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Kicking Down The Firewall: An Examination of the Leadership Decisions Behind the Gramm-Leach-Bliley Act

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Kicking Down The Firewall:
An Examination of the Leadership Decisions Behind the Gramm-Leach-Bliley Act

by

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Report

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Abstract

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The late 1990's was a time of great wealth and prosperity in the United States. With this economic fervor came a new era of deregulation of the financial services industry. During this time, Congress passed the Financial Services Modernization Act of 1999, otherwise referred to as the Gramm-Leach-Bliley Act (GBLA). This law removed the final barrier (contained in Depression-era Glass-Steagall legislation) between mixing investment banking and commercial banking in the United States. The purpose of this report is to explain the intentions of the law's supporters and detractors, to discuss why this period was a particularly ripe time for such a policy, to examine the leadership decisions that contributed to the passage of GLBA, and to understand the motives behind a "new Glass-Steagall" bill today. This paper focuses only on the deregulatory parts of GLBA relevant to Glass-Steagall's repeal. It does not examine the privacy protections, et al. of GLBA at any length. Also contained in the analysis is a brief discussion of whether GLBA's stated intentions have been violated through the mixing of banking and commerce that has

emerged in the present day. Finally, this report ends with a discussion on the fidelity of our national debate on banking regulation, and what it means for the federal government to manage risk in American financial markets in support of the public interest.

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Chapter 1: Introduction

The Gramm-Leach-Bliley Act (GLBA) was passed in November 1999. It was seen by many as an institutional necessity for the modern age of banking – to others, an abomination and an excuse for the excesses of deregulation. Both Democratic and Republican legislators have recently called for a "new Glass-Steagall" which would restore the provisions of a firewall between commercial and investment banks. While many people understand the effects of the law, it can be difficult to explain the rationale used to push the proposal through Congress. Consensus about the law has been lacking among today's policymakers, who often misconstrue or guess at GLBA's purposes.

This report will explore the leadership decisions and perspectives of the principal actors at the time of the law's passage – including the bill sponsors, other Senators and Members of Congress, representatives of major commercial banks, the Clinton Treasury Department, and the Federal Reserve under Chairman Alan Greenspan. We will specifically be addressing the deregulatory sections of the Gramm-Leach-Bliley Act. The portions of GLBA concerning financial privacy are outside the scope of this report, as they are largely unrelated to the repeal of the Glass-Steagall provisions. The goal of this report is to better understand, in as straightforward and faithful way as possible, why the late 1990's was fertile ground for passing this landmark legislation.

IMPETUS FOR THE REPORT

So why study the Gramm-Leach-Bliley Act specifically? Because this law perennially arises in debates as a pivotal moment in our economic history, yet few people can provide a comprehensive logic as to why it was passed. The reaction to this law is nearly always polarized – from those who believe that the Glass-Steagall Act should

never have been repealed, to those who believe that GLBA has had little detrimental effect on the economy at all. The usual interpretations are high-impact or low-impact, with few arguments in between.

Whether you agree with GLBA or not, it unquestionably provided the legal mechanism to create megabanks in the United States. Suddenly, the idea of a local banker became more and more foreign to everyday people. For our generation – which was told to take risks and trust the market – we encountered the new faceless behemoths of financial services, for anything from health insurance, to commercial loans, to establishing everyday checking accounts. The idea of competitive interest rates – or serious bank competition at all – sounded like an archaic concept. The only way to harness the time value of money was to invest in the market. And for a while, that seemed just fine.

Some defenders of GLBA state that bigger banks mean a broader distribution of risk, and therefore less bank failures. Others counter that GLBA led directly to "too big to fail." The intention of this report is to identify and explain the reasons behind this policy change, which had a revolutionary impact on how we view banking in the United States. Before we assess whether these reasons have validity today, we should try to understand why GLBA seemed like a good idea at the time, to the extent that it sounded like common sense to the leaders who supported it.

IMPLICATIONS FOR TODAY

This is the overarching question from who are now proposing reform: would Glass-Steagall have had a net positive effect on the great financial crisis of 2007-2008 – and would a new law better protect our markets today? Experts are mixed in their

posterior analysis. In the immediate aftermath of the financial crisis, Treasury Secretary Timothy Geithner downplayed the need for a new Glass-Steagall firewall.

> A huge amount of risk built up outside our banking system, outside the safeguards and protections we put in place in the Great Depression…when the storm hit it put enormous pressure on a part of the system that provided about half the credit to the American economy. Nothing to do with Glass-Steagall.[1]

Ironically, one of the biggest advocates for GLBA, former Citigroup chairman Sanford Weill, now argues in support of Glass-Steagall's restoration. "What we should probably do is go and split up investment banking from banking…have banks do something that's not going to risk the taxpayer dollars, that's not going to be too-big-to-fail."[2]

Legislative memory may have also had a role in the passage of GLBA. As noted by University of Texas Professor Lew Spellman, not even the oldest Senator at the time – Strom Thurmond – had been around to witness the debate of why Glass-Steagall was made into law.[3] The story of why Glass-Steagall passed relied entirely on second-hand narratives of its legislative history. Of course, this point is generalizable to any other legislative policies which have not been changed or substantially revised for more than a generation. But it is especially salient with regards to GLBA, as the booming economy of the 1990's provided a backdrop where Members of Congress might rightfully wonder why this law needed to exist in the first place.

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[1] Mattingly, Phil, and Cheyenne Hopkins. "Glass-Steagall Fans Plan New Assault If Volcker Rule Deemed Weak." Bloomberg, 8 Dec. 2013.
[2] Hirsh, Michael. "A Rising Tide Against Big Banks." *National Journal* 25 July 2012.
[3] Spellman, Lew. Message to the author. 14 Jan. 2014. With thanks to Professor Spellman for allowing me to reproduce his perspective here.

This was an era of overarching prosperity. The recession of the early 1990's was now a faraway memory. A renewed sense of optimism arrived with the excitement of the technology sector and its promise of an interconnected world. Moreover, the United States was the only real hegemon on the world stage, increasing this sense of invincibility. Under these political circumstances, it's easy to see this era as a time when a law breaking down fulsome barriers would be welcomed in the political debate.

Firewalls, in the physical world, are made of reinforced concrete. They are intended to be impenetrable to most conflagrations. "Knocking" down a firewall may seem like a more appropriate metaphor for destroying such a structure. But deregulation was not caused by the inevitable wrecking ball of history. It was achieved by an active coalition of advocates chipping away at the firewall in concert. This committed team of policymakers took their sledgehammers and eventually found daylight between the realms of commercial and investment banking. The Gramm-Leach-Bliley Act was the culmination of a longtime mission undertaken by its champions, rather than an inexorable change in public policy. In fact, when we see any legislation branded with the term "modernization," we should be aware that it is only one distinct philosophy of modernity, crafted by the worldview of its creators and its supporters.

Chapter 2: Setting the Stage for Deregulation

WHAT WAS GLASS-STEAGALL?

The Glass-Steagall provisions refer to several sections of the Banking Act of 1933, a Depression-era attempt to control the excesses of the banking industry, at a time when the American public had tremendous distrust of the financial services sector. Proposed by Sen. Carter Glass and Rep. Henry Steagall, the provisions banned affiliation between traditional commercial banks and the more risky, yet potentially lucrative securities firms.[4] The enactment of this legislation was preceded by the investigative work of the Pecora Commission, named after its chief counsel, Ferdinand Pecora. This task force, authorized by the Senate Banking and Currency Committee, was commissioned with comprehending the underpinnings of bank failures in the aftermath of the 1929 crash.[5] Pecora eviscerated the banking industry, often through subpoenaed testimony of top-level financiers.[6] The message from Pecora was clear: Wall Street could not be left to its own devices, and for the sake of public welfare, the federal government would have to intervene more directly in its affairs.

