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Moving Beyond Calls for a "New Glass-Steagall"

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EXECUTIVE SUMMARY

Reuters

Four years after the financial shocks of 2008, with the developed world's economies still suffering and bankers' miscalculations and misdeeds still permanent fixtures on the front page, we are still trying to sort out the causes of the crisis and the appropriate policy responses. In the wake of the recent revelations about trading losses at J.P. Morgan and the manipulation of LIBOR rates, cries for further reform are again rising, with many dismissing the two-year-old Dodd-Frank Act as off-target or insufficiently bold. One particular reform idea has proven surprisingly resilient: "We need a new version of the Glass-Steagall Act." Of late, characters ranging from former Kansas City Fed President Thomas Hoenig to UK Labour leader Ed Miliband to the ever-eclectic Lyndon LaRouche have called for a revival of Glass-Steagall in some form, warning that the financial sector and taxpayers will not be safe without resurrecting the law that separated commercial and investment banking.[1] While most advocates of a new Glass-Steagall seem to be on the left, prominent Republicans have sometimes joined in, including former Speaker Newt Gingrich

[1] Thomas Hoenig, "No More Welfare for Banks," *Wall Street Journal* (June 10, 2012) (http://online.wsj.com/article/SB10001424052702303665904577454262040249418.html); Hannah Kuchler and Kiran Stacey, "Labour hints at separating 'casino' banks," *Financial Times* (July 9, 2012) (http://www.ft.com/intl/cms/s/0/da5b7b9e-c9b7-11e1-a5e2-00144feabdc0.html#axzz20zNAsxko); "Restore Glass-Steagall," landing page at LaRouchePAC (http://larouchepac.com/glass-steagall).

and current House Budget Chairman and Vice Presidential Nominee Paul Ryan.[2] Even Sandy Weill, the architect of the merger between Citi and Traveler's Group which dealt Glass-Steagall one of its final blows, has penitently endorsed bringing back the wall.[3]

In this Research Paper, I assess the various demands behind calls for a new Glass-Steagall, from the weakest to the strongest; argue that they are generally ungrounded in the historical reality of the Glass-Steagall Act; and finally discuss reforms that more directly address legitimate concerns.

What Do People Want When They Call for a "New Glass-Steagall"?

A. Political Posturing

We should recognize that some of the calls for a new Glass-Steagall are simply about political posturing.

To begin, we should recognize that some of the calls for a new Glass-Steagall are simply about political posturing. The repeal of Glass-Steagall is presented as a morality tale, in which the forces of "maniacal deregulation" cleared away the venerable New Deal law in pursuit of filthy lucre and, as a direct consequence, brought us the financial crisis.[4] Even on the other side of the Atlantic, there is an emotional sense that banks "got away with it," and deserve a serious reprisal. The critics feel that dismemberment at the hands of the law that (supposedly) kept them in check for so many years is the least that banks should suffer.[5]

Candidate Barack Obama advanced more-or-less the same angle all the way back in March 2008, decrying Glass-Steagall's repeal as part of a larger dismantling of regulatory frameworks "aided by a legal but corrupt bargain in which campaign money all too often shaped policy and watered down

[2] "Newt Gingrich: Transcript of ABC/Yahoo News Exclusive Interview," *ABC News* (November 8, 2011) (http://abcnews.go.com/Politics/newt-gingrich-transcript-abcyahoo-news-exclusive-interview/story?id=14909601&singlePage=true#.TrrNP1Z1bcw); M.J. Lee, "Romney, Ryan not in lockstep on Wall Street Reform," Politico (August 17, 2012) (http://www.politico.com/news/stories/0812/79813.html).

[3] Donal Griffin and Christine Harper, "Former Citigroup CEO Weill Says Banks Should Be Broken Up," *Bloomberg* (July 25, 2012) (http://www.bloomberg.com/news/2012-07-25/former-citigroup-chairman-weill-says-banks-should-be-broken-up.html). Fellow Citi veterans John S. Reed and Richard Parsons have also expressed doubts about the wisdom of Glass-Steagall repeal; Donal Griffin, "Ex-Citigroup CEO Says Volcker Rule needs 'Severe Penalties'," *Bloomberg* (February 14, 2012) (http://www.bloomberg.com/news/2012-02-14/ex-citigroup-ceo-reed-says-volcker-rule-needs-pay-curbs-severe-penalties.html); Kim Chipman and Christine Harper, "Parsons Blames Glass-Steagall Repeal for Crisis," *Bloomberg* (April 19, 2012) (http://www.bloomberg.com/news/2012-04-19/parsons-blames-glass-steagall-repeal-for-crisis.html).

