 S.E.C. 907 (1961).

20 SEC Securities Exchange Act Release No. 9267 (July 29, 1971), reprinted in [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,163.

21 This access to information may be an important consideration to prospective trust customers in choosing a bank as trustee:

> A bank officer making a loan is likely to learn as much about the internal affairs of his borrower as the management. Trustors know this. That is just the reason why many of them entrust their funds to bankers as fiduciaries.

on "material inside information," however, is currently considered to be contrary to public policy, as expressed in the Securities Exchange Act and enforced through rule 10b-5. That rule reflects the policy that there is an inherent inequity involved where one investor takes advantage of such inside information knowing that it is unavailable to the general investing public. Transfers of information between the trust and commercial departments are therefore unchallengeable only so long as "material inside information" does not pass.[22] Thus, balanced against its fiduciary duty to trust customers, the bank trustee now has an implied obligation to the investing public.

It is in this context that commercial banks have attempted to erect and have asserted the existence of a "wall"—a barrier to the flow of any "material" or "privileged" information—between the trust department on one side and the bank's directors and commercial department on the other. Conceptually, the existence of a wall implies that the trust department acts autonomously on the basis of information generated internally or received from independent external sources. Thus, with a completely and demonstrably effective wall, the trust department could not successfully be charged with trading on "material inside information" simply because such information was available to the commercial department.

A number of legal problems confront bank trustees seeking to establish a wall as a means of resolving the potential conflicts and reducing the potential legal liabilities arising from the imposition of rule 10b-5 requirements on traditional information flows. While the magnitude of these problems is somewhat dependent upon the character and solidity of a particular wall, the technical legal issues involved are common to all wall-using banks. One problem that must be surmounted in designing a wall is that distinctions must be drawn between information that is definitely privileged and information that is either not privileged or of uncertain status. The law surrounding rule 10b-5, as it has developed thus far, implies that a trustee possessing material inside information cannot use this information to benefit his fiduciary accounts.[23] Accordingly, were a beneficiary to institute a surcharge action against a trustee for failure to use material inside information

Statement of John Lee, Executive Vice President of the New York Clearing House, in a panel discussion, Banking Regulation—Too Much, Too Little—and the Prospects for the Seventies, 26 Bus. Lawyer 139, 148 (1970).

[22] Harfield, Texas Gulf Sulphur and Bank Internal Procedures Between the Trust and Commercial Departments, 86 Banking L.J. 869, 873 (1969).

[23] This conclusion may be distilled from the series of cases arising out of the manner in which Merrill Lynch, as underwriting broker, handled the issuance of Douglas Aircraft Co. securities. See Shulof v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,147 (S.D.N.Y. 1971); Smachlo v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,148 (S.D.N.Y. 1971).

in investment decision-making, a court would probably dismiss the suit on the grounds that the beneficiary had no right to expect an illegal act by a trustee.[24] Much of the information received by the various departments of a walled bank, however, is not "material inside information." The total walling-off of departments would therefore impede the flow of that relevant information which is not barred from use by "insider" prohibitions. Although it is possible to hypothesize a wall capable of selectively filtering out "material inside information" while permitting the free flow of all other useful knowledge, in reality such discriminating control presents formidable administrative difficulties. As noted below, none of the walls revealed by the present study were organized with sufficient care and administrative apparatus to suggest the likelihood that such discrimination can be exercised.

A second difficulty arises from the fact that the concept of "material inside information" is imprecise, and what appears to be privileged information at the time it is first noted by the trustee bank may later be found by a court to be non-privileged. Fear of such an occurrence has been partially allayed by the recent *Investors Management* decision. In that case, the SEC asserted that:

> [T]here is no basis for the stated concern that a fiduciary who refrains from acting because he has received what he believes to be restricted information would be held derelict if it should later develop that the information could in fact have been acted upon legally. If that belief is reasonable, his non-action could not be held improper.[25]

In spite of this holding, there are still a number of valid reasons for fiduciary concern. First, this statement does not apply to a case where, because a wall is unable to discriminate between different kinds of information, the trust department fails to receive from the commercial

[24] The language of *Cady, Roberts* seems to imply that the fiduciary's duty to obey rule 10b-5 is paramount. The SEC held that the relationship of a broker to his discretionary accounts "could not justify any actions by him contrary to law. Even if we assume the existence of conflicting fiduciary obligations, there can be no doubt which is primary here. On these facts, clients may not expect of a broker the benefits of his inside information at the expense of the public generally." 40 S.E.C. at 916. The duties of a trustee to his beneficiary may well be greater than those which a broker owes to his client. The SEC reaffirmed its position in *Investors Management*, holding that "[t]he obligations of a fiduciary do not include performing an illegal Act." [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. at 80,522. Judge Friendly, speaking about the trustees' conflicting duties in a similar situation, said that the plaintiff beneficiary "could hardly be heard to claim compensation for the premium he might have extracted from some innocent victim if he had known of the fraud and the buyer did not." Levine v. Seilon, Inc., 439 F.2d 328, 333 (2d Cir. 1971).