EARLIER EFFORTS AT DEREGULATION

This was not the first time that the bill sponsors had addressed this issue with legislation. Indeed, as with most major laws, building the coalition to support final passage took several years, reaching back to the 1980's.[7] The philosophical idea behind the GLBA sponsors' intent was that banks were losing their competitive edge in the

[4] Please see the "Glossary" section for precise definitions of the various types of financial entities referred to throughout this report.
[5] "The Long Demise of Glass-Steagall." PBS Frontline, 2 May 2014.
[6] Chernow, Ron. "Where Is Our Ferdinand Pecora? [Op-ed]." *New York Times*. 9 Jan. 2009.
[7] "The Long Demise of Glass-Steagall." PBS Frontline, 2 May 2014.

globalized world economy. They claimed to be losing market share with other global banks, and they pointed their finger at one big reason why: Glass-Steagall. This was an argument deployed at hearings and in the media, and promoted among the foot soldiers of Wall Street firms. The United States was having its capitalistic honor challenged by Deutsche Bank, National Westminster Bank, and other foreign entities.

This argument was combined with a slightly more specious one: that the technological change of modernity meant that – from an innovation point of view – these regulations were outliving their usefulness in the fast-paced world of late-20th Century finance. This follows a common trend in economics, in which theorists take an ongoing technological trend and make the rhetorical jump to claim it explains cutting edge monetary and financial policy.

BRANDING: MODERNIZATION

The term "modernization" had been employed early on – but never so deftly as when combined with the Internet era. By 1999, the repeal of Glass-Steagall was explicitly packaged under this modernization branding. The age of the Internet had arrived, and Sen. Gramm and others latched onto this new buzzword with aplomb. Indeed, most of GLBA as we know it has more to do with privacy concerns related to the sharing and selling of financial information, especially by electronic means. As Bernard Shull writes:

> A typical view expressed in Congress was that new technologies, financial innovations and modern regulation had made the Glass-Steagall Act restrictions unnecessary for reasons of bank safety, and counterproductive in preventing risk-reducing diversification.[8]

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[8] Shull, Bernard. "Banking, Commerce, and Competition under the Gramm-Leach-Bliley Act." *The Antitrust Bulletin* Spring (2002), 35.

Another argument supporting "modernization" was that the banking industry was fundamentally different operation than it had been in the early 20th Century. We could ostensibly see this arise as a debate point during the reform of any law: a contention that the rule is simply outdated, and therefore doesn't deserve to exist. It's the key philosophical position behind "sunset clauses" that are common in many state legislatures. Yet before we declare a law obsolete, we should look at the heritage of the policy – just as you wouldn't build a home on the waterfront without checking for a history of flooding. The sponsors' position here is that the "business models that existed in the late 1930's" had become extinct by the late 20th century. "Bank requirements have historically been more costly," Charles Whitehead writes, "reflecting the relative ability of securities firms and insurance companies to bear risk. Banks, however, were not disadvantaged so long as they only competed with other banks."[9]

But let's question the assumption here. The banking industry had become "modern" because it had been gradually deregulated – not because modernity dragged banks into a different era of doing business. Supporters of GLBA could argue that the increased deregulation came as a result of expanded competition between banks and securities firms – that it was essentially a chicken-and-egg scenario. Because securities firms were looking to compete in technologically new environments, the banks were being backed into a corner, forced to seek deregulatory measures so they could compete:

> "The increased competition coupled with financial (e.g., securitization) and technological innovation (e.g. computers, automated tellers machines (ATMs)) blurred the lines between the products, services, and activities offered by and

[9] Whitehead, Charles K. *Reframing Financial Regulation*, 90 B.U. L. Rev. 1, 5 (2010) found in: Carpenter, David, and M. Maureen Murphy. *Permissible Securities Activities of Commercial Banks under the Glass-Steagall Act and the Gramm-Leach-Bliley Act*. Rep. Congressional Research Service, 12 Apr. 2010, 2.

engaged in commercial banks and securities firms (and insurance companies) even though their distinct regulatory systems largely remained intact."[10]

As we analyze this law, we should understand the clear difference between the *means* of providing financial services to consumers (i.e, technology), and the different nature of the financial instruments themselves. Banks wanted to go into the investment business. "This trend began…in the 1970's. High inflation coupled with a consumer movement to interest-bearing accounts and investment products, such as money market funds offered by securities firms, reduced the profitability of traditional bank products."[11] In other words, commercial banks wanted to expand outside their market niche because their profit margins were unsatisfactory in the face of rampant inflation. Even five years after the law was passed, a financial services lobbyist testified to the Senate Banking Committee: "Banks, securities firms, and insurance companies can choose to affiliate under whatever structure best fits their business plan."[12] This is an approach designed to satisfy the preferences *of the firm*, rather than the demands of the market – it has little to do with technology, and everything to do with sheer competition. As Jerry Markham noted in 2000:

> "Modern banking no longer fits the 1930's profile around which financial services regulation is built. Banks are acting as conduits by generating loans that are

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[10] Carpenter, David, and M. Maureen Murphy. *Permissible Securities Activities of Commercial Banks under the Glass-Steagall Act and the Gramm-Leach-Bliley Act*. Rep. Congressional Research Service, 12 Apr. 2010, 2.
[11] Ibid., 8.
[12] United States. Cong. Senate. Committee on Banking, Housing, and Urban Affairs. *Examination of the Gramm-Leach-Bliley Act Five Years after Its Passage: Hearing before the Committee on Banking, Housing, and Urban Affairs, United States Senate, One Hundred Eighth Congress, Second Session, on the Gramm-Leach-Bliley Act (P.L. 106-102), to Enhance Competition in the Financial Services Industry by Providing a Prudential Framework for the Affiliation of Banks, Securities Firms, and Other Financial Service Providers, July 13, 2004*. 108th Cong., 2nd sess. S. Doc. Washington: U.S. G.P.O., 2006, 16.

> securitized or syndicated and then sold rather than retained as assets in the manner of traditional commercial banking."[13]

But why should banks have the privilege to both securitize assets and take advantage of the Federal Reserve discount window, FDIC protections, and other provisions we have to keep banks solvent and healthy?[14] This seems like a clear redefinition of what we commonly know as a commercial bank. The movement to restructure American banking spanned several decades – and while one part of this effort occurred during the recession of the early 1990's, the legislation was ultimately passed during the non-crisis atmosphere of the end of the century.[15] We should ask whether the public interest was seriously considered during this foundational restructuring of American banking. As Bernard Shull mentions, "GLB does not explicitly include a net public benefits test as part of the process for determining activities to be financial in nature or incidental."[16] Could Congress create such a metric for the public interest today?

GREENSPAN, SUMMERS, AND RUBIN

The deregulatory movement of the 1990's also reached inside the federal agencies charged with regulating American financial services. Joseph Stiglitz, the former head of the Council of Economic Advisers, wrote about this agency culture, with special mention of Treasury Secretary Robert Rubin's support of the Glass-Steagall repeal:

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[13] Markham, Jerry W. *Banking Regulation: Its History and Future*, 221, found in: Carpenter, David, and M. Maureen Murphy. *Permissible Securities Activities of Commercial Banks under the Glass-Steagall Act and the Gramm-Leach-Bliley Act*. Rep. Congressional Research Service, 12 Apr. 2010, 8.

[14] Carpenter, David, and M. Maureen Murphy. *Permissible Securities Activities of Commercial Banks under the Glass-Steagall Act and the Gramm-Leach-Bliley Act*. Rep. Congressional Research Service, 12 Apr. 2010, 3.

[15] Shull, Bernard. "Banking, Commerce, and Competition under the Gramm-Leach-Bliley Act." *The Antitrust Bulletin* Spring (2002), 34-35.

[16] Ibid., 46.

> In the mid-nineties, the banks mounted a concerted campaign to have Glass-Steagall repealed. The conditions were favorable. Prosperity made the notion of bank failure seem very remote (though the S&L crisis of the eighties ought to have been a caution). Another significant positive factor fell into place with the appointment, in 1995, of Robert Rubin as Secretary of the Treasury. Rubin was a banker himself—the former co-chair of Goldman Sachs—and he actively supported the repeal effort. While conceding the potential for conflict of interest, Treasury insisted that it could deal with the problem by requiring barriers – "Chinese walls," again – between one area of a bank's activity and another. As Chairman of the Council of Economic Advisers, I worried about the conflicts of interest, about the effect on competition, but these worries were quickly shunted aside.[17]

These "Chinese walls" that Secretary Rubin mentions are good faith constructions that parts of a financial firm will not communicate with each other. They are enforceable by regulation, but they are largely based on trust. The concept that the financial services market could be self-regulating seemed to have achieved legitimacy in the minds of Treasury officials of the era. There was a bullish tendency toward trusting that the firms in the market knew best. In the case of Secretary Rubin, his personal history of working at a major investment firm provided a strong familiarity of its practices.