[4] Robert Weissman, "Reflection on Glass-Steagall and Maniacal Deregulation," *Common Dreams* (November 12, 2009) (http://www.commondreams.org/view/2009/11/12-8); see also Barry Ritholtz, "Repeal of Glass-Steagall: Not a Cause, a Multiplier," *Washington Post* (August 4, 2012) (http://www.washingtonpost.com/repeal-of-glass-steagall-not-a-cause-but-a-multiplier/2012/08/02/gJQAuvvRXX_story.html), who puzzlingly says Glass-Steagall repeal "was a continuum of the radical deregulation movement."

[5] "Glass and Steagall rise from the dead—should they be welcomed?" *EuroWeek* 1264-10. (July 2012) (http://www.euroweek.com/Article/3058581/86052/Glass-and-Steagall-rise-from-the-deadshould-they-be-welcomed.html?eventcookielogin=Login&cookielogin=1).

oversight."[6] Often, this point is underscored by attributing Glass-Steagall's repeal primarily to Phil Gramm (R-TX)—after all, the leading name in the Gramm-Leach Bliley Act, and a leading pusher of extreme laissez-faire ideology.[7]

Some people may be reading along and nodding, thinking that banks indeed deserve their comeuppance. Be that as it may, this tale about Glass-Steagall is largely fiction as a historical matter, as I explain in the next section. Even if it were true, showing off our righteous anger is not a good reason to overhaul our regulatory system.

B. Common Sense Separation

In her Senate campaign in Massachusetts, Elizabeth Warren has repeatedly called for a New Glass-Steagall, distilling her argument into a tidy slogan: "Banking should be boring."[8] By this, reformers mean that commercial banking—the business of taking deposits and making loans—should be a staid and unglamorous way of achieving modest affluence rather than the risky gateway to a world of unfathomable riches, which should be left to the hedge funders and investment bankers. Under this theory, finance can be divided into distinct "utility" and "casino" functions. Mixing the two—which ending Glass-Steagall permitted—led directly to the crisis in 2008. The elegantly specious syllogism runs something like this:

1) Commercial banking should be boring.

2) Commercial banking was boring under Glass-Steagall, from 1933 to 1999.

3) Therefore we should bring back Glass-Steagall.

The first of these statements is more problematic than it may seem: nothing about "just" making loans is inherently safe, and indeed some of the financial institutions (such as Countrywide) that got into the most trouble in the subprime crisis did so almost entirely through lending.[9] Segregating banking functions in different institutions won't change this potential for risk.[10] As the next section of the paper explains, the second statement is once again shaky history; the

[6] Barack Obama, "Renewing the American Economy," Speech at Cooper Union (March 27, 2008) (http://www.nytimes.com/2008/03/27/us/politics/27text-obama.html?pagewanted=print).

[7] For example, Joseph E. Stiglitz, "Capitalist Fools," *Vanity Fair* (January 2009) (http://www.vanityfair.com/magazine/2009/01/stiglitz200901?printable=true).

[8] Robert Rizzuto, "Elizabeth Warren renews call for Glass-Steagall Act following JPMorgan's announcement that risky trading loss grew to $5.8 billion," *The Republican* (July 13, 2012) (http://www.masslive.com/politics/index.ssf/2012/07/elizabeth_warren_renews_call_f.html). See also Warren's campaign website (http://elizabethwarren.com/blog/banking-should-be-boring).

[9] Richard Spillenkothen, former director of the division of banking supervision and regulation at the Federal Reserve, recently reminded potential reformers that making loans is "one of the riskiest businesses banks engage in and has been a major contributing factor to most financial crises in the world over the last 50 years." Reported in Andrew Ross Sorkin, "Reinstating an Old Rule is Not a Cure for Crisis," *New York Times* (May 22, 2012) (http://query.nytimes.com/gst/fullpage.html?res=9502E6DE163FF931A15756C0A9649D8B63&pagewanted=all).

[10] Some argue that it was the availability of investment banking riches to commercial bankers that allowed the culture of banking to shift in the first place; the classic statement belongs to Calvin Trillin, "Wall Street Smarts," *New York Times* (October 14, 2009) (http://www.nytimes.com/2009/10/14/opinion/14trillin.html?_r=2&src=sch). Whether a separation at this point could really unscramble the egg is highly questionable.

financial world was hardly static during the whole of Glass-Steagall's 66-year lifespan. But regardless, the third statement's inference simply does not follow. *If* we want less risky commercial banking (and it isn't altogether clear that we do), there is a far better way to get it: increase capital requirements. Arguing for a new Glass-Steagall provides a comparatively attractive piece of political rhetoric, since it seems to represent an increase in safety without a contraction in lending. But if reduced risk is the real goal, Glass-Steagall is no substitute.[11]