[25] Investors Management Co., SEC Securities Exchange Act Release No. 9267 (July 29, 1971) reprinted in [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,163, at 80,522.

department information about which no confidentiality issue could have been raised. Second, the Commission opinion still leaves open the question of the "reasonableness" of a bank's belief that particular information must be regarded as privileged. Finally, the courts themselves have not yet spoken on this question. Thus, despite the language of the opinion, it cannot be assumed that the failure of a trust department to receive or to use certain information can be successfully defended simply on the basis of the bank's paramount duty to obey rule 10b-5.[26]

A third problem is one of credibility and ability to prove, in a 10b-5 action, effective separation. There is, after all, a legal unity and a common interest among bank departments separated by a wall. One set of officers and directors is charged with legal responsibility for all parts of the bank. The passing of crucial information between departments is obviously quite simple to accomplish. Thus where trust department trading has occurred while the commercial department was in possession of borderline or confidential information, the burden of proving the existence of an effective wall could present real difficulties; and even where the bank is able to demonstrate that a solid wall exists, the question of jury acceptance of such proof remains. In the *Investors Management* case, several of the defendants failed to convince the SEC that they had traded on the basis of *non-privileged* information. A footnote by the Commission contains the following language:

> We consider it appropriate to observe that in future cases we would view as suspect and subject to close scrutiny a defense that there was no internal communication of material non-public information and its source by a member of a broker-dealer firm or other investment organization who received it, where a transaction of the kind indicated by it was effected by his organization immediately or closely thereafter. A showing of such receipt and transaction prior to the time the information became public should in itself constitute strong evidence of knowledge by the one who effected the transaction and by the firm.[27]

[26] The recent case of Black v. Shearson, Hammill & Co., 266 Cal. App. 2d 362, 72 Cal. Rptr. 157 (Ct. App. 1968), exemplifies the unsympathetic view which some courts have taken toward a fiduciary who places himself in a conflict of interest situation. The court said: "[W]e have been given no sufficient reason for permitting a person to avoid one fiduciary obligation by accepting another which conflicts with it . . . . The officer-director's conflict in duties is the classic problem encountered by one who serves two masters. It should not be resolved by weighing the conflicting duties; it should be avoided in advance . . . or terminated when it appears." Id. at 368, 72 Cal. Rptr. at 161. For a discussion of this case, see Leiman, Conflict of Interest and Related Problems of Broker-Dealers and Investment Advisors, First Annual PLI Institute on Securities Regulation 335-38 (Mundheim, Fleischer, and Glazer eds. 1970).

[27] [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. at 80,522 n.28.

In borderline cases, therefore, the bank trustee may be proceeding at some risk. If the bank acts in a manner consistent with the possession of inside information, prior to the public disclosure of such information, it may be held to be a "tippee"[28]—the "tip" having been passed to the trust department by the commercial department or by a bank director with relevant outside affiliations. To prove the existence of an effective wall in such a case would pose practical and evidentiary difficulties. On the other hand, should an effective wall be established, preventing any information from being transmitted to or used by the trust department, the bank may open itself up to suit by trust beneficiaries alleging that the bank's failure to utilize non-privileged information to protect the trust or to advance its investment objectives was a breach of duty.[29] The fact that the information was withheld from the trust department in the interest of avoiding transmission of material inside information would not excuse the failure,[30] since the bank trustee should not have put itself in a position where its interest in the maintenance of normal commercial relationships and the avoidance of 10b-5 suits might conflict with its duty to act in the best interests of the trust.[31]

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[28] The term "tippee" refers to one who, although unrelated to a corporation, receives inside information concerning it from another who *does* stand in a fiduciary relationship with the corporation. See Bromberg, Tippee Risks and Liabilities, 3 Rev. Sec. Reg. 875 (1970).

[29] As indicated above, see text at notes 4-5 supra, banks traditionally held out their commercial departments to be a special source of information. Today, trust department advertising continues to call attention to an institution's information gathering skills in the investment area. A recent advertisement for the First National City Bank (New York) uses the following language: "Our research department knows how to harvest the most significant investment information. They keep on top of what's happening in the city. All around the country. In all fields of investment." Institutional Investor 25 (August 1971). Courts may hold an institutional trustee to its representations of superior investment skill. See, e.g., Liberty Title and Trust Co. v. Plews, 142 N.J.Eq. 493, 60 A.2d 630 (Ct. Ch. 1948). Where a wall obstructs the flow of relevant investment information and the trust beneficiaries have not been notified of this constraint, a court may find that the trustee has not made adequate full disclosure.

[30] A bank's directors are specifically responsible for the trust department, including the investment and disposition of property. Comptroller of the Currency of the United States, Comptroller's Manual for Representatives in Trust, § 9.7.

[31] There is a line of cases holding that a corporate trustee may not put itself in a position where its interest is or might be in conflict with its duty. See, e.g., Albright v. Jefferson County Nat'l Bank, 292 N.Y. 31, 53 N.E.2d 753 (1944); In re Ryan's Will, 291 N.Y. 376, 52 N.E.2d 909 (1943). An exception to this rule may be made where the creator of the trust has placed the trustee in an obvious conflict of interest situation which was recognized and accepted at the time the trust was drawn. In re Kellog's Trust, 35 Misc. 2d 541, 230 N.Y.S.2d 836 (Sup. Ct. 1962). See also Black v. Shearson, Hammill & Co., 266 Cal. App. 2d 362, 72 Cal. Rptr. 157 (Ct. App. 1968), discussed in note 26 supra.

