Bank Supervisors Throw Glass-Steagall Thunderbolt

by Anita Gallagher

Jan. 20—FDIC Vice Chairman Thomas Hoenig and Dallas Federal Reserve Chairman Richard Fisher, in back-to-back calls on Jan. 16 and 17, called for breaking up U.S. megabanks into smaller entities based on function, and limiting government insurance solely to commerical bank functions.

Writing in the daily trade publication *American Banker* on Jan. 17, Hoenig, who served as chairman of the Kansas City Federal Reserve (1991-2011), proposed a simple solution to the problem of "too big to fail" banks: Remove the "safety net" of Federal insurance from non-bank activities, since without it the largest banks would shrink drastically, as investors demand that these banks hold stronger assets. Hoenig called for the restoration of the Glass-Steagall Act, Franklin Roosevelt's 1933 legislation which "served the United States from the Great Depression until 1999." Glass-Steagall was introduced into the new Congress as H.R. 129, "The Return to Prudent Banking Act," by Rep. Marcy Kaptur (D-Ohio).

On Jan. 16, Dallas Fed Chairman Fisher, speaking to the Committee for the Republic in Washington, D.C., opened his remarks by referencing the American Revolution against the British, declaring, "I shall speak forth my sentiments freely, and without reserve. This is no time for ceremony . . . [it] is one of awful moment to this country."

Fisher said, "Everyone and his sister knows that financial institutions deemed too big to fail were at the epicenter of the 2007-2009 financial crisis." He calls for restructuring the "too big to fail" banks and says, "Only the resulting downsized commercial banking operations—and not shadow banking affiliates or the parent company—would benefit from the safety net of Federal deposit insurance and access to the Federal Reserve's discount window."

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FDIC Vice Chairman Thomas Hoenig: Restore Glass-Steagall; no safety net for investment banks.

CNN/YouTube

Dallas Fed President Richard Fisher: Cut the megabanks down to size.

Athough Fisher does not name it, this principle is the core of the 1933 Glass-Steagall Act.

Looks Like a Movement

Lyndon LaRouche, who forecast the bursting of the financial bubble in July 2007, prior to the explosion of the mortgage crisis that Fall, commented that "the lid is coming off" pent-up demands to go back to Glass-Steagall, before hyperinflation destroys the United States. There must be no compromise, LaRouche said. Many banks will go belly-up with this, but the U.S. banking system must be saved. How?

Step two, said LaRouche, after the worthless paper is written off, is that the U.S. must immediately go to a credit system, exactly as Treasury Secretary Alexander Hamilton did, and issue new credit for large-scale physical-economic projects, such as the North American Water and Power Alliance (NAWAPA), to bring water to the western states from Canada, to solve the many problems caused by aridity.

There is a revolt among bankers, in Texas and elsewhere, LaRouche noted, which means there is a movement. The Federal Reserve districts will move against Chairman Ben Bernanke's Quantitative Easing IV: Jeffrey Lacker, President of the Richmond Federal Reserve, voted against QEIV at the Federal Open Market Committee meeting on Dec. 12, and Kansas City Fed President Esther George (Hoenig's replacement), and Philadelphia Fed President Charles Plosser also opposed it.

On Jan. 16, Paul Craig Roberts, President Ronald Reagan's Assistant Undersecretary of the Treasury, attacked the "fiscal cliff" debate as a "diversion" from the real economic issues: "Prior to financial deregulation, essentially the repeal of the Glass-Steagall Act and the non-regulation of derivatives . . . commercial banks took depositors' deposits and made loans to businesses and consumers. . . . With the repeal of Glass-Steagall, these honest commercial banks became gambling casinos. . . ."

No Safety Net, No 'Too Big To Fail'

Without a Federal safety net, banks will downsize themselves, and thus, there will be no more "too big to fail" problem. Hoenig writes: "Given calls for breaking up the largest banks and placing the nonbank broker-dealer activities in separate companies to successfully compete without public support, it is fair to ask, 'Will they remain too big to fail?' The short answer is no. . . . Structured correctly and without a government backstop, the market would demand stronger capital and safer growth. This would enhance the ability to place them into bankruptcy instead of the arms of the taxpayer, should they run into trouble." This separation also means that investment banks cannot use their depositor base to fund speculation.

Richard Fisher agrees, writing: "Under our proposal, only the commerical bank would have access to deposit insurance provided by the FDIC, and discount window loans provided by the Federal Reserve. These two features of the safety net would explicitly, by statute, become unavailable to any shadow banking affiliate (brokerage, insurance company, securities subsidiary, etc.) of the commercial bank, or any obligations of the parent holding company."

Fisher then proposes, "To reinforce this statute and its credibility, every customer and counterparty of every shadow banking affiliate and of the senior holding company would be required to agree to a sign a new covenant, a simple disclosure statement that acknowledges their unprotected status," and offers this example, like a cigarette package label:

"WARNING: Conducting business with this affiliate of the _______ bank holding company carries NO federal deposit insurance or other federal government protection or guarantees. I, ___________, fully understand that in conducting business with __________ banking affiliate, I have NO federal deposit insurance or other federal government protection or guarantees, and my investment is totally at risk."

The Dodd-Frank bill to regulate banks was a total failure, says Fisher. Withdrawing Federal safety net protection from the megabanks is the simple solution: "At present, 99.8 percent of the banking organizations in America are subject to sufficient regulatory or shareholder/market discipline to contain the risk of misbehavior that could threaten the stability of the financial system. Zero-point-two percent are not. Their very existence threatens both economic and financial stability."

On Jan. 19, *New York Times* financial columnist Gretchen Morgenson wrote, "The response to Mr. Fisher's proposal has been resoundingly positive. Immediately after the speech was posted Wednesday evening on the Dallas Fed's website, heavy traffic caused the site to shut down."

The *Fiscal Times Newsletter* (Peterson Institute) reported that Fisher had told them that "after the Wednesday night speech, he had been called unsolicited by lawmakers from both parties." He stressed in a post-speech interview that he thought both Democratic and Republican lawmakers were ready to support his proposed regulations.