Reformers calling for a 'new Glass-Steagall' on these grounds nevertheless already won a huge battle when they won inclusion of the Volcker rule, often billed as "Glass-Steagall Lite," in the Dodd-Frank Act. The Volcker rule prohibits all banking entities under Federal Reserve supervision from engaging in proprietary trading or owning any part of a hedge fund or private equity fund.[12] From its passage, advocates of strict separation have claimed the rule was either too subtle or too easy for banks to evade, but of late these claims have begun to crescendo, exemplified by former Secretary of Labor Robert Reich's admonition that we should "stop pretending the Volcker Rule, with its giant loophole, will be adequate…."[13] Former FDIC Chair Sheila Bair also worries that the Volcker Rule's "mind-boggling complexity" may doom it to failure; both suggest that a return to Glass-Steagall would be more effective.[14]

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These complaints are premature: the Volcker rule has yet to be finalized or implemented, and there are many good reasons (including the banks' stated distaste for the rule) to think that it will have significant effects. Yes, it is extremely complicated; no, that does not instantly doom it to irrelevance, even if in the long run its complexity creates opportunities for regulatory erosion.[15] As I argue below, targeted amendments to shore up the rules we have are probably more constructive than abstract calls for a system-wide reconfiguration.

[11] Professor Warren seems to understand all of this perfectly well—when asked whether Glass-Steagall would have prevented JPMorgan's recent trading losses, or the crisis in 2008, she has demurred, insisting instead that Glass-Steagall is an understandable symbol to rally the public behind. See the first footnote in Matt Levine, "Whom Should We Prevent From Blowing Themselves Up, and Why?" *Dealbreaker* (May 22, 2012) (http://dealbreaker.com/2012/05/whom-should-we-prevent-from-blowing-themselves-up-and-why/). Given this attitude, it is hard to understand why Warren would not simply advocate for the still-simpler and better-targeted measure of capping bank size.

[12] Dodd Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), § 619.

[13] Robert Reich, "Time to bring back Glass-Steagall?" *Marketplace* (May 16, 2012) (http://www.marketplace.org/topics/business/commentary/time-bring-back-glass-steagall). Also see James B. Steward, "Volcker Rule, Once Simple, Now Boggles," *New York Times* (October 21, 2011) (http://www.nytimes.com/2011/10/22/business/volcker-rule-grows-from-simple-to-complex.html?pagewanted=all).

[14] Sheila Bair, "We need a new Volcker rule for banks," *Fortune* (December 9, 2011) (http://finance.fortune.cnn.com/2011/12/09/volcker-rule-sheila-bair/).

[15] An indispensible source of commentary on the Volcker rule is the blog *Economics of Contempt*, including the following posts: "The Volcker Rule Isn't Being Diluted," (September 25, 2011) (http://economicsofcontempt.blogspot.com/2011/09/volcker-rule-isnt-being-diluted.html); "The Volcker Rule and 'Flipping the Presumption'" (March 3, 2012) (http://economicsofcontempt.blogspot.com/2012/03/volcker-rule-and-flipping-presumption.html); "JPMorgan and the Volcker Rule's Hedging Exception" (May 20, 2012) (http://economicsofcontempt.blogspot.com/2012/05/jpmorgan-and-volcker-rules-hedging.html).

C. *"No More Taxpayer Bailouts" – Segregating Insured Deposits from Risk-Taking*

Probably the most popular reason given to justify bringing back Glass-Steagall's separation is to safeguard FDIC-insured deposits from being lost through risky activities—i.e., "ending taxpayer bailouts." As this position goes, financial risk-taking is all well and good, but it should be done without the benefit of the FDIC's support, which is intended to protect only the quotidian business of ordinary banking. Representative Maurice Hinchey (D-NY) laments that "banks were empowered to make large bets with depositors' money, and money they didn't really have," leading to taxpayers footing the bill during the crisis.[16] Protecting taxpayers has also been the consistent refrain of the Senate Banking Committee's Ranking Member, Richard Shelby (R-AL).[17] In MSNBC's Dylan Ratigan's more colloquial phrasing, the risk takers must disclaim any need for a government safety net and "Be a man."[18]

Nearly everyone would like to spare taxpayers further exposure to financial institutions' losses. The question is how to do it. A quick examination of the events of 2008 calls into question a new Glass-Steagall's ability to get at the problem. Failing institutions of all different types, including Bear Stearns and AIG, ended up receiving government assistance. Institutions' closeness to FDIC-insured deposits had almost nothing to do with government decisions to intervene. If a financial institution is "too big to fail" (TBTF), then the crux of the problem is that it does not matter what extant laws have promised: the government feels it has no choice but to save the institution or risk widespread financial chaos, and will employ considerable legal creativity to provide a backstop. Taxpayers are at risk *not* because deposit-taking and risky bets are allowed under the same corporate umbrella, but because their government cannot credibly promise not to stave off financial apocalypse if it has the power to do so. Glass-Steagall, old or new, would not change this dynamic.[19] At the same time, as many have noted, insisting on a strict separation of commercial and investment banking would have made coping with the crisis more difficult by preventing large bank holding companies with deposit-taking institutions from absorbing failing investment firms.