The rule suggested by these cases is obviously not predominant, else the potential conflicts of corporate trustees could not have become as extensive as they are in fact, but it hovers in the background as a consideration that may be brought to bear in cases where beneficiaries are dissatisfied with the trustee's conduct. Although the rule would

II. The Wall as a Business Reality

The wall is not a physical barrier between departments, although it may provide for their physical separation; it is essentially a body of rules and procedures designed to control the interdepartmental flow of information. Most walls are not intended to prevent the passage of all information or to terminate all forms of contact between departments. The typical wall is much more limited in scope—a result, in large part, of major structural and legal impediments to complete separation.

A. *Business Impediments to a Solid Wall*

1. *Reciprocal Service and New Business Effort*

Implicit in the preceding discussion of the new legal environment facing trust banks is the fact that the efforts of the past decade to establish a wall between trust and commercial departments of banks have *not* arisen from the business needs of the separate departments or of the bank as a whole. On the contrary, the business advantages of associated operations were the key elements underlying the long process of integration of trust and commercial operations.[82] The advantages of knowledge-sharing and the usefulness of information flows have already been mentioned.[83] In addition, an affiliated trust department—in its role as a so-called "feeder"—has long been recognized as a factor facilitating the expansion of the commercial department, and aiding in the retention of existing bank customers, by permitting the bank to offer a full line of banking services. Indeed, the services offered by the trust department may be the marginal element that wins or holds a customer,[84] and it may be necessary to offer such services in a comprehensive package if rivals are doing so. Customers initially brought into the bank by the trust department may be induced to purchase other bank services.[85] Trust departments control the disposi-

probably not be applied where trust beneficiaries could have profited by the use of confidential information that was held in the commercial department but not transmitted to or used by the trust department, it could well be considered pertinent where confidential information fails to pass through a wall constructed to circumvent potential conflicts of interest, or where corporate relationships influence the acquisition, sale, or non-sale of trust securities.

[82] See J. G. Smith, The Development of Trust Companies in the United States 356, 364, 409 (1927); Searle, Trust New Business Program, 106 Trusts and Estates 1133 (1967); Kanaly, The Bank Trust Department: Its Purposes and Their Achievement, 108 Trusts and Estates 883 (1969).

[83] See text at notes 12-14 supra.

[84] Treman, Need of Close Working Relationship Between Commercial and Trust Departments, 100 Trusts and Estates 1169, 1170 (1961) [hereinafter cited as Treman], states that "when a bank offers well rounded and competent trust service, it can often hold important banking business that would otherwise be lost to competing institutions."

[85] "It should be part of every trust officer's duty, and so pointed out to him, that

tion of trust deposit accounts, which traditionally have been held almost exclusively in the associated bank.[36] Finally, these associational benefits accrue in addition to whatever profits are generated internally by the trust department itself.

Other parts of the bank, especially the commercial department, have provided important reciprocal sources of business for the trust department:

> As the trust business became more and more an affiliated service of commercial banks over the past 125 years, it was increasingly natural that commercial customers of banks constituted the best sources for trust business. For this reason the degree of cooperation between commercial banking officers, directors and the trust department has always been important in the development of trust business.[37]

Invitations to the bank to serve as corporate trustee, registrar, transfer agent, or custodian of employee benefit plans, are more readily obtained from the bank's commercial customers than from strangers, and new business activities in the trust department focus heavily on soliciting corporate business from the bank's commercial customers.[38]

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he must lose no opportunity to create new business for or serve other interests of the bank. It is only by assisting the other fellow to build up his department that we can rightfully expect or actually get him to assist us in building up ours." Roseberry, Coordination of Trust and Banking Department Activities, Proceedings of the Twelfth Mid-Winter Trust Conference 56 (1931). "It is almost inevitable that if your competitor serves your trust customer, the customer becomes his customer. On the other hand, the trust department may be used as a tool to reach your competitor's customer. If he becomes a trust customer, he is likely to become a banking customer." Ferguson, Trust Department Profits—At What Expense?, 102 Trusts & Estates 1173 (1963).

36 In many banks the trust department is the largest single bank depositor. "Commercial banks compete intensely for deposits; and a trust department is one of the banking department's best and most reliable customers . . . . As a banking department customer, the trust department is unique; its substantial balances exist without expense to the banking department for solicitation or supervision." Treman, supra note 34, at 1169-70.

37 Hunt, The Bank Loan Officer as a Source of New Business 5 (1961) (unpublished thesis on file at the Pacific Coast Banking School, Seattle, Washington).

38 According to studies cited in Hunt, supra note 37, at 2-3, 19-20, the volume of trust business originating from commercial customers was estimated to be on the order of 50% in 1945 and 1950 and about 25% in 1960. The expanding importance of employee benefit plans has probably increased this percentage over the last decade. In the present study, estimates provided by nine respondents of the amount of trust business attributable to commercial customers ranged from 30% to 80%, the median being approximately 50%.