The debate on GLBA was ongoing during the handoff from Secretary Rubin to incoming Secretary Lawrence Summers at the Treasury Department. Summers was also strongly in support of bank deregulation, and became a public spokesman for the Clinton Administration on the cause. The one issue where Democrats decided to mount a coordinated opposition was on provisions related to redlining. Generally defined, redlining is the practice of withholding home mortgages and other loans toward underprivileged and minority communities on the part of financial institutions. The Community Reinvestment Act of 1977 strengthened protections against redlining,

[17] Stiglitz, Joseph E. *The Roaring Nineties: A New History of the World's Most Prosperous Decade*. New York: W.W. Norton, 2003, 160.

requiring banks to establish similar lending practices and criteria across the spectrum of neighborhoods and borrowers.[18] The original bill drafted by Sen. Gramm, Rep. Leach, and Rep. Bliley did not have these increased safeguards, and the White House made it clear that they would be necessary for its eventual passage:

> "If the bill were presented to the President in its current form, the President would veto the bill," Treasury Secretary Lawrence H. Summers said. "The Administration is disappointed by the recommendations on the Financial Modernization Bill put forth by Chairmen Gramm, Leach, and Bliley today. A flawed process risks producing flawed legislation. In important respects, the chairmen's proposal abandons the bipartisan consensus that the House legislation achieved."
>
> Mr. Summers and other Administration officials criticized the legislation today for failing to provide privacy protections for consumers and for heavily diluting the Community Reinvestment Act. That 1977 law encourages banks and savings associations to make loans to minorities, farmers, inner-city residents and others who have historically been denied access to credit.[19]

In fact, once these provisions were agreed to in conference committee, the strengthening of the Community Reinvestment Act became a key part of touting the law. Both Secretary Summers and President Clinton highlighted these provisions during the signing ceremony at the White House on November 12, 1999.[20]

In a sense, it is ironic that policymakers stood up to protect the right of homeowners to take out loans, but also did not protect borrowers from being preyed upon with subprime mortgages. They were essentially preserving the market for the banking industry's later subprime lending abuses. Aspiring homeowners deserved loans, but they should have received good loans, with strong protections and non-exorbitant provisions.

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[18] "Community Reinvestment Act (CRA)." Board of Governors of the Federal Reserve System.

[19] Labaton, Stephen. "Republicans Propose a Deal on Financial Services." *New York Times*. 13 Oct. 1999.

[20] U.S. Department of the Treasury. Office of Public Affairs. *Statement by President Bill Clinton at the Signing of the Financial Modernization Bill*. 12 Nov. 1999.

Perhaps a more humane policy would have been to couple anti-redlining efforts with stronger guidelines and mandatory information for financial services consumers. Of course, this would not have itself staved off the subprime crisis – but it would have helped borrowers understand the risks they were getting into.

Federal Reserve Chairman Alan Greenspan viewed financial deregulation as the obvious and prudential way forward. He used his influence from the Federal Reserve to support this policy – not just in tacit approval, but also with concrete regulatory prescriptions over the years, to gradually ease the idea of deregulation into policymakers' minds.[21] The most vivid example of this is the Fed's approved merger between Citibank and Travelers Insurance – before GLBA became law. By issuing a two-year waiver to sanction this action, Greenspan and the Federal Reserve Board created a trial run of sorts, allowing policymakers a limited window to see what a new universal bank would look like.[22] Most importantly, he altered the status quo – and as any advocate knows, the status quo is the easiest policy to retain, barring some sort of overriding crisis.

By issuing a waiver to the newly formed Citigroup, Greenspan had directly inserted himself into the Congressional debate, deftly changing the appearance of universal banking from risky to commonplace. The shift is extraordinary. It is difficult to quantify the impact this assist from the Fed had on lawmakers, but the signaling was clear. Greenspan, then seen as a god in financial circles, had given superbanks his imprimatur, and affirmed that this was the way forward for the American economy.

The cult of Greenspan had taken hold in the imagination of many Americans by the late 1990's, and he was now giving lawmakers substantial cover in voting for the GLBA legislation. Additionally, Robert Auerbach suggests that Greenspan personally

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[21] "The Long Demise of Glass-Steagall." PBS Frontline, 2 May 2014.
[22] Ibid.

lobbied Congress on behalf of the law, by "sitting in a room near where the House-Senate conference committee was meeting on the bill, he could conveniently lobby members who sought his highly regarded advice on why they should vote for the bill."[23] Greenspan wasn't alone in his high-profile advocacy for Citigroup and GLBA. Treasury Secretary Robert Rubin joined Citigroup shortly after leaving government, and his hire was seen as tacit support for GLBA and its superbank goals:

> It was Weill who hired former Treasury Secretary Robert Rubin in 1999 to ensure that the Glass-Steagall Act, which separated investment from commercial banking, would be repealed by Congress later that year. As Weill wrote later in his memoir, *The Real Deal*, having Rubin on board "translated into a highly visible public endorsement."[24]

Once again, passing a major piece of legislation such as GLBA required a team. Before it was proposed in the 106th Congress, this coalition of advocates had primed the policymaking space and had been working multiple angles from both the executive and legislative branches. They made their own luck in creating a political environment more hospitable to broad deregulatory change.

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[23] Auerbach, Robert D. *Deception and Abuse at the Fed: Henry B. Gonzalez Battles Alan Greenspan's Bank*. Austin: U of Texas, 2008, 163.

[24] Hirsh, Michael. "A Rising Tide Against Big Banks." *National Journal* 25 July 2012.

Chapter 3: The Debate in Congress

In retrospect, the passage of Gramm-Leach-Bliley may seem like a foregone conclusion. After all, the final roll call on GLBA succeeded with large majorities of both Republicans and Democrats in each chamber.[25] But the record of the debate is somewhat more nuanced. The Democratic caucuses in Congress did not object strongly to the philosophy behind the bill, and instead chose to extract Republican concessions toward the anti-redlining clauses that would become a part of the bill. Meanwhile, a coalition of support from the Clinton Administration, the Federal Reserve, the private sector, and within Congress was portraying GLBA as a necessary step to survive in the reality of today's business world. A handful of liberal Democratic Senators and Members of Congress did speak against the bill, serving as lighthouses cautioning against removing the firewall. Some research also suggests that campaign contributions had a significant impact on otherwise liberal Members who eventually voted for final passage.

GLBA did indeed have some outspoken critics in Congress, especially from the more liberal members of each Democratic caucus. It is important to remember that these voices did participate in the debate, and that the precepts of banking deregulation were not held by everyone. However, for those that did espouse the deregulatory philosophy, it is illustrative to hear the rationale they used during the debates on the floor.

Senate

Before the vote on final passage, Senator Byron Dorgan of North Dakota raised the specter of past crises, and his concern that the banking industry was becoming increasingly enamored with risk:

[25] "S. 900 (106th): Gramm-Leach-Bliley Act (On the Conference Report)."*Govtrack.us*.

> Federally-insured banks in this country are trading in derivatives out of their own proprietary accounts. You could just as well put a roulette wheel in the bank lobby. That is what it is….You think there is not risk here? There is dramatic risk, and it is increasing. This piece of legislation acts as if it does not exist. It ignores it. A philosopher and author once said: those who cannot remember the past are condemned to repeat it. We have a piece of legislation on the floor today that I hope very much, for the sake of not only those who vote for it and believe in it but for the American people who will eventually have to pick up the pieces – I hope this works.[26]

Meanwhile, Senator Barbara Mikulski of Maryland expressed concerns about macro issues – that the power of American bank charters was being consolidated into the hands of a select handful of people. Moreover, the bigger these entities got, the more prone they could be toward manipulation, confusion, and abuse of the average financial services consumer:

> First, I am concerned that if we relax the laws about who can own and operate financial institutions, an unhealthy concentration of financial resources will be the inevitable result. The savings of the many will be controlled by the few. If we relax banking regulations in this country, Americans will know less about where their deposits are kept and about how they are being used….Second, I am concerned that complex financial and insurance products will now be sold in a cluttered market by untrained individuals. Investment and insurance planning for families is a very important process. These are some of the most important decisions that families make. They should be made with the assistance of certified professionals – whom the family can trust. By breaking down these fire walls and allowing various companies to offer insurance and complex investment products, we run the risk that consumers will be confused, defrauded, and treated like market segments and not individuals with unique needs and goals.[27]

Other Democratic floor speeches generally supported GLBA, or in the case of Senators Boxer and Harkin, opposed it primarily on privacy grounds.[28] The progressive

[26] United States. Cong. Senate. Congressional Record. 106th Cong., 1st sess. S. Doc. S13896-S13897
[27] Ibid., S13898.
[28] Ibid., S13899.