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[16] Michael Hirsh, "An Odd Post-Crash Couple," *The Daily Beast* (December 14, 2009) (http://www.thedailybeast.com/newsweek/2009/12/14/an-odd-post-crash-couple.html).

[17] "Should We Reinstate Glass Steagall?" *Big Think* (January 27, 2010) (http://bigthink.com/ideas/18436).

[18] "David Stockman on Mitt, Newt and Crony Capitalism," *The Dylan Ratigan Show* (January 23, 2012) (transcript and video available at http://www.ritholtz.com/blog/2012/01/david-stockman-on-mitt-newt-and-crony-capitalism/).

[19] There is perhaps an argument to be made that allowing non-bank TBTF institutions access to FDIC-insured deposits magnifies the moral hazard they pose by allowing them greater access to capital. But, rather than supporting a revival of Glass-Steagall, this logic more directly supports imposing stricter risk controls on all institutions with FDIC-insured deposits, including pure commercial banks, or limiting the extent of FDIC insurance available to any institution.

D. Mitigating TBTF by Shrinking Financial Institutions

There is, however, a related argument connecting Glass-Steagall to TBTF that represents the strongest argument in favor of reviving the old law. In this version, separating commercial and investment banking is just one way of cleaving giant banks into smaller parts, each of which is less likely to be TBTF. Reducing size also reduces firms' outsized political influence, making them less likely to capture the political process and secure unneeded bailouts at taxpayer expense.[20] Arguably, a market with more firms is also a more robust and stable one, so that reducing firm size through a Glass-Steagall-like separation would improve the financial system's resilience.[21]

Smaller size might also have other virtues, as some of the most insightful proponents of reviving Glass-Steagall have emphasized. Former Senator Ted Kaufman (D-DE), for example, has argued that giant institutions are more likely to have conflicts and be more difficult to manage effectively.[22] I return to these points below, where I argue that there are more direct and sensible ways of addressing these concerns than reviving Glass-Steagall. To understand why, let us first pause to examine historical experience under Glass-Steagall.

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Checking the History – Experience Under the Glass-Steagall Act and the Gramm-Leach-Bliley Act

It may be obtuse to hear the contemporary calls for "bringing back Glass-Steagall" as actually advocating a return to the historical reality of Glass-Steagall; but, political tin ear or no, that is how they sound to me. Because the integrity of historical facts is important for its own sake, and because almost nobody calling for a new Glass-Steagall gets into the mechanics of what that would entail, in this section I briefly delve into the history of the Act to describe what the law meant in practice.

What we now know as Glass-Steagall (§§ 16, 20, 21, 32 of the Banking Act of 1933) was primarily the work of the architect of the Federal Reserve System, Senator Carter Glass (D-VA).[23] By separating commercial and investment banking into separate legal structures, the law would purportedly prevent:

[20] Luigi Zingales, "How Political Clout Made Banks Too Big to Fail," *Bloomberg* (May 29, 2012) (http://www.bloomberg.com/news/2012-05-29/how-political-clout-made-banks-too-big-to-fail.html). Zingales also notes that with commercial and investment banks split, their lobbying interests diverged to some extent, thereby reducing their agenda-setting power.

[21] Luigi Zingales, "Why I was won over by Glass-Steagall," *Financial Times* (June 10, 2012) (http://www.ft.com/intl/cms/s/0/cb3e52be-b08d-11e1-8b36-00144feabdc0.html#axzz20FDa0JCQ).

[22] Shahien Nasiripour, "Senator Calls for Aggressive Financial Reform, Deplores Current 'Incremental' Steps," Huffington *Post* (May 11, 2010) (http://www.huffingtonpost.com/2010/03/11/senator-calls-for-aggress_n_494699.html).

[23] Federal deposit insurance, enacted in the same bill, was advanced primarily by Representative Henry Steagall (D-AL), in spite of deep skepticism by many politicians, including President Roosevelt. See Jean Reith Schroedel, *Congress, the President, and Policymaking: A Historical Analysis* (Armonk, NY: M.E. Sharpe, Inc., 1994): ch. 3; Susan Estabrook Kennedy, *The Banking Crisis of 1933* (Lexington, KY: University Press of Kentucky, 1973).

1)Banks making risky investments in securities, thereby endangering deposits; 2)Unsound loans made to prop up companies in which a bank was invested; 3)Pushing underwritten securities onto banking customers.[24] The new law satisfied widespread demand for action in the wake of the financial system's cataclysmic meltdown, but Glass's ideas were also highly congenial to dedicated securities firms, which would greatly benefit from having a large part of their competition banned. Far from being a regulatory regime that acquisitive bankers were always eager to scrap, throughout its history dedicated investment banks remained the most vocal and active supporters of maintaining a "wall of separation."