A recent SEC study has found a significant positive correlation between bank-customer relationships via the trust department and commercial department customers: "Loan and demand deposits also are associated positively with the existence of a managerial relationship [e.g., management of employee benefit plan funds] between a bank and a company . . . . Among other institutional types, the only positive, systematic correlation is between plan management and institutional size, indicating that

Moreover, a significant amount of solicitation effort in the personal trust and agency area is devoted to attracting the individual business of officials of commercial customers.[39]

Such cooperative efforts to generate new business involve information exchanges and some degree of coordinated activity between trust and commercial departments. They commonly go beyond mere *ad hoc* referrals regarding specific prospects, and often include: (1) systematic transmission of credit information as a basis for contacts;[40] (2) programs teaming new business officers in the trust department with certain commercial officers; (3) quota and reward systems for referrals; (4) joint presentations to prospective customers; and (5) formal educational sessions.[41] A discussion among trust officers of the methods of utilizing to maximum advantage the trust department/commercial department relationship has been summarized as follows:

> [Officer #1] said her trust department arranges annually a special program for commercial officers, partly educational and partly social. Usually three trust officers cover three aspects of trust department activity, and over a ten year period this gives a lot of officer education. [Officer #2] said that in his bank all credit files that meet certain criteria are reviewed by the trust department as well as the loan officers.

these services are ordinarily provided by larger institutions." Institutional Investor Study Report of the Securities and Exchange Commission, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. 2729 (1971).

39 See, e.g., United States Trust Company of New York, 1969 Annual Report 5:

> In October we instituted a new service known as Plan FOUR, which consists of an overall review and continuing surveillance of the personal financial affairs of groups of top executives of major corporations. Our compensation will be provided by the corporations themselves, which will offer our package of services as a valuable and, we believe, sought-after fringe benefit. We have all of the capabilities for this type of individual counseling within our organization today, and the value to us of the establishment of such working relationships with many of the leaders of American industry cannot be over-estimated.

40 See, e.g., Wilkinson, Don't Isolate Your Trust Department, 99 Trusts and Estates 576, 577 (1960), in which one bank's program was described as follows: "[A] copy of every credit memorandum comes to our trust department, so that we are able to pick up the names of those good commercial customers who may otherwise have been overlooked by our lending officers." Officers of seven banks interviewed in the present study reported that credit information and reports of commercial officers are continually transferred to new business trust officers to facilitate contacts with potential clients.

41 A fairly typical operation in one moderate-sized bank was summarized by a new business officer in a personal interview with the authors as follows: Each new business officer is assigned to a number of group heads on the commercial side. He is to work with those heads to get them to stimulate the employees under them to get new business. There is a printed schedule of rewards for referrals that is applicable to either commercial officers or estate planning officers. The estate planning officers focus their efforts on establishing rapport with the group heads. There are also monthly sales meetings that bring together both commercial and trust department personnel, at which the estate planning people get fifteen minutes in which they can report progress, prod, and instruct on the new business effort.

> [Officer #3] said his department has direct talks with loan officers and is now preparing a sales-oriented manual. [Officer #4] stated that some banks have an educational trust training program for bank officers . . . .[42]

In spite of the new business obtained through such methods, trust departments frequently operate at a loss on the basis of standard bank accounting principles.[43] Indeed, such losses have been a long-standing problem in the trust field.[44] Even many of the larger trust departments appear to be unprofitable if bank earnings from trust deposits are not credited to their profit and loss account.[45] The widespread phenomenon of trust department losses, coupled with the continued operation and spread of these departments, suggests that their raison d'être must often come from their special importance to the larger entity—that is, from benefits to the bank that are external to the trust department. Such justifiable functional integration is not easily reconciled with the structural separation of a solid wall.

2. *Structural Obstacles to a Wall*

The solidity of a wall between the commercial and trust departments is affected by certain characteristics of banks and bank trust departments inherent in the institutional structure. The board of directors of the bank is legally responsible for bank profits *and* for the proper performance of fiduciary obligations in all cases where the bank is a trustee.[46] It is the stockholders' capital fund that protects the

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42 106 Trusts and Estates 1115, 1121 (1967).

43 Searle, Trust New Business Program, 106 Trusts and Estates 1133, 1136 (1967), estimates that "at least three quarters of the trust departments of the nation are unprofitable, even after allowing them credit for monies on deposit with the banking department, as well as credit for services performed for the banking department."

44 Smith, supra note 32, at 364.

45 The 1969 annual survey of trust department income and expenses in New York, New Jersey and Fairfield County, Connecticut, carried out by the New York Federal Reserve Bank indicated that 69 of the 126 trust departments surveyed, or over 50%, showed net losses before taking into account bank earnings from trust customers' commercial deposits. After deposit credits only 29 showed net losses. Trust Department Income and Expenses, 109 Trusts and Estates 960 (1970).

The advantage of trust deposits to many trustee banks, though still invaluable, may be diminishing somewhat. There has been increased pressure in the last decade to minimize trust department cash and to allocate these values to the fiduciary accounts themselves. It is not inconceivable that bank handling of trust deposits may be under legal attack in the not too distant future in the same manner as is the traditional appropriation by the bank of a large fraction of the value of brokerage commissions via the purchase of deposits. For a discussion of the class actions filed against the Chemical Bank New York Trust Co. and the Morgan Guaranty Trust Co. for alleged misuse of brokerage commissions, see 81 BNA Sec. Reg. & L. Rep. at A-1 (December 16, 1970).