Senators who spoke up were few, in the face of a bill supported both by leadership and the Clinton White House. The debate was genial, with several friendly colloquies between Senator Phil Gramm and other Senators. There was a general air of inevitability for the bill, and rightfully so – the measure passed 90-8-1.[29] In framing the passage of GLBA, Senator Chris Dodd of Connecticut cast it in grand historical terms, as if this bill was the culmination of decades of advocacy – and it was.

> I rise today, as well, in strong support of this very historic conference report accompanying S. 900, which I believe will receive strong bipartisan support….I have been a member of the Senate Banking Committee since the first day I was sworn into the Senate, almost 19 years ago. I think this effort dates to about 1967 or 1968, more than 30 years ago. This has been an ongoing debate and issue on the part of the Banking Committees of the Senate and the House….So I speak today on behalf of a lot of people who have come before us. I think of people such as Senator Don Riegle of Michigan, who worked very hard on this; Senator Jake Garn; William Proxmire, the first chairman I served under on the Banking Committee. They all labored hard to try to come up with a means by which we might modernize these services….to accommodate the efficiencies and demands of the end of the 20th century. We begin, in about 60 days, a new millennium where already the ability to transact financial business on a global basis can be done in nanoseconds around the globe—a far cry from where we were three years ago when this effort first began to try to address some of the realities that had overtaken the Glass-Steagall Act, as sound a piece of legislation as it was, which was adopted so many years ago.[30]

This was a heady speech by Senator Dodd, placing GLBA firmly in the context of a turning point in American economic history. It is a particularly useful defense of the law from a Democratic perspective. Senator Dodd respects Glass-Steagall as a "sound" piece of legislation at the time, but indicates that those times have passed. Indeed, by invoking the millennium, Senator Dodd primes us to understand GLBA as a preparation

[29] Ibid., S13917.
[30] Ibid., S13885-S13886.

for a bright new future for American financial services. In his view, the fact that transactions move quickly is a *good* thing, as it speaks to the ramping up of the strength of our markets. Technology is again conflated with economic theory. Finally, Senator Dodd mentions that GLBA had been in the works for decades, giving the bill landmark status as the culmination of years of developments in banking legislation.

HOUSE OF REPRESENTATIVES

On the House side, Representative John Dingell of Michigan, as the ranking member of the House Commerce Committee, led the floor debate against GLBA and its final passage. In his floor statement, Rep. Dingell mentions the flip side of modernization and deregulation, which is a potentially much more insecure world:

> Madam Speaker, I rise in strong opposition to this bill. It recognizes technological and regulatory changes that have blurred the lines between industries and products. However, it fails to recognize that human nature has not changed. It also fails to recognize something else. The technology that has changed has made it much easier to take money from the innocent and from the unsuspecting. It relaxes protection for investors, taxpayers, depositors, and consumers.[31]

Dingell's critique also predicted the spreading growth of banks under GLBA, along with an explicit warning that these firms would become "too big to fail" and would require bailouts from the United States government – a foretelling of the later policy debates surrounding the 2007-2008 crisis.

> Not only are they going to be big banks, but they are going to be big everything, because they are going to be in securities and insurance, in issuance of stocks and bonds and underwriting, and they are also going to be in banks. And under this legislation, the whole of the regulatory structure is so obfuscated and so confused

[31] United States. Cong. House. Congressional Record. 106th Cong., 1st sess. H. Doc., H11530

> that liability in one area is going to fall over into liability in the next. Taxpayers are going to be called upon to cure the failures we are creating tonight, and it is going to cost a lot of money, and it is coming. Just be prepared for those events.
>
> You are going to find that they are too big to fail, so the Fed is going to be in and other Federal agencies are going to be in to bail them out. Just expect that.[32]

Rep. Thomas Bliley used his extensive floor speech as a rallying cry to frame the legislation in quite a noteworthy way: by claiming the role of underdog. Countervailing the concept that GLBA was written at the behest of banking interests, Rep. Bliley claimed that they were about to pass this bill *in spite of* lobbyist influence.

> Last term, we were told by every industry lobbyist and Washington trade associations that this bill was dead; that it could not be done; that Congress had neither the will nor the vision to overcome the special interests opposed to this legislation.
>
> Whether out of ignorance or hardheadedness we continued to push forward, suffering the opposition at various points of almost every industry faction and interest, but we prevailed.
>
> Two years ago our committee breathed life into this legislation by putting consumers first. Until then every special interest group had agreed in concept to a level playing field; but just with a slight tilt toward their industry….Our committee said no to these special interest lobbyists. We laid down the law that activities should be regulated with the same strong consumer protections and safeguards no matter where they activity takes place.
>
> This is called functional regulation, and functional regulation means that everyone gets the same oversight, the same rules, with no special advantage towards any party. The lobbyists do not like it but it is common sense, and it is right.[33]

This speech shows the natural desire in federal policymaking to claim that your actions are independent of outside influence, and that new legislation is designed to

[32] Ibid., H11542.
[33] Ibid., H11533.

protect the interests of everyday Americans, rather than big firms. Yet to some extent, Rep. Bliley is mincing words here. He is proud that his committee was able to resist persuasion from individual firms and industries – but what about the philosophical difference of deregulation itself? All of the financial services lobbyists that Rep. Bliley mentioned believed in GLBA – they just wanted to refine the details on implementation. We will discuss the influence of banking lobbyists as a whole later in this chapter.

PETER FITZGERALD

An interesting sidenote to the passage of GLBA is the abstention of Sen. Peter Fitzgerald of Illinois, the Republican who would retire in 2004, making way for Barack Obama to be elected to this seat. Sen. Fitzgerald was a banker by profession, and had substantial holdings in the Bank of Montreal at the time.[34] He apparently saw GLBA as beneficial enough to his industry that it was a conflict of interest. Sen. Fitzgerald voted "present" in the Senate during both the initial floor vote and the vote on the conference committee report.[35] There is little to infer from this, except to understand that GLBA was seen – by one of its own – to be a boon to the financial services industry.

THE INFLUENCE OF LOBBYISTS

Some skeptics have argued that Democratic votes on GLBA were "bought" by the financial services industry, primarily via campaign contributions. An earlier LBJ School master's report on GLBA, published in 2001, specifically addresses this issue. Donald Thalhuber studied the campaign contributions to both Republican and Democratic

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[34] Merrion, Paul. "Don't Bank on This Fitzgerald Vote." *Crain's Chicago Business*. 22 Mar. 1999.
[35] "How Peter Fitzgerald Voted on All Votes." *The U.S. Congress Votes Database*. *Washington Post*, 163.

lawmakers, using 1999 scores from Americans for Democratic Action to rank the "liberal quotient" of each Member of Congress.[36] He acknowledged that Republicans were intuitively more likely to vote for a deregulatory measure, and then turned his attention to liberal Members of Congress at the time:

> But what about the House members who, at least on the Gramm-Leach-Bliley Act, cast votes that seem to contradict their general political ideologies? When glancing over the Gramm-Leach-Bliley roll call, one cannot help but notice all of the Democrats, whom one would expect to fiercely oppose Gramm-Leach-Bliley, who cast votes to pass the modernization bill.[37]

Using a regression analysis, Thalhuber studied whether campaign donations had an expected effect on the vote for final passage of GLBA. He concluded that Republicans had no statistically significant change in their point of view based on contributions. However, for the Democrats it was a different story: "money from the financial services industry is a significant predictor of a liberal House member's vote on the Gramm-Leach-Bliley Act." Thalhuber mentions that such a regression is not possible for the Senate, as "every Senate liberal voted against the Gramm-Leach-Bliley Act, while every conservative Senator voted for the measure."[38]

Given this information, we can reach a couple of possible conclusions. One is that Members of Congress were so money thirsty in the late 1990's – this was before the enactment of McCain-Feingold – that they would have sold out their true beliefs for an infusion of campaign cash. (Notably, Thalhuber does not weight his analysis based on how marginal a Member's district is perceived to be. Politicians in tight races are much

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[36] Thalhuber, Donald William. *A Campaign Finance Reform Study Concerning Contributions from the Financial Services Industry and the Roll Call Vote on the Gramm-Leach-Bliley Act of 1999.* Thesis. The University of Texas at Austin, 2001, 40.
[37] Ibid., 39.
[38] Ibid., 42.

more likely to take contributions from nearly any source.) The second explanation is less nefarious: many liberals in the House of Representatives actually wanted to believe in deregulation, and banking lobbyists employed both monetary and rhetorical encouragement to sway these Members to their side.