Although most banks were satisfied to maintain symbiotic relationships with separated investment houses until the 1950s, at that point various pressures began to test just what the separation required. A special challenge was how Bank Holding Companies (BHCs), companies that controlled at least one national (commercial) bank, would be treated. After many false starts, Congress set out a fairly clear policy with the Bank Holding Company Act of 1956 and amendments in 1966 and 1970: BHCs would be regulated by the Federal Reserve, and could not control both commercial banks and investment banks.[25] Importantly, though, the Act was not meant to prohibit commercial banks from undertaking activities "so closely related to banking as to be a proper incident thereto" and it provided no explicit laundry list of prohibited activities.[26]

Exactly what commercial banks (or their corporate affiliates under the same BHC umbrella) were allowed to do became a source of controversy and protracted litigation over the subsequent decades.[27] Glass-Steagall (plus the Bank Holding Company Act) thus meant quite different things in 1950, 1970, and 1990, even if those calling for the Act's revival never specify which vintage they prefer. Commercial banks gradually won from their regulators (mainly the Office of the Comptroller of the Currency and the Federal Reserve Board of Governors) the ability to conduct a greater range of activities, including underwriting government securities, commercial paper, and mortgage-backed securities; marketing insurance; and providing brokerage services for customers.[28] All of these changes took place through regulatory

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[24] George Bentson, *The Separation of Commercial and Investment Banking: The Glass-Steagall Act Revisited and Reconsidered* (London: MacMillan Press, 1990): 11-12.

[25] *Congressional Quarterly Almanac* 12 (1956): 557; 21 (1965): 856-57; 22 (1966): 762-66; 25 (1969): 942; 26 (1970): 880. This is a slight oversimplification, as minor exceptions persisted.

[26] See Michael A. Jessee and Steven A. Seelig, *Bank Holding Companies and the Public Interest* (Lexington, MA: Lexington Books, 1977): 8-12, 30-37; David H. Carpenter and M. Maureen Murphy, "Permissible Securities Activities of Commercial Banks Under the Glass-Steagall Act and Gramm-Leach-Bliley Act," Congressional Research Service 7-5700, R41181 (2010) (http://assets.opencrs.com/rpts/R41181_20100412.pdf): 10-15.

[27] Important cases include: *Investment Company Institute v. Camp*, 401 U.S. 617 (1971); *Board of Governors v. ICI*, 450 U.S. 46 (1981); *SIA v. Board of Governors*, 468 U.S. 137 (1984) (often called *Becker* or *Banker's Trust*); *Board of Governors v. Dimension Financial Corporation*, 474 U.S. 361 (1986); *SIA v. Board of Governors*, 807 F.2d 1052 (D.C. Cir., 1986); *American Bankers Association v. SEC*, 804 F.2d 739 (D.C. Cir., 1986); *Nationsbank v. VALIC*, 513 U.S. 251 (1995); *Barnett Bank v. Nelson*, 517 U.S. 25 (1996).

[28] Office of the Comptroller of the Currency, "Looking Ahead to 1983," *Quarterly Journal* 2:1 (1983): 39-42; Office of the Comptroller of the Currency, "Decision of the Comptroller of the Currency on the Application by

reinterpretations, as Congress failed to provide guidance and courts did their best to accommodate regulators while preserving at least a little of the statutory text's bite. Throughout the 1990s, Representative Jim Leach (R-IA) championed reform that would bring law and reality into accord, failing to build a winning coalition on many occasions before finally shepherding the Gramm-Leach-Bliley Act (GLB) to passage in 1999.[29] (Crediting or blaming Phil Gramm as the law's primary champion is ironic, considering that his preoccupation with issues related to renewal of the Community Reinvestment Act were the fatal obstacle to passage of Glass-Steagall reform in 1998.[30]) Though GLB was billed by many as a "repeal" of the New Deal law, arguably banks could accomplish everything they were entitled to do after its passage under the chipped-out auspices of Glass-Steagall.[31] It should be noted that at no time, under either law, could banks themselves undertake various classes of risky activities; instead, the question is what activities would be permitted to bank affiliates under the same corporate umbrella.