46 "All matters pertinent [to the operation and performance of the trust department], including determination of policies, the investment and disposition of property

trust beneficiaries, and any surcharge for a failure of responsibility by the directors will be levied upon that fund.[47] Thus the board and the chief executive officers of the bank have a responsibility to both the commercial *and* trust departments, and the creation of an effective wall could require of them a dichotomy of mind that may be difficult or impossible to attain.[48]

The same structural problem is evident where the bank's investment policies are said to depend in large measure on its knowing and evaluating corporate management. An officer of the United States Trust Company of New York, for example, has said that his company makes about eighty percent of its investment judgment on the basis of management.[49] Another officer of the same company stated that "[a]t U.S. Trust we very seldom invest a substantial amount in a company whose management we've never met." He indicated that management can best be appraised when the corporation is a customer of the bank's commercial operation.[50] Once these officers have made an appraisal of management from the standpoint of the bank as a lender, they will find it difficult to change that appraisal on the ground of new information flowing into the commercial department without simultaneously altering their judgment of that management from the standpoint of their responsibilities to trust accounts.

The board and chief executive officers, in attempting to establish an effective wall, may delegate responsibility to lower echelon personnel and create separate units between which few if any interchanges of information occur. Ultimate responsibility nonetheless remains with those charged with legal obligations to the bank's shareholders. Thus, even where divisional separation and delegation of authority are relatively great, in strategic cases or crisis situations the matter will be brought before the board or principal executives for action, and the wall may suddenly disintegrate as information from all departments is pooled in the interest of the larger entity. Typical of the examples

held in a fiduciary capacity, and the direction and review of the actions of all officers, employees and committees utilized by the bank in the exercise of its fiduciary powers, are the responsibility of the Board." Comptroller of the Currency of the United States, Comptroller's Manual for Representatives in Trust § 9.7.

47 See, e.g., N.Y. Bank. Law § 100-b (McKinney 1971).

48 Speaking at a panel discussion dealing with bank-related insider problems, Mr. Phillip Loomis, General Counsel of the SEC, stated:

> I was talking about this point to a banker—and it wasn't too small a bank. He said that he was often consulted by both the trust department and the commercial department, and that what he learned in one capacity he had to "forget" in the other, which struck me as something of a mental feat!

The Loan Officer and Conflicts of Interest, 51 J. Comm'l Bank Lending 3, 10 (1969).

49 Statement of T. Richard Spoor, Vice President, United States Trust Co., quoted in Report on New Jersey Trust Conference, 108 Trusts and Estates 54, 56 (1969).

50 Statement of Charles Buek, How the SEC Study Views Bank Trusts—and Vice Versa, 89 Finance 34, 40 (1971).

which illustrate this point is a case in which a good corporate customer of a large bank with a relatively solid wall refused to pay the higher charges levied by the trust department on custodial accounts, on the ground that the company's bank deposit was sufficiently large to exempt it from such an increase. The matter was taken to the chief executive officer of the bank for a decision. He decided to accommodate the customer, who was permitted to escape the higher rates. Interestingly, no credit was given to the trust department for the deposit which justified this discriminatorily low rate, although the department was permitted to note this arrangement and concession in their internal reports to top management.[51]

Another important form of wall breakdown, illustrative of the limited delegation of authority to a walled division, may occur when the trust department wishes to sell a large block of stock in a corporation which is a valued commercial customer. In one such case, where the customer had earlier evidenced a sensitivity to such "disloyal" behavior on the part of one of its major banks, the matter was placed in the hands of the chief executive officer of the bank. It was this top officer rather than the ranking trust department executive who gave clearance for the sale. A third type of case, in which a crisis situation generates a sudden flow of information outside of the trust department, may be illustrated by the events surrounding the threatened tender offer made in 1969 by Leasco Data Processing Corporation for Chemical Bank of New York. In the process of responding to this threat, the top management of Chemical Bank, which had established an official "wall" between the commercial and trust departments through which no privileged information could flow, very quickly put itself in possession of a detailed breakdown of the amount of Leasco stock held in the various trust accounts of the Chemical Bank trust department.[52]

Within the formal organization of most banks there is generally a directors' committee concerned with trust affairs. This committee is sometimes comprised solely of outside directors, but more commonly includes both outside and inside directors, having at least one executive officer of the bank among them. In some cases, this board trust committee is essentially inactive, functioning only as a formal body to fulfill a legal requirement—a "rubber stamp"; or it may be designed mainly to evaluate the trust personnel, who are given the authority to make all fundamental decisions. In other cases, however, the board trust committee is active in setting trust department policy, planning

[51] This case was related in a confidential interview between the author and an officer of the trust department in question.

[52] Hearings on Leasco Data Processing Corp. Before the Antitrust Subcomm. of the House Comm. on the Judiciary, 91st Cong., 2d Sess., pt. 2, at 148, 532 (1969).

investment strategies or evaluating trust department security holdings.[53]

Officer-director participation in trust department decision-making varies in degree from bank to bank and is hard to measure very precisely. In reviewing the collected interview data and documents examined in the present study, it was found that in about twenty banks, or approximately one-third of those examined, commercial officers were currently serving or had recently served on active decision-making committees within the trust department. An intensive review of more detailed data available for twelve large and medium-sized trust departments revealed that in five cases the board trust committee, or individual high level commercial officers serving on trust committees, played an "active" role in trust department decision-making. In three cases the board was clearly inactive. In the four remaining banks, the evidence was conflicting and unclear, partly because of recent changes in structure and policy. In the five instances where there were either active boards, effective officers, or both, the duality of function of these officials extended into the committee and decision-making structure itself. Thus, the involvement of bank directors at decision-making levels of bank administration is a further structural obstacle to an effective wall.