Chapter 4: Analysis of the Law After Passage

EARLY ANALYSIS FROM FIRMS

A slideshow by Milton Berlinski, on behalf of Goldman Sachs in 2000, showed just how deeply and readily financiers understood the impact of GLBA on the banking world. This early Goldman presentation projects that "bank-to-bank activity may rise," that "bank acquisitions of insurance companies have not materialized," and that the "Internet may lead to more aggressive one-stop shopping combinations."[39] We have certainly seen evidence of the first point, as the 21st century has seen more fast-paced investment activity between banks and investment firms, compared to these firms' interactions with everyday clients. It is the rather intricate activity of this "bank-to-bank" commerce, via sophisticated financial instruments, that propels the on-paper wealth created in bubble markets – precisely the type of activity which contributed to the 2007-2008 financial crisis.

Additionally, Berlinski's assertion that insurance companies would be left by the wayside supports our earlier discussion on that part of the law. It seems that Goldman knew early on that insurance was unlikely to be a key dimension of future GLBA mergers. Finally, the concept of the Internet as a "one-stop shop" for banking seems unnecessary and far-fetched, but certainly aligned with the popular wisdom of the day. Indeed, we do see all kinds of online banking today, but consumers are less likely to need services consolidated under one banner. One can, after all, visit Ally for competitive banking rates, E-Trade to purchase investments, and HealthCare.gov as a clearinghouse to purchase health insurance. All of these websites, and their sibling sites, have specialized strength in specific areas of the market, rather than needing to rely on a big

[39] Berlinski, Milton. "Gramm-Leach-Bliley Act Mergers and Acquisition Opportunities and Issues." *After the Gramm-Leach-Bliley Act: A Road Map for Banks, Securities Firms, and Investment Managers*. Eds. Cohen, H. Rodgin., and William J. Sweet. New York: Practising Law Institute, 2000, 13-15.

bank banner (e.g., "HSBC" or "TD Bank"). In this sense, the proponents of GLBA were incorrect to insist that the Internet necessitated the collapse of the firewall for the purposes of "one-stop shopping." In fact, consumers have organically developed confidence and loyalty to these niche online financial firms over the years, in the comparatively similar way that stores sent mail order catalogs to households in the past.

ENRON

The collapse of Enron was the first major crisis of confidence for GLBA and its provisions. GLBA itself was not responsible for the moral lapses and creative accounting at Enron and Arthur Andersen, but the implications of its deregulation affected the way banks behaved toward the troubled firm. As Joseph Stiglitz writes:

> The consequences predicted by the critics of Glass-Steagall repeal only began to come to light as the corporate and banking scandals emerged. Most notable was Enron's banks continuing to provide it credit even as its prospects looked increasingly murky.[40]
>
> The Glass-Steagall Act's repeal meant that bankers held on longer than they otherwise would have—they still hoped to make money from Enron's multiple deals—but eventually, as the stock continued to plunge, they could not continue to lend.[41]

Stiglitz points out that because of GLBA, banks were prevented from properly being banks. We expect that traditional banking involves a rational risk assessment of a commercial firm, indicating its trustworthiness. With Enron, banks were deeply involved

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[40] Stiglitz, Joseph E. *The Roaring Nineties: A New History of the World's Most Prosperous Decade*. New York: W.W. Norton, 2003, 161.
[41] Ibid., 243.

with their multi-pronged investment in the company, leading to a conflict of interest. As a 2003 Congressional Research Service report notes:

> Financial holding companies participated in derivatives transactions with the firm. Their affiliated banks provided large off-balance-sheet lines of credit, which Enron drew upon when it could not tap the short-term securities ("commercial paper") market. When Enron's precarious financial health became apparent, Citi and Morgan agreed to provide new financing for Enron and actively sought its rescue….that plan failed. As a result, several prominent banking companies faced large exposure to Enron.[42]

The example of Enron shows how banks can act rationally toward their own self-interest, but irrationally toward the public good. While good banking policy dictates that Enron should have been allowed to fail earlier, financial holding companies propped the firm up so that their investments would suffer less. This was a side effect of the GLBA provisions, and the first major example of banks encountering conflicting priorities as a result of being spread across multiple financial industries.

EFFECTS ON BANK MERGERS

The era of GLBA was also the advent of massive commercial bank mergers, where formerly regional banks gobbled each other up to form huge national banking conglomerates – the brands of which are familiar to us as Bank of America, Wells Fargo, Chase, HSBC, et al.[43] This had been predicted by some supporters of the law at the time of its passage. The idea was that more "universal banks" would begin to appear, with

[42] Jackson, William. *Enron's Banking Relationships and Congressional Repeal of the Glass-Steagall Act Separating Bank Lending from Investment Banking*. Rep. Congressional Research Service, 16 Sept 2003, 4.
[43] "Online Financial Innovations: Internet Strategies for Financial Institutions. Top 150 Largest Banks."

lowered operating costs based on the pooled resources of their subsidiary banks, and leveraging the strength of their newly-created joint branding.

Rep. Thomas Bliley, interviewed in 2001, appeared proud of the bank mergers that had happened by that point, although insisting that wasn't the purpose of the law.[44]

> "What we set up was a broad framework where people who had ideas would be able to carry them out and wouldn't have some artificial barrier to prevent them from doing so. We wanted everybody to know what the rules were and have everybody playing by the same rules."[45]

Rep. Bliley also insisted that the purpose of GLBA was not to mix banking and commerce, and lamented that more wasn't done to keep businesses from buying smaller savings and loan associations. "To me that was downgrading a person's investment. I didn't think you should do that, but I didn't prevail."[46] Overall, Rep. Bliley has a notably optimistic point of view about how the law had been developing, which we might expect from a sponsor two years after passage. But we should also take his long-term strategy outlook with a grain of salt, as he mentions in the same interview that the greatest challenge to financial services is not stability, but creating a framework to provide insurance against terrorist attacks. While that was certainly a trenchant point in late 2001, it was not the only major challenge that would face the banking sector in that decade.[47]

Watchdog economists such as Bernard Shull had warned as early as 2002 that GLBA would threaten Glass-Steagall's other purpose of "preserving competition in nonbanking markets" in addition to its bulwark against economic catastrophe. [48]

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[44] "Bliley Tells Revisionists to Wait for History." *The American Banker*. Thomson Financial, 30 Nov. 2001.
[45] Ibid.
[46] Ibid.
[47] Ibid.
[48] Shull, Bernard. "Banking, Commerce, and Competition under the Gramm-Leach-Bliley Act." *The Antitrust Bulletin* Spring (2002), 26.

> "Recent proposals and rulings by the agencies elaborating new standards under GLB imply the likelihood of a progressive and extensive expansion of permissible activities into what, today, is perceived as 'commerce.' This expansion, along with other elements of GLB, place at risk Congress's intent to sustain the separation of banking and commerce. In the context of other banking and regulatory developments, it also raises serious questions about likely competitive effects."[49]

Of course, what is one firm's opportunity is another firm's loss. The lack of competition in one sector means that those firms with greater resources and market share will take advantage of the chance to dominate an industry. What is interesting is that Shull sees this in the tea leaves as early as 2002, based on the regulatory decisions being handed down from agencies in the executive branch.[50] These were the early years of the George W. Bush Administration, and we can expect that these regulators were more philosophically disposed toward reducing barriers in markets, rather than strengthening restrictions between firms. We could argue whether this was a good policy – whether it had a beneficial effect for consumers, or a hindering effect for entrepreneurs, or both. But one lesson is clear: the administration of a major law is just as important as its passage. After all, it was regulatory rulings that interpreted the law after it had left the legislative branch, opening the door for the kind of banking-commerce mixing that we will discuss in greater detail in the next chapter.

