

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

BOARD OF TRUSTEES OF THE AFTRA RETIREMENT FUND,  
in its capacity as a fiduciary of the AFTRA Retirement Fund,  
individually and on behalf of all others similarly situated,

Plaintiff,

v.

JPMORGAN CHASE BANK, N.A.,

Defendant.

No. 09-cv-00686 (SAS) (DCF)

BOARD OF TRUSTEES OF THE IMPERIAL COUNTY  
EMPLOYEES' RETIREMENT SYSTEM, in its capacity as a  
fiduciary of the Imperial County Employees' Retirement System,  
individually and on behalf of all others similarly situated,

Plaintiff,

v.

JPMORGAN CHASE BANK, N.A.,

Defendant.

No. 09-cv-03020 (SAS) (DCF)

THE INVESTMENT COMMITTEE OF THE MANHATTAN AND  
BRONX SURFACE TRANSIT OPERATING AUTHORITY  
PENSION PLAN, in its capacity as a fiduciary of the MaBSTOA  
Pension Plan, individually and on behalf of all others similarly  
situated,

Plaintiff,

v.

JPMORGAN CHASE BANK, N.A.,

Defendant.

No. 09-cv-04408 (SAS) (DCF)

**MEMORANDUM OF LAW OF AMICUS CURIAE THE SECURITIES INDUSTRY  
AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF THE MOTION FOR  
PARTIAL SUMMARY JUDGMENT BY JPMORGAN CHASE BANK, N.A.**

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**CORPORATE DISCLOSURE STATEMENT**

Pursuant to Rule 7.1(a) of the Federal Rules of Civil Procedure, Amicus Curiae The Securities Industry and Financial Markets Association hereby certifies that it is a non-profit corporation. It has no parent corporation and no publicly held corporation owns 10% or more of its stock.

### **PRELIMINARY STATEMENT**<sup>1</sup>

For nearly a century, American financial institutions have provided both fiduciary trust services and commercial lending under one roof. In that time, neither Congress nor the financial regulators charged with overseeing financial institutions have ever suggested that a financial institution which extends credit to a corporate customer has breached any duty – much less a duty of loyalty – to a fiduciary client that holds the same corporation’s securities in its account. Plaintiffs seek here to impose liability on defendant JPMorgan Chase Bank, N.A. (“JPMorgan”) on just such a theory. In sum, plaintiffs contend that, by extending secured credit to a non-party customer, Sigma Finance, Inc. (“Sigma”) through a repurchase agreement (“repo”),<sup>2</sup> JPMorgan breached its duty of loyalty to plaintiffs, clients of JPMorgan’s Securities Lending department, because their discretionary investment accounts held securities issued by Sigma.<sup>3</sup>

The Securities Industry and Financial Markets Association (“SIFMA”) seeks to be heard on its members’ behalf because plaintiffs’ unprecedented and novel theory contradicts decades of Congressional and regulatory guidance allowing integrated financial institutions to provide both investment management and corporate finance services, would make it extremely costly for financial institutions to provide many of the services Congress and the regulators have permitted,

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<sup>1</sup> While Second Circuit Local Rule 29.1 does not apply to proceedings in this Court, SIFMA states, consistent with that Rule, that no party’s counsel authored this brief in whole or in part; that no party or party’s counsel contributed money that was intended to fund preparing or submitting the brief; and that no person other than SIFMA, its members, and its counsel contributed money that was intended to fund preparing or submitting this brief. 2d Cir. L.R. 29.1.

<sup>2</sup> The term “repo” comes from “sale and repurchase agreement.” In a typical repo transaction, the “borrower” sells securities (the “collateral”) to the “lender” in exchange for cash (the “loan”) with an agreement to repurchase the same securities at a later date for a premium above the original sale price (the “interest”). In some circumstances, the borrower and lender will agree to “overcollateralize” the repo transaction through a “haircut,” where the value of the securities sold exceeds the value received in cash. Repos are commonly treated by courts as secured loans. *See, e.g., United States v. Manko*, 979 F.2d 900, 902 (2d Cir. 1992) (noting that “[i]n effect, a repurchase agreement is a loan in the amount of the proceeds of the original sale, collateralized by [the security], with interest equal to the difference between the sale and the repurchase prices”); *Resolution Trust Corp. v. Aetna Cas. & Sur. Co. of Ill.*, 25 F.3d 570, 578 (7th Cir. 1994).