3. *Obstacles Arising from Association and Proximity*

Another set of obstacles to an effective wall may be described as associational factors. The smaller the bank and trust department, the more likely that trust and commercial people will be in close physical proximity. In some cases they may even be identical persons. Even in large institutions, dining facilities, for example, are usually shared in common by all bank departments. There is also a fair amount of personnel movement between trust and commercial departments in some banks, which makes close personal relationships likely.

Under these circumstances, information available to the commercial department and relevant to the trust department may well be in the mind of the trust officer by virtue of his simultaneous occupancy of a commercial banking position; otherwise it is probably nearby, in the possession of the people—often personal friends or acquaintances—who work under the same roof, for the same management and corporate ends. In short, the forces of common interest, close physical proximity and ties of personal loyalty could be overcome only by an extremely strong wall.

[53] These and succeeding statements are based primarily on interviews conducted by the authors and staff with past and present employees of over 60 trust banks.

4. *Efficiency Considerations*

A major obstacle to the creation of a fully effective wall between the commercial and trust departments is the fact that such a wall would be detrimental to bank efficiency in a number of ways. A wall would make the gathering of information and the marketing of bank services more costly and less effective.[54] A wall would also reduce the possibility of utilizing available manpower in special projects. In many banks, trust department personnel have been used to work on merger plans, or on company analyses for domestic or foreign correspondents, which require access to privileged commercial information. Strict adherence to the wall concept would interrupt this interdepartmental flow of personnel and reduce the ability of the bank to utilize its skilled manpower with maximum efficiency.[55]

B. *The Current State of Bank Walls*[56]

In a majority of walled banks the essential component of the wall is an official policy statement or rule prohibiting the transfer of confidential information between departments, or limiting other departments' access to commercial department credit files. The demand for a wall is likely to be directly related to bank size. Thus in many trust banks, particularly smaller institutions whose trust and commercial personnel overlap, no walls have yet been established. Moreover, small institutions generally have relatively few commercial customers whose securities are likely to be of interest to the trust department. Even among the larger banks, however, rules have not been promulgated in all cases; in the sample studied, several banks with trust assets in excess of $1 billion had still not established an official rule on transfers of information between departments.

Of the thirty banks examined in this study for which information was available regarding the accessibility of credit files to the trust department, eleven banks reported that the files were available currently, either directly (six banks) or by roundabout procedures (five banks); ten banks reported that credit files were accessible in the recent past (1966-1970); and nine banks reported that credit files were entirely closed off. These results should be accepted with some qualification, however. This is an area of constant change, so that the ten banks that indicated continued accessibility may have since changed

54 Roseberry, supra note 35, at 54-55.

55 Treman, supra note 34, at 1169. The legal pressures for a wall recently caused one large trust department, which had used its research personnel with considerable flexibility in a single department servicing the needs of both the commercial and the trust investing sector, to separate the two completely.

56 This section describes the scope and character of bank walls in the period 1967-1971 based upon interviews with current and former trust bank personnel.

their policies. Moreover, in seven of the nine banks where credit files were reportedly inaccessible to the trust department, the information on inaccessibility was derived solely from "official" policies or rules as reported by high officers of the bank; no data was gathered from lower echelon personnel or outsiders either confirming or denying the effective implementation of these policies.

Of the banks that have closed off or sharply restricted trust department access to commercial credit files, few, if any, have terminated all communication between analysts, portfolio managers and loan officers in the various departments. In most cases the official walls are applicable only to confidential information. For example, at Chase Manhattan Bank, one of the first banks to concern itself with this problem, the official policy guide not only confines its wall prohibitions to "inside information" but states explicitly that "[t]hese instructions . . . in no way alter the duty of those charged with trust investment decisions to obtain all relevant information which they can properly receive and use. The proscription relates solely to 'inside information' which is 'material.' "[67]

Certain forms of two-way verbal communication between departments are still acknowledged by personnel in most large banks with official walls,[68] and access of commercial personnel to trust department files and analysts is often unrestricted even where the flow in the opposite direction is limited.[69] A trust department officer in a walled bank is generally still permitted to contact a loan officer for non-privileged information, such as a generalized judgment on the quality of the management of a corporate customer; and a loan officer will sometimes consult with a knowledgeable trust department analyst on such matters as the analyst's interpretation of some complex facts contained in the prospectus for a security offering.

The available data indicate that both decisions as to what constitutes "privileged" information and enforcement of wall rules are generally left to the individuals subject to the rules. The Chase memorandum cited above, one of the few that attempts to define the difficult terms involved, states that "[t]o be 'material,' the information

[67] Chase Manhattan Bank, Policy Guide, quoted in Staff of Antitrust Subcomm. of the House Judiciary Comm., 92d Cong., 1st Sess., Investigation of Conglomerate Corporations 198-99 (1971) [hereinafter cited as Investigation of Conglomerate Corporations]. The policy guide of Nov. 4, 1968, was still in effect and applicable in late 1971.

[68] Of 31 banks responding the questions concerning verbal communication between personnel in the commercial and trust departments, only 4 reported that commercial officers are not permitted to talk to trust department people at all. In the remaining 27 banks, although willingness to discuss investment matters varied, 17 reported that commercial officers readily communicate with trust department personnel.