[49] Ibid, 27.
[50] Ibid.

THE "HARDWARE STORE" ANALOGY

Metaphors are freely deployed in economic policy debates, as a way to make dense theory seem more real. One defense of the viability of superbanks was to compare them to hardware stores:

> Suppose we walk into our local hardware store and ask the owner to recommend a brand of paint for painting our garage. How confident are we that he has our best interests at heart, rather than his own short-run private-profitability interest at heart? We usually rely on his interest in retaining us as a long-run customer – that is, if he gives us bad advice this time, we are not going to come back. Thus, some tempering of his potential short-run greediness occurs, because he is interested in the long-run.[51]

Of course, this metaphor is absurd. The purchase of a faulty hammer or a poorly mixed gallon of latex paint will surely frustrate the customer. On the other hand, the decimation of a retirement plan because of bank failure will traumatize the entire livelihood of a financial services customer. And on a macro-level, the overexposure of risk in the banking industry as a whole might precipitate a major crisis, from which it is not easy to recover one's earlier investments. It's not quite the same thing as returning a gallon of paint.

However, the hardware store is a helpful metaphor to understand the overall thinking behind GLBA's supporters: why would a commercial bank devalue its customers, just because it had taken on a portfolio of new financial products? Wouldn't a bank continue to run like any other business, in which it strives to provide a competitive deal to the marketplace? And wouldn't a bank lose customers if its clients were dissatisfied? While this seems intuitive, the answer is far more complicated. After all, we

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[51] White, Lawrence J. "Commentary on 'Rationale of Current Regulatory Approaches to Banks' Securities Activities" found in: Ramírez, Carlos D., and Daren Lawrence Bakst. *Will the Gramm-Leach-Bliley Act Change the Future of Corporate Finance?* Washington, D.C.: National Legal Center for the Public Interest, 2000, 12.

have not seen a serious competition for customers over certificate of deposit rates in many years. The more likely answer here is that the diversification of financial products meant that commercial banks now had many more investment streams to draw from, thereby reducing the need for more traditional high-interest savings and loan operations. And the bigger the bank got, the more leverage it had in the market – and the less responsive it needed to be to the everyday saver or mortgage holder.

WHAT HAPPENED WITH INSURANCE?

Ironically, the ability for banks to merge with insurance companies has been downplayed over the life of GLBA. While the very first superbank was a mix of banking and insurance (Citibank and Travelers Group), the merger didn't last long. In fact, Travelers was turned into a subsidiary and was sold in part to MetLife later in the decade.[52] This was indicative of the insurance angle throughout the life of GLBA: while the original law allowed for mergers between securities firms, banks, and insurers, the real focus (and moneymaker) was the relationship between banks and their procuring of investment assets. We might ask why the insurance dimension was de-emphasized over the years, especially when it was so highly touted during GLBA's passage. One explanation is that policymakers and bankers didn't foresee the minimal impact of combining insurance with other forms of banking. A more cynical thought is that insurance was being used as a branding vehicle, which would be less repulsive and more intuitive in the minds of Americans, rather than explicitly focusing on the securities-banking combination alone.

[52] Dash, Eric. "MetLife to Buy Insurance Unit From Citigroup." *New York Times*. 1 Feb. 2005.

THE GREAT CRISIS OF 2007-2008

The elephant in the room is the impact of GLBA on the failure and collapse of financial markets in 2007-2008. Most skeptics are ready to believe that GLBA directly contributed to the crashing financial services industry, on account of the huge overexposure of risk in subprime mortgages, et al. by the banks. The pushback from GLBA's sponsors has been fierce. In 2009, Sen. Phil Gramm claimed that Europe had never had these restrictions, and yet the crisis had at least partially started here:

> Gramm, who before he got into politics was an economics professor at Texas A&M, took to the task with relish. He was dismissive of the charge that Glass-Steagall repeal has been a big problem. "Europe never had Glass-Steagall," he said. "So why didn't this happen in Europe rather than here?"[53]

This is a specious argument, as nearly every major bank had to be bailed out during the crisis, regardless of where they were geographically headquartered. In 2012, Sen. Gramm continued the defense of the bill, claiming that the firms most affected by the crisis were those who were less expansive in their market reach:

> "I don't see any evidence that allowing them to affiliate through holding companies had anything to do with the financial crisis nor has anybody ever presented any evidence to suggest that it did," said Gramm, 70. Companies that failed such as Lehman Brothers Holdings Inc. "tended to be narrowly focused."[54]

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[53] Fox, Justin. "Phil Gramm Says the Banking Crisis Is (Mostly) Not His Fault."*Time*. 24 Jan. 2009.

[54] Harper, Christine. "Breaking Up Banks Won't Make Them Safer, Ex-Senator Says." *Bloomberg*. 12 July 2012.

The Cato Institute also sought to preemptively defend against attacks on GLBA with a 2009 white paper, authored by Mark Calabria, providing further assurances surrounding the law:

> Even before its passage, investment banks were already allowed to trade and hold the very financial assets at the center of the financial crisis: mortgage-backed securities, derivatives, credit-default swaps, collateralized debt obligations. The shift of investment banks into holding substantial trading portfolios resulted from their increased capital base as a result of most investment banks becoming publicly held companies, a structure allowed under Glass-Steagall.[55]

This is a curious defense of the law, as it hinges on the premise the GLBA had minimal effect on the banking industry – and if that was the case, why was there such an effort to pass it? While there may be limited instances where Calabria's analysis is correct, it seems evident that GLBA – by its very nature – had given banks the opportunity to invest in much more risky securities than they had otherwise done before. His second assertion is a common one, and has some merit: investment firms and banks were taking greater risks now, because they were more likely to be publicly owned institutions, and therefore using shareholders' equity rather than the partners' equity to invest. We can certainly see the problem of moral hazard here. But what does this have to do with deregulation? Regardless of who owns the bank, it now has an expanded *means* of risk-taking available to its managing directors, as a result of GLBA and its deregulatory policies.

These arguments illustrate the difficulty of discussing GLBA in reference to the Great Recession. There were many variables at play – from American subprime debt, to credit default swaps, to huge trade imbalances on Europe's periphery, et al. – and

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[55] Calabria, Mark A. "Did Deregulation Cause the Financial Crisis?" *Cato Policy Report* XXXI (July 2009): 1. Cato Institute.

isolating GLBA's specific impact is extremely tough to parse out. This debate is made all the more tricky by policymakers who are looking to reinforce preconceived opinions about who is to blame, rather than take an objectively critical look at the lending and investment institutions themselves.

At least one of the bill sponsors, Rep. Bliley, seems to have softened his stance on whether deregulation was necessary. In contrast to his proud floor speech at the time of passage, a later interview in 2012 showed him to have a rather subdued view of the law, as if it was an unavoidable development spurred on by lobbyists:

> Thomas J. Bliley Jr., a former Republican congressman from Virginia and another co-author of Gramm-Leach-Bliley, said that the financial industry had been lobbying ever since the 1930s to overturn Glass-Steagall.
>
> "All of a sudden in the late '90s they all came together and agreed that we should get rid of it and of course we did," said Bliley, 80, who now lives in Richmond, Virginia, and is a senior government affairs adviser for Steptoe & Johnson LLP. "I don't know enough to really give you an answer" on whether it was a mistake.[56]

When interviewed by the PBS show Frontline in 2009, Joseph Stiglitz reflected on the impact of taking down the Glass-Steagall restrictions before the crisis. Stiglitz had been on the Council of Economic Advisors from 1993-1997, just before the firewall finally came down. His critique is that the expansion of risk had left public interest out of the picture, in favor of placating the investment desires of the big banks:

> Banks that are too big to fail have incentives to engage in excessive risk taking. And that's exactly what happened. The increase in the concentration in the banking system in the years after the repeal of Glass-Steagall has been enormous, and we've seen the excessive risk taking, which American taxpayers have had to pay hundreds of billions of dollars for.