<sup>3</sup> *See* Letter from Peter H. LeVan, Jr. to Honorable Judge Shira A. Scheindlin at 2 (Sept. 24, 2010).

and would limit the availability of or substantially increase the cost of both investment services and corporate credit. Specifically:

- Regulators have permitted the simultaneous operation of commercial banking and trust services for nearly one hundred years without finding inherent “conflicts” in transactions between a bank and an issuer whose securities are held in the accounts of trust clients, including secured lending extended to such an issuer;
- Modern multiservice financial institutions participate in thousands of arm’s-length transactions every day as part of critical functions that would be impaired by a theory of fiduciary duty that includes third party issuers;
- Due to the alleged “conflicts” posed by the hundreds of thousands of positions held by their fiduciary clients, firms may be forced to reduce their participation in lending transactions and shrink their investment management arms, resulting in diminished credit and capital formation, and reduced access to services and products for investment management clients.

For all of these reasons, SIFMA respectfully requests that the Court grant defendant JPMorgan’s motion for partial summary judgment on the basis that, as matter of law, a financial services institution does not violate a fiduciary duty owed to its investment management clients simply by extending secured credit to an issuer whose securities are held in the fiduciary clients’ accounts.

#### **SIFMA’S INTEREST IN THIS CASE**

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers.<sup>4</sup> SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit [www.sifma.org](http://www.sifma.org).

Plaintiffs’ novel “conflict of interest” theory is of great concern to SIFMA’s members. The putative “conflict” posited by plaintiffs would be endemic to every financial institution which manages assets (through fiduciary or trust accounts, discretionary accounts, or mutual

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<sup>4</sup> JPMorgan is a member of SIFMA.

funds) and engages in corporate lending, merger advisory or other corporate finance business. Indeed, plaintiffs' theory would make it difficult for multiservice financial institutions to simultaneously engage in many traditional investment management and corporate finance businesses.

## ARGUMENT

### POINT I

#### **PLAINTIFFS SEEK TO IMPOSE A DEFINITION OF FIDUCIARY DUTY THAT IS COUNTER TO THE POLICIES EMBODIED IN CURRENT BANKING LAW AND REGULATION AND WOULD IMPOSE UNTENABLE CONFLICTS ON THE ROUTINE FUNCTIONING OF BANKS**

A little more than a decade ago, Congress enacted legislation permitting modern multiservice diversified financial institutions to provide, among other things, asset management, retail and commercial banking, investment banking, insurance, and treasury and securities services. Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999). The purpose of this and prior laws authorizing financial institutions to provide the diversified services plaintiffs here claim raise "conflicts of interest" was to increase competition, allow institutions to realize economies of scale and scope and reduce the cost of asset management and corporate finance. *See* H.R. Rep. No. 106-74, at 98 (1999).<sup>5</sup>

What is more, the provision of commercial banking alongside trust services is nothing new. Federal law dating back to 1913 has permitted national banks to manage trust accounts while simultaneously engaging in commercial lending, Federal Reserve Act of 1913, § 11(k), 38 Stat. 251, 262, and federal regulators have authorized secured lending activity that is the functional equivalent of the repo financing at issue here. The Office of the Comptroller of the Currency (the "OCC"), the federal agency charged with the chartering, regulation and

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<sup>5</sup> *See also* Testimony of Sen. Bayh, 145 Cong. Rec. S13883, S13911-12 (Nov. 4, 1999) (permitting multiservice financial institutions "will also lead to greater efficiency, lower interest rates, and greater access to credit. It will also lead to greater innovation in the new marketplace with greater competition").

supervision of national banks under the National Bank Act, permits the commercial arm of a national bank to make secured loans *directly* to a fiduciary client. 12 C.F.R. § 9.12. Likewise, the Federal Deposit Insurance Corporation (the “FDIC”), the primary federal regulator for the 4,900 banks chartered by states that do not join the Federal Reserve System, authorizes the simultaneous investment of fiduciary assets and commercial bank lending *with respect to the same issuer*, provided that an information barrier is in place. *FDIC Trust Exam. Man.* § 8(D), available at [http://www.fdic.gov/regulators/examination/trustmanual/section\\_8/section\\_viii.html](http://www.fdic.gov/regulators/examination/trustmanual/section_8/section_viii.html).

The SEC and other regulators allow financial institutions to efficiently address potential conflicts through the creation and maintenance of information walls that stop the flow of material nonpublic information.<sup>6</sup> Congress and the SEC made clear their intent that banking institutions should not find their businesses *hindered* by the synergistic affiliation of multiple banking functions, providing that “a multiservice firm with an effective Chinese Wall would not be liable for trades effected on one side of the wall, *notwithstanding inside information possessed by firm employees on the other side.*” H.R. Rep. No. 98-355, at 28 n.52 (1984) (emphasis added).