[69] The problem of confidentiality rarely arises in connection with information originating with the trust department, so that the flow from that department to the commercial department does not raise serious insider problems.

must be such that, if generally known, it would be likely to affect investment decisions or the market value of the security involved. To be 'inside,' the information must not have been publicly disclosed."[60] Even these definitions clearly leave a great deal to be resolved by the enforcing individual or group. The frequent absence of any official definition of inside information, and the even more general failure to produce operational rules for identifying different classes of information, suggest that some walls may be only "for the record," and that others may be extremely crude in application. Unless the cutoff of information flows is comprehensive—and the data reveal that it generally is not—a serious effort at sorting out privileged and nonprivileged information, involving considerable thought, operational definitions and enforcement machinery, is required if the wall involved is to accomplish its objectives.

In some banks, individuals are advised to consult their department head or the bank's legal counsel in cases where there is doubt as to the confidentiality of information and the appropriateness of interdepartmental communications. In other banks, communication between trust department and commercial department personnel can be carried out only with the approval of the head of the department.[61] Apart from this procedural arrangement, the present study revealed no instance where special enforcement machinery has been established to supervise interdepartmental information flows on a continuing basis. Thus it may be concluded that even today, with a few possible and partial exceptions, the wall can be and is breached even where official wall rules have been announced.[62]

The coordination of trust department and commercial personnel in undertaking new business solicitation efforts on a joint basis has

[60] Investigation of Conglomerate Corporations, supra note 57, at 198-99.

[61] In a recent panel discussion before an audience of bankers, one banker-participant made the following statement:

> In our shop the trust department officer can get the credit file only if he gets approval from the manager of the credit department. Just as a matter of interest, with a show of hands, how many people here work in banks where only the commercial banking officers can get to the credit files? In other words, where the trust department officers cannot get those files under any circumstances. [The show of hands was a little less than a majority of the audience.]

Statement of Mr. Duffy, quoted in The Loan Officer and Conflicts of Interest, 51 J. Comm'l Bank Lending 3, 10 (1969).

[62] According to Mr. David Rockefeller, Chairman of Chase Manhattan Bank: "To assure the proper use and control of information received by the bank in its several capacities, there is no flow, or incidental communication of inside information, from the commercial departments or divisions of the bank to the fiduciary investment department . . ." Hearings on H.R. 5700, H.R. 3287 & H.R. 7440 Before the House Comm. on Banking and Currency, 92d Cong., 1st Sess., pt. 2, at 751 (1971) (testimony of Mr. Rockefeller). In light of the textual conclusions above, it is submitted that it is unlikely this assertion is accurate and that indeed the accuracy of such a statement is beyond Mr. Rockefeller's or any similarly situated bank officer's capacity to know.

already been noted.[63] Little or no attempt has been made to erect a wall in this sphere, which involves referrals, introductions, and often joint briefings and educational efforts. When customers call at the bank, for social or other reasons, it is not uncommon for both trust department and commercial personnel to be invited to the technical presentations or social gatherings, each of which may have a business value for the respective department. When the securities of a commercial customer are to be sold by the trust department, the commercial officer in charge of the account is frequently notified in advance.

There is also a continuing tendency on the part of bank officers to look upon the bank as a single entity whose various parts can be mobilized in the interest of individual departments, thus benefiting the profit-making organization as a whole. Several examples have been cited above.[64] A further illustration is provided in the recent Investigation of Conglomerate Corporations,[65] where an executive of a customer of the walled Chase Manhattan Bank (who had himself previously been an officer of Chase), expressed a desire to pay for a trust department service with an additional commercial balance rather than a larger fee. An internal office memorandum of Chase, dated October 3, 1967, states:

> During a discussion with [the customer officer] yesterday, [he] asked me whether or not the transfer agency relationships we have from Gulf & Western are profitable to us. [He] felt that because of the high volume, these may not be showing the profit that we would like. If this is the case, he would prefer that we make our adjustment in balances rather than by increasing fees.[66]

It is interesting to note that compensation to the trust department in the form of payment to the commercial arm of the bank was not automatically ruled out as impermissible, and was, in fact, suggested by a former Chase officer. Compensation to the "other side" of the wall, then, is a convenience that some commercial customers desire, and even a walled bank finds it difficult to avoid making this kind of accommodation for good customers. It is clear, then, that some form of communication and mechanical adjustment will have to move across the wall in order to implement an intrabank compensation arrangement satisfactory to all departments.

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63 See text at notes 37-45 supra.

64 See text following note 33 supra.

65 Investigation of Conglomerate Corporations, supra note 57.

66 Id. at 182-83.

Conclusion

The traditional role played by most bank trust departments as service adjuncts of the commercial bank, and the role of the commercial arm in facilitating the growth of trust business, have involved close communication and reciprocal accomodation between the two departments. The relationships arising out of these integrated operations facilitated the bank's performance of its fiduciary duties as trustee, and originally constituted a major reason for the affiliation of trust and commercial operations within one banking institution.[67] However, these same interdepartmental relationships seriously hamper the bank in its attempt to comply with the legal duties imposed upon it by rule 10b-5 as it is currently interpreted by the courts. The deep mark left by the historic association of trust and commercial departments, together with a wide array of business objectives, structural, associational and efficiency considerations, makes a truly effective wall between these departments costly to the banks and inherently difficult to construct or maintain. The challenge to the law in attempting to resolve these problems is formidable. Changing business practices give rise to a proliferation of unanticipated legal issues, and temporary solutions rapidly became institutionalized, creating vested interests that courts may be reluctant to challenge on the basis of abstract principles.[68] The result is chronic uncertainty as to the state of the law at the frontier of "advanced" business practice, with the facts of individual cases frequently giving little indication as to what decisions might result with a somewhat altered factual context.