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Was this just a case of slow-motion capture, so that modern reformers should aspire to some "pure" version of Glass-Steagall circa 1933? Given the deregulatory environment of the 1970s and 1980s, some would undoubtedly characterize it that way, but the truth is more complex. During this time, the nation's system of commercial banking regulations was in danger of being marginalized. Corporate bank loans lost out to Wall Street-backed commercial paper (short-term corporate bonds); bank deposits, subject to strict interest rate ceilings under Regulation Q until the early 1980s, were outcompeted by new, more flexible money market mutual funds.[32] This phenomenon of commercial banks being cut out of the loop, called "disintermediation," meant that the well-developed regulatory system for commercial banking covered a shrinking proportion of the nation's assets, a trend which pleased the securities industry but worried banking regulators charged with overseeing the stability of the nation's financial system. The Chairman of the FDIC from 1981-1985, William Isaac, would later write, "[B]y confining banks to a narrow range of products and services of declining profitability, Glass-Steagall threatens the long-term health

Security Pacific National Bank to Establish an Operating Subsidiary to Be Known as Security Pacific Discount Brokerage Services, Inc," *Quarterly Journal* 1:4 (1982): 40-44; "Interpretive Letter #366," *Quarterly Journal* 5:4 (1986): 20-21; Federal Reserve Board of Governors, "Order Approving Application to Underwrite and Deal in Government Securities and Money Market Instruments and to Offer Investment Advisory Services," 70 Fed. Res. Bull. 661 (August 1984); "Order Approving Application to Engage in Combined Investment Advisory and Securities Execution Services," 72 Fed. Res. Bull. 584 (Aug. 1986); "Order Conditionally Approving Application to Underwrite and Deal in Certain Securities to a Limited Extent," 73 Fed. Res. Bull. 607 (July 1987); "Order Approving Applications to Engage in Limited Underwriting and Dealing in Certain Securities," 73 Fed. Res. Bull. 473 (June 1987).

[29] *Congressional Quarterly Almanac* 44 (1988): 231-41; 47 (1991): 76-91; 51 (1995): 2-80-2-84; 52 (1996): 2-44-2-54; 53 (1997): 2-74-2-75; 54 (1998): 5-5-5-14; 55 (1999): 5-5-5-31.

[30] *Congressional Quarterly Almanac* 55 (1999): 5-10.

[31] Keith R. Fisher, "Orphan of Invention: Why the Gramm-Leach-Bliley Act was Unnecessary," *Oregon Law Review* 80 (2001): 1301-1421.

[32] R. Alton Gilbert, "Requiem for Regulation Q: What It Did and Why It Passed Away," *Federal Reserve Bank of St. Louis Review* (February 1986): 22-37; Ron Chernow, *The Death of the Banker: The Decline and Fall of the Great Financial Dynasties and the Triumph of the Small Investor* (New York: Vintage Books, 1997).

and survival of banks as the fulcrum of our regulatory system."[33] Regulators thought their best course was to bend Glass-Steagall's requirements rather than seeing the whole system of financial regulations break. When GLB finally came along, it mostly streamlined and equalized competition that regulators had been incrementally allowing, rather than revolutionizing the regulatory system.[34]

None of this is to say that GLB was a perfect law. Rather than criticizing the repeal of Glass-Steagall per se, the convocation of financial sages known as the Group of Thirty criticized holes in the regulatory landscape left by the 1999 Act, and lamented that regulation remained tied to institutional typologies rather than functions.[35] But "going back to Glass-Steagall" does not outline a coherent path to fix these issues, which were present just as much before GLB as after. At the same time, it is doubtful whether today's reformers really care whether BHC affiliates can underwrite corporate paper or offer low-level brokerage services. "Bring back Glass-Steagall" has instead become code for "break up the big banks."

If not Glass-Steagall, Then What?

So, the calls for a new Glass-Steagall are largely symbolism ungrounded in history. To the extent that legislators take them too literally, they will probably find a political dead-end.[36] Should those hoping for further financial reform nevertheless try to rally around the "new Glass-Steagall" flag to take advantage of the energy and public support now turned to that cause? That is a question for political strategists to answer, but doing so may distract from any number of more promising and realistic reform opportunities.

Framing the discussion around Glass-Steagall leads us to act as if nothing has changed in banking regulation since 2008, which could hardly be further from the truth. The Dodd-Frank Act made dozens of major changes and hundreds of minor ones, many of which have yet to be implemented but are on their way. Discussions of "breaking up the banks" or "ending TBTF" should begin with what Dodd-Frank did on these fronts, rather than starting from either of the

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[33] William M. Isaac and Melanie L. Fein, "Facing the Future—Life Without Glass-Steagall," *Catholic University Law Review* 37 (1988): 281-322, 285.

[34] For a further defense of the GLB Act, see James A. Leach, "The Lure of Leveraging: Wall Street, Congress, and the Invisible Government," in *Financial Market Regulation: Legislation and Implications*, ed. John A. Tatom (Indianapolis, IN: Networks Financial Institute, 2011): 187-219. For a very different and more critical assessment of the philosophy behind expanding bank powers, see Martin Mayer, "Glass-Steagall in Our Future: How Straight, How Narrow," in the same volume, 31-41.