Similarly, the Employee Retirement Income Security Act of 1974 (“ERISA”), which sets forth the fiduciary responsibilities owed by financial institutions that exercise discretionary control over the investment of pension plan assets, does not prohibit an institution from

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<sup>6</sup> The SEC and Congress codified the use of information barriers in a wide variety of insider trading contexts, including in Rule 14e-3b relating to tender offers, 17 C.F.R. § 240.14e-3, Rule 10b5-1 liability, 17 C.F.R. § 240.10b5-1(c)(2), the Insider Trading Sanctions Act of 1984 (the “ITSA”), 15 U.S.C. § 78u(d)(2), and the 1988 Insider Trading and Securities Fraud Enforcement Act (the “ITSFA”), 15 U.S.C. § 78o(f), as well as conflicts involving potentially improper influence exercised by investment banking interests on research analysts. *See* Sec. Exch. Act. § 15D(a)(3), 15 U.S.C. § 78o-6(a)(3); *Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the NYSE Relating to Exchange Rules 344, 345A and 472 and by the NASD, Inc. Relating to Research Analyst Conflicts of Interest*, SEC Rel. No. 34-48252, 2003 WL 21750579 (July 29, 2003). Likewise, the Federal Reserve endorses information barriers to prevent conflicts. *See Federal Reserve Policy Statement Concerning Use of Inside Information*, 43 Fed. Reg. 12,755, 12,756 (Mar. 27, 1978). Moreover, the SEC has provided guidance making clear that “[o]nly the individual(s) actually involved in the investment decision are covered by the [phrase ‘investment decisionmaker(s)] and [the Rule] does not include individual(s) that have a purely supervisory authority with respect to investment decisions.” *SEC Final Rule: Tender Offers*, 45 Fed. Reg. 60,410, 60,415 n.42 (Sept. 12, 1980) (emphasis added).

extending credit to an issuer whose securities are held in a pension plan's investment account, nor does it require a financial institution to breach an information wall separating its investment management arm and commercial lending business. To the contrary, ERISA contemplates that a financial institution may wear multiple hats without conflict, providing that an institution acts as a fiduciary to a plan only "to the extent" the actions taken by the institution are in its capacity as investment manager with respect to the plan's assets. *See* 29 U.S.C. § 1002(21)(A) (emphasis added). Likewise, the Supreme Court held that the necessary "threshold question" in a breach of fiduciary action under ERISA is not simply whether the institution's actions "adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint." *Pegram v. Herdrich*, 530 U.S. 211, 225-26 (2000). Accordingly, courts find that the actions taken by financial institutions in capacities outside their fiduciary investment management role with respect to plan customers, *e.g.*, the extension of secured lending by other departments within a financial institution to an issuer whose securities are held in a plan's fiduciary account, do not violate a fiduciary duty under ERISA. *See, e.g., Friend v. Sanwa Bank Cal.*, 35 F.3d 466, 469 (9th Cir. 1994); *Ershick v. United Mo. Bank of Kan. City, N.A.*, 948 F.2d 660, 671 (10th Cir. 1991).<sup>7</sup>

Plaintiffs' theory of liability ignores the regulatory and Congressional imprimatur on Chinese Walls as an effective conflict resolution tool, and would undermine the very efficiencies and economies of scale and scope sought by Congress and the financial regulators. Resolution of the supposed "conflicts" created by arm's-length transactions with third party issuers across the fiduciary, commercial banking and investment banking lines of *every* multiservice firm would be extremely burdensome, making each transaction more costly and reducing the availability of credit advisory and other services. Industrywide, nearly every transaction would require a

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<sup>7</sup> Absent the imposition of fiduciary duties to plaintiffs beyond its investment management role, JPMorgan's alleged motive for providing secured loans to Sigma is simply not relevant and cannot – standing alone – create a duty of loyalty where none otherwise exists.

conflict analysis against the approximately \$43 trillion in assets managed by affiliated investment advisers. See Speech by SEC Commissioner Luis Aguilar, *SEC's Oversight of the Adviser Industry Bolsters Investor Protection* (May 7, 2009), available at <http://www.sec.gov/news/speech/2009/spch0507091aa.htm>.<sup>8</sup> A brief consideration of several key “principal” activities routinely undertaken by financial institutions like JPMorgan, including lending, merger advisory, market making, and underwriting services, demonstrates the impracticality, prohibitive costs and burden imposed by the position-by-position disclosure and consent advocated by plaintiffs.