To a considerable extent the wall that banks have built over the past ten years is an artificial product of the legal necessities and pressures discussed above. In the larger banks, increased size and bureaucratization have facilitated the necessary separation. A large trust

[67] For a further discussion of this point, see Herman, Conflicts of Interest in the Savings and Loan Industry, Wharton School Study of the Savings and Loan Industry for the Home Loan Bank Board 773-81 (1969).

[68] The Kentucky Court of Appeals, confronted with a trust law prohibition potentially applicable to a current business practice, reasoned as follows:

> It seems to us that the rigorous rule of absolute prohibition of trust-to-trust transactions, irrespective of the particular circumstances, as laid down by the Ohio Supreme Court . . . and perhaps by other courts less explicitly or directly, is not required in the application of the principle of loyalty. Some of the largest and strongest financial institutions of the country have become such because of their satisfactory trusteeship of many estates. It appears to be a common practice and one generally recognized among the most honorable of financiers as proper and legitimate. So far as it is reflected in the opinions of the courts of the country the practice seldom resulted in harm.

Bryan v. Security Trust Co., 296 Ky. 95, 102, 176 S.W.2d 104, 109 (1943). See also In re Rees' Estate, 53 Ohio L. Abs. 385, 85 N.E.2d 563 (Ct. App. 1949), holding that the duty of the court, in light of modern business transactions, is to determine whether there is a substantial breach of legal requirements rather than mere technical breaches.

department develops its own organizational interests, objectives and autonomy. Physical separation and profit center status reinforce the impetus toward autonomy. Increased legal pressures for the wall have been partially met through greater bank formalization of trust department autonomy.

In some banks, especially smaller institutions, the construction of a wall has not even been attempted as yet; in others it has been built, but in general it has been made with materials that have failed to resolve the problems that flow from the impact of rule 10b-5 on the historic role and continuing mode of integration of the trust department into the commercial bank. A resolution of these difficulties will not be easy. Total separation of trust and commercial activities into completely unaffiliated entities, if required by law, would settle the uncertainty, but this solution involves two principal difficulties. First, a large number of existing trust relationships are based upon the financial power, responsibility and influence arising from the bank's commercial activities, so that severing the relationship would present a formidable array of legal problems. A second difficulty arises from the service nature and relatively low profitability of bank-supplied trust services. The advantages to banks derived from providing these services, and certain efficiencies in marketing, have almost certainly kept the costs of trust services to public buyers below those that would prevail in a bank-free trust service market.[69] It is difficult to recommend, and would be difficult for legislatures to require, structural changes that are likely to injure the consumer of the relevant services, unless the evil to be eliminated can be shown to be of great significance. Proof of such significance has not been forthcoming. It is submitted that the insider evils that would be corrected by total separation of trust and commercial functions are not of major social importance.

Spin-offs into holding companies would be a half-way solution that would seem to get at few, if any, of the problems considered in this article. The same may be said for the Hunt Commission recommendations.[70] Those that are relevant here propose that:

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69 The existence of 49 non-deposit trust companies raises the possibility that splitting off a trust department from a commercial bank would leave the trust department as a viable entity. An examination of the existing non-deposit trust companies, however, reveals that few are primarily in the business of offering fiduciary services to the public. Some of them are in, or have evolved out of, the business of managing the wealth of one family or operating as custodian to a title insurer or mutual fund. Those independent non-deposit trust companies that are conducting a public fiduciary business find themselves at a competitive disadvantage in such vital areas as generating new business leads and meeting the rates charged by other fiduciaries for comparable services. Few of the trust companies unaffiliated with a commercial bank are prospering.

70 The 1970 Economic Report of the President called for the appointment of a special presidential commission charged with conducting a thorough analysis of the structure and regulation of financial institutions in the United States and to submit

> [1] trust departments in banks with total trust assets greater than $200 million deny trust department investment personnel access to commercial banking department credit information. [2] no director, officer or employee of a corporate fiduciary recommends or initiates any purchase or sale of securities on the basis of insider information.[71]

Such proposals are naive. The problem is not primarily the termination of a steady flow of inside information between departments; rather it is one of preventing the relatively infrequent transmission of especially critical and strategic pieces of information. The Hunt Commission's proposals fail to get at the root of this problem, which relates to the interest of the bank as a profit-making entity in using all available information, the proximity and reciprocity interrelationships between bank departments, and the structural overlap of power and responsibility among the top officers and the board of directors. It is doubtful whether the costs of the real solution to the problem—total separation—would be justified by the resulting benefits, and existing wall rules and reforms such as those suggested by the Hunt Commission seem to be inherently flimsy, a whistling in the dark.

recommendations directed toward improving the nation's financial system. The commission was appointed on February 19, 1970 and Reed O. Hunt was named as Chairman. The Commission submitted its findings and recommendations in a report dated December, 1971.

71 Report of the President's Commission on Financial Structure and Regulation (Hunt Commission) 101 (1971).