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[56] Harper, Christine. "Breaking Up Banks Won't Make Them Safer, Ex-Senator Says." *Bloomberg*. 12 July 2012.

> And the third factor that I think was not fully appreciated at the time, but clearly is evident since, was that the culture of these two kinds of institutions is and ought to be very different. Investment banks take rich people's money and are exposed to undertake risk, which is appropriate to those seeking high returns but can bear the high risk. ... The basic commercial banks are supposed to provide finance to small and medium-sized enterprises. They are an essential part of the lifeblood of an economy. That kind of banking is supposed to be boring; it's supposed to be conservative; it's supposed to do the job of assessing risk and making sure capital goes to where it's supposed to go."[57]

Now, a defender of deregulation may see Stiglitz's critique and think: so what? The biggest investment firms manage a lot of investments because they are leaders of the industry. Moreover, haven't the benefits of a booming economy trickled-down and supported the creation of millions of jobs? While the scope of this paper does not warrant an expansive discussion on trickle-down job creation theory, we can wonder about the wisdom of this paradigm of financial services. Such an economy does indeed garner huge short-term profit margins for investors, all while everyone hopes that the bubble doesn't pop from a bonanza of investment in securities. Regardless, when the economy does collapse, as we saw in 2007-2008, all of the jobs that financiers claim to have created quickly disappear. We might wonder if a more "conservative" or "boring" type of banking would help our economy grow at a steady rate, rather than banks spending their energy and capital seeking short-term jackpots.

PRESIDENT CLINTON'S VIEWS

President Clinton has been a passionate defender of GLBA for most of its years of existence, as demonstrated by an interview in 2008:

[57] "Interview: Joseph Stiglitz." *Frontline*. PBS. 8 July 2009.

> You know, Phil Gramm and I disagreed on a lot of things, but he can't possibly be wrong about everything. On the Glass-Steagall thing, like I said, if you could demonstrate to me that it was a mistake, I'd be glad to look at the evidence. But I can't blame [the Republicans]. This wasn't something they forced me into. I really believed that given the level of oversight of banks and their ability to have more patient capital, if you made it possible for [commercial banks] to go into the investment banking business as Continental European investment banks could always do, that it might give us a more stable source of long-term investment.[58]

In other words, President Clinton agreed with the idea that American banks needed new tools to compete with overseas firms, and he very much wanted to believe in the deregulatory process. But what did he mean by "patient capital"? "Long-term" investment is not necessarily synonymous with "stable" – it depends on the financial instrument. We expect patient capital to be a conservative asset with a confident guarantee of earnings, rather than investments housed in complicated securities with uncertain rates of return. This quote shows how much President Clinton had believed that deregulation was the right thing to do at the time, as a means of freeing up more investment capital in the system.

With regards to the financial crisis, President Clinton had initially claimed that there wasn't much impact from GLBA on risk exposure in the markets. He even rejected the idea that GLBA was true deregulation:

> No, because it wasn't a complete deregulation at all. We still have heavy regulations and insurance on bank deposits, requirements on banks for capital and disclosure. I thought at the time that it might lead to more stable investments and a reduced pressure on Wall Street to produce quarterly profits that were always bigger than the previous quarter. But I have really thought about this a lot. I don't see that signing that bill had anything to do with the current crisis. Indeed, one of the things that has helped stabilize the current situation as much as it has is the

[58] Bartiromo, Maria. "Bill Clinton on the Banking Crisis, McCain, and Hillary."*Bloomberg Businessweek*. Bloomberg, 23 Sept. 2008.

> purchase of Merrill Lynch by Bank of America, which was much smoother than it would have been if I hadn't signed that bill.[59]

President Clinton's argument is that GLBA should have spurred a more conservative, reliable offering of securities by Wall Street, in order to meet consumer demands via the banks. But in contrast to his point, the rush of greater earnings propelled the investment sector forward through most of the 2000's leading up to the crisis. While President Clinton is correct in saying that bank regulation still existed for traditional commercial banking, the disjointed nature of regulating the newly expansive financial holding companies made comprehensive regulation difficult. Perhaps an agency with unified authority over such firms would have helped recognize warning signs and indicators that precipitated the crisis.

By 2010, President Clinton's views had shifted somewhat, with his expressed regret that they had sacrificed potentially useful regulatory authority by repealing the Glass-Steagall provisions:

> Well, I think on the derivatives – before the Glass-Steagall Act was repealed, it had been breached. There was already a total merger practically of commercial and investment banking, and really the main thing that the Glass-Steagall Act did was to give us some power to regulate it – the repeal. And also to give old fashion traditional banks in all over America the right to take an investment interest if they wanted to forestall bankruptcy. Sadly none of them did that. Mostly it was just the continued blurring of the lines, but only about a third of all the money loaned today is loaned through traditional banking channels and that was well underway before that legislation was signed. So I don't feel the same way about that.[60]

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[59] Ibid.

[60] Harris, Evan. "Clinton: I Was Wrong to Listen to Wrong Advice Against Regulating Derivatives." *This Week*. ABC News. 17 Apr. 2010.

President Clinton recognized that the trend lines were moving away from commercial banking and toward securities, but believed this development had been a long time in the making. While he acknowledges that this ongoing trend inspired GLBA, he now sounds ambivalent that Glass-Steagall was reversed so quickly. Underlying his words is the belief in the seeming inevitability of deregulation that other supporters of GLBA had expressed in similar interviews before.

Chapter 5: Gramm-Leach-Bliley Today

THE CONTINUED MIXING OF BANKING AND COMMERCE

One of the most alarming developments surrounding GLBA is the emergence of a new class of hybrid banking-commerce activities now permitted under the law. While its original sponsors indicated that GLBA was not intended to mix banking and commerce, loopholes in the law have been opened up and elongated in various ways. In 2013, *New York Times* reporter David Kocieniewski chronicled how Goldman Sachs was manipulating the world aluminum markets by transporting the metal from warehouse to warehouse, all while exploiting the resultant higher global demand:

> "This industrial dance has been choreographed by Goldman to exploit pricing regulations set up by an overseas commodities exchange, an investigation by *The New York Times* has found. The back-and-forth lengthens the storage time. And that adds many millions a year to the coffers of Goldman, which owns the warehouses and charges rent to store the metal. It also increases prices paid by manufacturers and consumers across the country."[61]

These ventures represent massive opportunities for abuse and manipulation of world markets. But what permits Goldman Sachs, now a bank, to directly invest in the same commodities that they're investing in?

Matt Taibbi, writing for *Rolling Stone* in 2014, argues that GLBA opened up an exploitable loophole, by which banks could influence commodities markets through direct investment, even to the point of controlling prices on the world market. This occurs using a GLBA provision that allowed investment banks *previously* involved in commodities trading (prior to 1997) to apply to become bank holding companies under the law and not divest their previous interests. As Taibbi notes, this "obscure provision of

[61] Kocieniewski, David. ""A Shuffle of Aluminum, but to Banks, Pure Gold"" *New York Times*. 20 July 2013.

Gramm-Leach-Bliley effectively applied to nobody." This was true – at least until the 2007-2008 crisis. By then, the only two firms previously active in commodities trading were Goldman Sachs and Morgan Stanley, and in the cash-starved and credit-starved days of the crisis, they applied to become bank holding companies, in order to access the Fed's discount window.[62]

> The Fed granted the requests overnight. The move saved the bacon of both firms.…After fucking up so badly that the government had to give them federal bank charters and bottomless wells of free cash to save their necks, the feds gave Goldman Sachs and Morgan Stanley hall passes to become cross-species monopolistic powers with almost limitless reach into any sectors of the economy.[63]

Taibbi's colorful hyperbole aside, it raises a key leadership question: why did the Fed choose to do this in 2008? To be sure, this allowed these firms to become banks, with the ability to buy up other troubled banks and securities firms. But was that the most important issue for the public interest in 2008? Surely Chairman Ben Bernanke and others saw that they were allowing a loophole to be exploited – but perhaps in the moments of that crisis, they didn't care. Scenarios like this raise questions about how we should revise our policies in the wake of crisis management actions. Rescuing the economy in the short-term should not mean creating oligarchic entities in the following years to come.[64]

During Taibbi's interviews, he contacted GLBA sponsor Rep. James Leach, who expressed surprise that the law was being used for such purposes. His commentary, more