- Secured and unsecured lending would be significantly curtailed.<sup>9</sup> Plaintiffs contend that a financial services institution is under a duty to “disclose or abstain,” under which the institution should either (i) *disclose* the proposed lending relationship with the third party issuer whose securities are held by a fiduciary client and gain the consent of that client, or (ii) *abstain* from the transaction altogether. The insider trading laws prohibit a financial services institution from “crossing” its information wall to disclose material nonpublic information received in confidence from lending clients to its investment management clients,<sup>10</sup> leaving abstention from all lending transactions with

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<sup>8</sup> Absurdities of market disruption abound under plaintiffs’ theory. Almost all transactions could create potential conflicts given that the securities of nearly every Fortune 500 company are held by the asset management accounts of the largest financial services institutions. Further, every fiduciary client would effectively be granted a controlling interest in the issuer whose securities it holds, no matter how small the position, with the ability to block any transaction with the investment manager’s affiliated businesses, even crucial lending arrangements.

<sup>9</sup> The repo transactions at issue here are economically and functionally equivalent to secured lending. The seller of securities, or the “borrower,” transfers securities as collateral for the cash loan received from the “lender” in the transaction. The “borrower,” despite passing legal title to the securities to the “lender,” retains both the economic benefits and market risk of the transferred collateral through retained beneficial ownership, and continues to mark-to-market the price of the security on its balance sheet. See Moorad Choudhry, *The Repo Handbook* 116-17 (2010). As discussed above, courts commonly treat repo transactions as akin to secured lending. See n.2, *supra*.

<sup>10</sup> See *United States v. O’Hagan*, 521 U.S. 642, 652 (1997); 17 C.F.R. § 240.10b5-2. Moreover, plaintiffs’ theory could place an investment management client itself in danger of liability as a “tippee” making investment decisions on the basis of material nonpublic information. See *SEC v. Svoboda*, 409 F. Supp. 2d 331, 340-41 (S.D.N.Y. 2006) (granting summary judgment on insider trading claims against both a defendant credit officer and his tippee who traded on the basis of material nonpublic information regarding the bank’s lending clients).

issuers whose securities are held by investment management clients as the only tenable option.<sup>11</sup>

- Merger advisory services would be similarly impaired in even a situation with two unaffiliated third party corporations. Suppose Company A approaches the bank for advice on a possible acquisition of Company B. Similar to the lending example, plaintiffs' theory would put the bank in an impossible position should *either* company's securities be held in fiduciary accounts because seeking investor consent would place the bank in violation of insider trading laws.
- Market makers play a key role in capital formation by providing liquidity for a wide range of assets in nearly all market conditions. A dealer stands ready to buy, sell or otherwise transact with customers, and accordingly, takes principal positions in anticipation of, and in response to, customer demand to buy or sell. Plaintiffs' theory would bring market making activities to a standstill because *every* buyer or seller could be an issuer with securities held in fiduciary accounts. The financial institution's scramble to clear conflicts would destroy the very transactional immediacy required for effective market making.
- Underwriting would also be severely restricted. For example, a financial institution may be approached by a corporation to raise equity or debt. As the underwriter, the institution often purchases the securities in a principal trade and distributes to investors. Plaintiffs' theory transforms the initial purchase *and* sale by the financial institution into a potential conflict.

Accordingly, the logical result of plaintiffs' theory would be the disaggregation of commercial and investment banking functions from asset management, negating the legislative will and public policy expressed in decades of legislation and regulation.<sup>12</sup> In fact, plaintiffs effectively ask the Court to impose a regulatory framework – separating all dealer functions from any brokerage or fiduciary functions – that was expressly rejected by the SEC *in the 1930s* because of the inevitable impairment of capital formation. *See SEC, Report on the Feasibility*

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<sup>11</sup> Congress and the SEC codified the use of information walls to prevent this very impassable “conflict” and allow the efficient operation of multiservice financial institutions. *See* n.6, *supra*. Indeed, the very purpose of a Chinese wall is to permit one side of a business to engage in securities transactions even when the business unit on the “other side” of the wall is duty bound to maintain the confidence of the issuer's information and is, accordingly, precluded from trading that issuer's securities. *See Cotton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 699 F. Supp. 251, 256 (N.D. Okla. 1988).

<sup>12</sup> Indeed, the SEC has a *statutory obligation*, when rulemaking, to consider “whether the action will promote efficiency, competition, and capital formation” under the Investment Adviser Act, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. *See* Pub. L. No. 104-290, § 106(a)-(c), 110 Stat. 3416, 3424-25 (1996); *see also Chamber of Commerce of United States v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005). Plaintiffs' effort to rewrite the rules governing financial institutions would consider none of these critical factors.