[35] Group of Thirty, "The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace" (October 2008) (http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf): 32-33.

[36] Alexander Bolton, "Senate Democrats not with Warren on reinstating Glass-Steagall bank act," The Hill (May 31, 2012) (http://thehill.com/homenews/senate/230181-senate-democrats-not-with-warren-on-reinstating-glass-steagall). Bills proposed to this point that would basically "reinstate" Glass-Steagall are S. 2886, the "Banking Integrity Act," and H.R. 4375, the "Glass-Steagall Restoration Act," from the 111th Congress; and H.R. 1489, the "Return to Prudent Banking Act," from the 112th. None of these has gotten any traction, even in committee.

(equally oblivious) premises of "everything in Dodd-Frank is an incoherent disaster" or "Dodd-Frank did nothing to rein in the big banks."[37]

Along with the aforementioned Volcker rule, which could clearly be strengthened through targeted amendments if reformers believe the final rule has too many exemptions, Dodd-Frank also creates a Financial Stability Oversight Council (FSOC) with significant discretionary powers to wield an Orderly Liquidation Authority; addresses capital requirements; and creates an Office of Financial Research charged with independently monitoring systemic stability. These are all potent tools for keeping banks (and systemically important non-bank entities, which were previously unregulated) safe and dismantling those determined to be unsafe. Reformers miss a golden opportunity if they ignore ways to improve these policies in favor of making grand pronouncements about Glass-Steagall.

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Critics of FSOC and the orderly liquidation authority charge that these parts of Dodd-Frank cement a cozy, "corporatist" relationship between the largest firms and their regulators, thereby exacerbating the very problem of TBTF that it was designed to cure.[38] They denounce the FSOC's considerable discretion in determining which institutions require resolution, both for creating the possibility for arbitrary destruction of firms and for exposing the FDIC's bank insurance fund to too many risks and thereby putting taxpayers on the hook. The second part of this critique is simply wrong—the Deposit Insurance Fund is funded by insurance premiums from banks themselves and there is a separate fund dedicated to its Orderly Liquidation Authority (under § 210(o) of Dodd-Frank) which requires risk-based assessments; if critics believe this fund is collecting too little, they should say so directly. As for FSOC discretion, if critics believe that the statute as it currently stands affords too much discretion, then the burden is on them to propose a clearer rule that would identify firms posing an unacceptable risk. This will be a difficult task, but possibly a valuable one if it allowed firms to know their standing with greater certainty.

Proponents of "breaking up the banks" or using Glass-Steagall-like measures to limit bank size should also start with the provisions that already exist in law. Little-discussed is the fact that banks exceeding 10% of the nation's deposits were already statutorily barred from making interstate acquisitions of other banks under the Riegle-Neal Act of 1994, though there were exceptions for absorbing failing banks.[39] Dodd-Frank § 121 allows the Fed Board to ban other mergers if

[37] A judicious example is Phillip Swagel, "Taking on the Notion of 'Too Big To Fail'," *Real Clear Markets* (April 18, 2012) (http://www.realclearmarkets.com/articles/2012/04/18/taking_on_the_notion_of_too_big_to_fail_99622.html).

[38] See, especially, the excellent discussion in David Skeel, *The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences* (New York: Wiley, 2010). This position was also included in the House Budget Committee's Report on the FY2013 budget, H. Con. Res. 112 (March 23, 2012) (http://www.gpo.gov/fdsys/pkg/CRPT-112hrpt421/pdf/CRPT-112hrpt421.pdf), 72-73.

[39] Codified in the Bank Holding Company Act, 12 U.S.C. 1842(d)(2)(A). As an aside, I cannot resist asking why we are not treated to regular denunciations of the Riegle-Neal Act's lifting of the prohibition on interstate branching alongside complaints about GLB. Few commentators even take notice of the huge aggregation that Riegle-Neal facilitated, though one thoughtful exception is Matthew Yglesias, "Glass-Steagall Is Mostly A Red

two-thirds of the board finds that it would "pose a grave threat to the financial stability of the United States," and § 622 hardens the 10% cap by bringing non-deposit liabilities and off-balance-sheet exposures into the assessment of bank size.[40] Clearly, this cap could be made harder, both by repealing the exceptions allowed for acquiring failing banks and by making what previously affected only prospective mergers apply to all existing firms. This latter change is the heart of the proposed SAFE Banking Act, S. 3048, sponsored by Senator Sherrod Brown (D-OH) and its companion bill, H.R. 5715, sponsored by Rep. Brad Miller (D-NC). The act would require America's largest banks to shrink themselves, which proponents argue is the only sure way to allow Dodd-Frank's resolution authority to function in an orderly and predictable manner.[41] Certainly there are strong counterarguments, but focusing on pure size caps is likely to lead to more fruitful discussions of TBTF than focusing on Glass-Steagall.