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[62] Taibbi, Matt. "The Vampire Squid Strikes Again: The Mega Banks' Most Devious Scam Yet." *Rolling Stone*. 12 Feb. 2014.
[63] Ibid.
[64] Ibid.

than a decade after the bill was passed, demonstrates the nebulousness of smaller provisions of the law, which are deregulatory in nature, but not in the intended way:

> Leach was shocked to hear that regulators had pointed to this section of a bill bearing his name as the legal authority allowing banks to gain control over physical-commodities markets. "That's news to me," says the mortified ex-congressman, now a law professor at the University of Iowa. "I assume no one at the time would have thought it would apply to commodities brokering of a nature that has recently been reported."
>
> One thing that is clear in the public record is that nobody was talking, at least publicly, about banks someday owning oil tankers or controlling the supply of industrial metals.
>
> The JPMorgan witness, Michael Patterson, told the House Financial Services Committee at the 1999 hearing that his idea of "complementary activities" was, say, a credit-card company putting out a restaurant guide. "One example is American Express, which publishes magazines," he testified. "*Travel + Leisure* magazine is complementary to the travel business. *Food & Wine* promotes dining out . . . which might lead to greater use of the American Express card."[65]

Interviews like this show the strange shift in a law as it survives the years. What were once intended to be very small provisions in the law – ostensibly for credit cards to hawk special interest magazines – had developed into gaping loopholes, advantageous to those with the resources to make use of them. Normally, these types of inconsistencies in a statute are weeded out through litigation, through the process of case law that glacially focuses on Congress's intent, constitutional repercussions, and the like. However, in regulations facing the banking industry, these interpretations are typically done through signals from regulators. In the absence of clear rulings, or the prosecution of those firms who were breaking (or bending) the law, private sector firms felt free to use loopholes as much as they saw fit. To put it another way, it was the absence of public sector oversight

[65] Ibid.

that served as an implicit leadership decision that allowed firms to essentially set their own rules as they went along.

ROLE OF TECHNOLOGY IN MARKETS

The contestation continues today that Glass-Steagall protections are technologically obsolete in today's world. This is surely an extension of the modernization argument that GLBA's sponsors relied so heavily upon. Under this perspective, our markets and regulatory processes have become so technologically advanced that we've outgrown the Depression-era restrictions that were intended for a much slower era.

We should be careful about this extrapolation, and not give ourselves too much credit. After all, we still live in an age where "flash crashes" can inexplicably make wealth vanish from the market in seconds, and where government regulators still seem a few steps behind the corporate strategies of leading financial firms. It is far more likely that similar market forces are at play today as during the 1930's, although they are conducted with shinier interfaces and with more up-to-the-minute commentary from cable news talking heads.

IMPLICIT BIASES IN THE DEREGULATION DEBATE

Discussions about interpreting GLBA typically fall along the same lines relevant to how a policymaker views and trusts the banking industry. If a policymaker believes in a deregulated market, he or she is much more likely to see GLBA as having little or no additional risk exposure. Market skeptics, on the other hand – who are usually suspicious of the self-interest of the firm – are quick to discuss the need for a "new Glass-Steagall."

In other words, the projections of GLBA's impact on potential market collapse fit closely with a policymaker's view of banking more broadly.

It is similar to the argument advanced by Jonathan Haidt in the *The Righteous Mind* – that the political (and religious) parts of our minds often take a stand first, then we look for the evidence afterward to support our predisposed conclusions.[66] That is, the individual policymaker feels strongly that GLBA will or will not impact market risk, then uses arguments to support his or her side of the issue. With all the complications intrinsic to economic policy, we might consider how much of our regulatory process is conducted this way – by relying on gut feelings first, and then using supporting rhetoric later.

THE "NEW GLASS-STEAGALL" MOVEMENT

In the United States Senate, a bipartisan coalition of Senators – led by Elizabeth Warren, John McCain, Angus King, and Maria Cantwell – has reignited the debate on whether a "new Glass-Steagall" is needed today, by introducing the "21st Century Glass-Steagall Act of 2013."[67] The political energy behind this movement will hinge upon how stringently the "Volcker Rule" provisions in the Dodd-Frank legislation are interpreted and implemented.[68] Should the "Volcker Rule" prove strong enough, the impetus may not exist in Congress to pass this new legislation. Conversely, if loose regulation continues, there will likely be political expediency in pursuing the revival of Glass-Steagall. There is still quite a lot of anger toward banks in political life today – emotions that are tapped by the progressive and libertarian wings of the Democratic and Republican parties alike.

[66] Haidt, Jonathan. *The Righteous Mind: Why Good People Are Divided by Politics and Religion*. New York: Pantheon, 2012, 52-56. The gist of his argument concerns the "rider" and the "elephant" – metaphors for the clarity of our rational mind vs. our closely-held political preconceptions.

[67] "21st Century Glass Steagall Act of 2013." *Official Website for U.S. Senator Elizabeth Warren*.

[68] Mattingly, Phil, and Cheyenne Hopkins. "Glass-Steagall Fans Plan New Assault If Volcker Rule Deemed Weak." Bloomberg, 8 Dec. 2013.

Memories of taxpayer-backed bailouts for “too big to fail” institutions still sting in the minds of many activists and voters. This is especially true in contrast to the stubborn recession that has left chronic unemployment in its wake, while the securities markets have largely recovered. If there is a way to channel this popular anger, then there will likely be opportunistic politicians who will want to join this coalition.

Chapter 6: Conclusions

So why does any of this matter today? Each side has assertions and counter-assertions about the macro-level risk involved with GLBA. The proponents of deregulated banking hold that Glass-Steagall's provisions would have had effectually no impact at all – or they argue, in the case of President Clinton, that Glass-Steagall actually would have restrained banks from buying up troubled securities firms in the aftermath of the 2008 crisis. (This is probably true, as some firms were so weakened that there had been talk of bankruptcy proceedings or bank nationalizations.) Opponents of GLBA contend that the law clearly changed the game in expanding the risk pool, allowing bankers to leap toward investments they knew were riskier, but had the promise of huge payoffs. In other words, GLBA was one step in the process of creating a more acceptable culture of risk in the New York markets. In an environment like that, who wants to be a sucker? The proclivity is to take as many risks as necessary to keep up with the competition – whether that means credit default swaps, subprime loans, or any number of other financial instruments with dubious credibility that are branded as mainstream investments.

The case for this shift is supported by one overall observation: the mission-specific nature of commercial banking has changed. Checking accounts rarely accrue interest, and savings accounts and certificates of deposit have rates that are near negligible. Traditional banks are finding money in other ways – through investments in Treasury securities, by taking advantage of the Fed's discount window, and via other means, such as market investments. The culture of savings-and-loan operations is imperiled by the lack of incentive for everyday Americans to keep their money in savings accounts and/or take out loans at reasonable rates. We can observe this all around us, and

we can wonder if financial firms have perhaps gotten distracted from commercial banking to focus on riding out the boom-and-bust bubble economy. If that is true, it has dire repercussions for our projections of strength in American financial services, as we face the inevitable next storm in our markets. The big question remains: are banks in a place where they can help American businesses and households grow and thrive? Or are they just being used as vehicles for the pursuance of other investment strategies?

Based on the information gleaned from this report, it appears that American bankers have a lot to gain from deregulation, mainly in the form of access to capital, the ability to better leverage, and the chance to invest in potentially high-yielding securities. But is this regulatory policy in the *public interest*, if it also cannibalizes our country's traditional commercial banking system? It would appear not. Furthermore, there is limited evidence supporting the argument that banks would lose market share in the United States, should the Glass-Steagall firewall provisions return. In addition, the GLBA loopholes that allow for mixing financial investment and the management of commodities are clearly harmful to free competition in the marketplace, essentially creating a surcharge on both industry and consumers.

On balance, the argument is clear: rebuilding the Glass-Steagall firewall, with its stringent restrictions, will help return the banking system to its compartmentalized and important separate role in society. And it will likely inspire commercial bankers to return their focus to the household and commercial lending and competitive interest-rate savings that Americans need during the ongoing recession. We owe it to ourselves to make a rational analysis of our country's needs, and to use that understanding to guide our judgment on banking policy. It is a far better approach than listening only to the unfettered and dire prognostications of firms with a vested interest in the policy outcome.

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