*and Advisability of the Complete Segregation of the Functions of Dealer and Broker* 109-10 (1936).<sup>13</sup> Even in the current regulatory environment in the aftermath of the financial crisis of 2007-2009, the disaggregation of fiduciary asset management and corporate finance functions has not been seriously considered by Congress or any financial regulator.<sup>14</sup> Plaintiffs' theory would undermine decades of beneficial financial services diversification legislated by Congress and would greatly increase the burden of executing even routine transactions.

## POINT II

### **PLAINTIFFS' THEORY WOULD IMPOSE ADVERSE ECONOMIC CONSEQUENCES, INCLUDING CREDIT AND LIQUIDITY CONTRACTION**

Besides abrogating longstanding law and regulation, plaintiffs' theory would substantially increase costs across virtually all financial services transactions and restrict the availability of products and services which provide essential liquidity and market efficiency.<sup>15</sup> In

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<sup>13</sup> In 1963, the SEC issued guidance noting the futility of attempting to resolve conflicts through the disaggregation of financial services functions:

Total elimination of all [conflicts of interest] is obviously quite out of the question . . . [S]egregation as a specific remedy for all the multifarious possibilities for conflicts in the complex securities business could not be a simple segregation in any traditional sense but would have to involve fragmentation of the business to a point where . . . each investor have his own broker who would not be permitted to act for any other customer or for himself.

SEC, *Report of Special Study of Securities Markets*, 88th Cong., 1st Sess., H.R. Doc. No. 95, pt. 1, at 440 (1963).

<sup>14</sup> S.A. 3884 (the "Cantwell-McCain Amendment"), the amendment proposed by Senators Maria Cantwell and John McCain to the Dodd-Frank Act, which sought the reinstatement of the separation of commercial and investment banking, did not contemplate the divestiture of investment management from commercial banking. See Press Release of Sen. Cantwell, *Cantwell, McCain Seek to Restore Glass-Steagall Safeguards by Separating Commercial and Investment Banking* (May 6, 2010), available at <http://cantwellsenate.gov/news/record.cfm?id=324753>. The Cantwell-McCain Amendment was never brought to a vote. Meanwhile, the "Volcker Rule," or section 619 of the Dodd-Frank Act, does not restrict bank lending or propose the separation of affiliated trust departments. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 619(d)(1), 124 Stat. 1379, 1623 (2010) (codified at 12 U.S.C. § 1851(d)(1)).

<sup>15</sup> The impact of any expansion of the fiduciary duty through litigation may also be magnified across the millions of retail accounts held by broker-dealers. Pursuant to Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC is considering

particular, firms will find the provision of fiduciary services to be more costly with increased risk and litigation uncertainty, resulting in greater costs and reduced efficiencies for customers of fiduciary and other financial services.

Perhaps most critically, financial services firms would face new and costly obstacles to routine lending transactions, particularly secured lending and the repo transactions at issue here. A contraction of the credit markets may impose wide ranging negative effects that extend beyond the health of the financial services industry, including the potential reduction of financing available for businesses to access capital for growth and the hiring of new workers.

Even limiting plaintiffs' newfound "conflicts" to repo financing would impose significant constraints on the market's access to capital. Repo funding is a critical component of the capital markets, *see* Choudhry, *The Repo Handbook, supra*, at 166-67, and is functionally no different from secured lending.<sup>16</sup> In mid-2008, repo activity was estimated to exceed \$10 trillion in the American market (or 70% of US GDP), and another \$10 trillion in the European market (or 65% of Euro area GDP). *See* Peter Hordahl & Michael King, *Developments in Repo Markets During the Financial Turmoil*, BIS Q. Rev. 37, 39 (Dec. 2008). Even a relatively minor contraction of repo lending would remove significant amounts of capital and liquidity from the global financial system. *See* Gary Gorton, *E-coli, Repo Madness, & the Financial Crisis*, 45 Bus. Econ. 164 (July 2010).

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adopting a "uniform fiduciary standard" applicable to investment advisers and broker-dealers. *See* SEC, *Study on Investment Advisers and Broker-Dealers* 165 (2011) (recommending a uniform standard), available at [www.sec.gov/news/studies/2011/913studyfinal.pdf](http://www.sec.gov/news/studies/2011/913studyfinal.pdf).

<sup>16</sup> *See* note 9, *supra*.

**CONCLUSION**

For all of these reasons, SIFMA respectfully requests that the Court grant defendant JPMorgan's motion for partial summary judgment on the basis that, as a matter of law, a financial services institution does not violate a fiduciary duty owed to its investment management clients simply by extending secured credit to an issuer whose securities are held in the fiduciary clients' accounts.

Dated: March 3, 2011  
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