Next, increasing capital requirements represents one of the most straightforward ways to get a safer, less-leveraged banking system—if that is indeed what we want in the current climate of consumer deleveraging and a struggling recovery. Dodd-Frank has left its mark here, too: § 165 requires adoption of prudential standards (including capital requirements) for systemically-important non-banks; § 171 tightens standards for banks; §§ 606 and 616 tighten standards for BHCs. As a result, overall leverage is down.[42] But more could be done. One possibility being explored, under § 115(c) of Dodd-Frank, is requiring financial institutions to use contingent capital—instruments that require their holders to purchase capital from issuers in some pre-specified circumstance, such as a crisis, providing "just-in-time" support.[43] Measuring capital adequacy is another point of contention, with critics of risk-weighted measures of assets worrying that models of risk will inevitably be gamed.[44] Regulators and reformers alike should remain focused on financial institutions' capital adequacy in crisis situations, including ensuring that current stress-testing policies are sufficiently challenging.

Finally, reformers should think about corporate governance reforms for all sorts of financial institutions. Rather than "Too Big to Fail," one of the most

Herring," *Think Progress* blog (October 17, 2011) (http://thinkprogress.org/yglesias/2011/10/17/345217/glass-steagall-is-mostly-a-red-herring/).

[40] Financial Stability Oversight Council, "Study & Recommendations Regarding Concentration Limits on Large Financial Companies" (January 2011) (http://www.treasury.gov/initiatives/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf), 4.

[41] Mike Konczal, "JP Morgan Proves that Size Does Matter," *Next New Deal* (May 15, 2012) (http://www.nextnewdeal.net/rortybomb/jp-morgan-proves-size-does-matter).

[42] Written Testimony of Treasury Secretary Geithner before the Senate Committee on Banking, Housing, and Urban Affairs on the Financial Stability Oversight Council Annual Report to Congress (July 26, 2012) (http://www.treasury.gov/press-center/press-releases/Pages/tg1654.aspx).

[43] Financial Stability Oversight Council, "Report to Congress on Study of a Contingent Capital Requirement for Certain Nonbank Financial Companies and Bank Holding Companies" (July 2012) (http://www.treasury.gov/initiatives/fsoc/Documents/Co%20co%20study%5b2%5d.pdf).

[44] See, e.g., Tracy Alloway, "How to tinker with bank risk-weightings," *FT Alphaville* (June 8, 2011) (http://ftalphaville.ft.com/blog/2011/06/08/588106/how-to-tinker-with-bank-risk-weightings/).

serious problems is that the largest financial institutions (including insurance firms like AIG, dedicated investment banks like Lehman, and universal banks like Citi) have become "too complex to manage." As Karen Shaw Petrou of Federal Financial Analytics has put it, being a bank director has become "a job that passeth understanding," requiring inhuman foresight and perspicacity. With hundreds of corporate subdivisions to oversee and many hundreds of requirements for the board members of SIFI institutions, it is easy to see how capacity for oversight (both corporate and regulatory) can be overwhelmed.[45] Vincent Reinhart, formerly of the Fed and now of AEI and Morgan Stanley, has also sounded this theme. The opacity of byzantine corporate structures makes it impossible for regulators to do their jobs, for markets to evaluate firms' stability or value, and for banks' managers to run their companies safely.[46] We should turn our attention to regulatory reforms that would simplify corporate structures, institutionalize best-practices for assessing and managing risk, and consolidate regulatory requirements where possible. Ensuring that the infant Office of Financial Research actively contributes to these developments should be a priority in coming years.

Ensuring that the infant Office of Financial Research actively contributes to these developments should be a priority in coming years.

The surge of interest in bringing back Glass-Steagall speaks to the understandable persistence of concerns about the safety and soundness of our banking system. There are ample reasons for these concerns, but I have argued that the focus on Glass-Steagall is largely misguided. Reformers should turn their energies elsewhere.

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[45] Karen Shaw Petrou, "A Job that Passeth Understanding: Or, Can Anyone Be a Bank Director Anymore?" Remarks Prepared for the 21st Annual Corporate Governance Conference, Kellogg School of Management (May 8, 2012) (http://www.fedfin.com/images/stories/press_center/speeches/Kellogg%20School%20of%20Management_Speech.pdf).

[46] Vincent Reinhart, "For Best Results: Simplify," Statement before the Senate Committee on Banking, Housing, and Urban Affairs on Establishing a Framework for Systemic Risk Regulation (July 23, 2009) (http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=c00a4670-8edd-4a6e-947f-09afb555fa4d); see also Reinhart's remarks at Brookings on September 15, 2009 (http://www.brookings.edu/events/2009/09/15-financial-crisis#ref-id=c59e86cac0fa096ed77917e476e6127d83a8d18f).