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What the Financial Services Industry Puts Together Let No Person Put Asunder: How the Gramm-Leach-Bliley Act Contributed to the 2008 - 2009 American Capital Markets Crisis

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ARTICLES

WHAT THE FINANCIAL SERVICES INDUSTRY PUTS TOGETHER LET NO PERSON PUT ASUNDER‡: HOW THE GRAMM-LEACH-BLILEY ACT CONTRIBUTED TO THE 2008–2009 AMERICAN CAPITAL MARKETS CRISIS

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ABSTRACT

The current subprime financial crisis has shaped up to be one of the most dramatic and impactful events in the past few decades. No one particular factor fully accounts for why the American economy suffered setbacks unseen since the Great Depression of the 1930s. Some of the roots of the current financial crisis started taking hold in 1999 when Congress passed the Financial Services Modernization Act, also known as the Gramm-Leach-Bliley Act. Gramm-Leach-Bliley brought about sweeping deregulation to the financial services industry. In essence, Gramm-Leach-Bliley swept away almost six decades of financial services regulation precipitated by the Great Depression of the 1930s. Gramm-Leach-Bliley explicitly repealed the Glass-Steagall Act passed in the 1930s to stamp out much of the evil that caused the Great Depression.

The year 2009 is a momentous year: it marks the ten-year anniversary of the passage of the Gramm-Leach-Bliley Act. This article posits that passage of the Gramm-Leach-Bliley Act in 1999,

‡ The passage in the Bible I draw on reads: "Wherefore they are no more twain, but one flesh. What therefore God hath joined together, let not man put asunder." *Matthew* 9:16 (King James).

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the Republican push for deregulation, and—most importantly—repeal of the firewalls established by the Glass-Steagall Act accounts for why America is in the midst of one of the worst and deepest financial crises in our nation's history. This article examines the Senate debates leading up to the passage of the Gramm-Leach-Bliley Act. Interestingly, a number of politicians issued powerful criticisms, predictions, and forecasts around the time of the passage of Gramm-Leach-Bliley that should have been taken seriously. Most notably, Senators Byron Dorgan (D-ND), Russell Feingold (D-WI), and Barbara Mikulski (D-MD) stood out as vocal critics.

To gain further insight into the reach and effect of the Gramm-Leach-Bliley Act, this article examines the deregulatory effect of the legislation on two corporations in particular: Citigroup and Bank of America. This article then examines whether firewalls are necessary in the financial services industry. As the Troubled Asset Relief Program ("TARP") has demonstrated, some institutions are "too big to fail." This article explores what a return to Glass-Steagall regulation would do to prevent the "too big to fail" problem. Alternatively, it explores a three-tiered approach to financial services industry regulation. Finally, it explores whether we should let financial service industry institutions fail from a market efficiency standpoint, in the absence of strong regulation in the form of firewalls or stringent regulatory oversight.

I. INTRODUCTION

The 2008–2009 financial/economic market crisis has staggered the United States capital markets, and has stunned and set back the global economy. Unlike some watershed events in our nation's and the world's history, the capital markets meltdown will not just end on a date certain in 2009: it promises to have a lasting impact on our lives for years and perhaps generations to come. In America, both Wall Street and Main Street have been rocked by the collapse of the capital markets. Neighborhoods are uninhabited due to foreclosures; banks and other financial institutions have gone under water; industrial giants have been forced into bankruptcy; individuals have lost their life's savings; and retirement and pension plans have all felt the sting of the collapse. The current financial crisis has been one of the deepest and most injurious events to take place during our lifetimes.

Analyzing the capital markets meltdown from a legal perspective is essential in order to engage in transformative thinking and policymaking and to avoid repeating the mistakes of the present in the future. Because we are in the midst of the capital markets crisis, there is virtually no legal scholarship in existence that analyzes the roots of the current capital markets meltdown in real time, or more importantly, the way forward in the future from a legal perspective.

Indeed, the current capital markets crisis has shaped up to be one of the most dramatic and impactful economic events in the past six decades. The causes of the current financial crisis are convoluted and complex. No one particular factor or reason fully accounts for why the American economy suffered setbacks unseen since the Great Depression of the 1930s. The current financial crisis has been "the worst financial crisis since the Great Depression [and] continues to roil and reshape the U.S. banking industry."[1] Some of the roots the current financial crisis started taking hold in 1999, when Congress passed the Financial Services Modernization Act of 1999, also known as the Graham-Leach-Bliley Act.[2] This act brought sweeping deregulation to the financial services industry.[3] For the financial services industry, the Gramm-Leach-Bliley Act "marked the end of regulation that addressed the perceived defects in the banking system thought to have caused the Great Depression."[4] The Graham-Leach-Bliley Act swept away almost six decades of financial services regulation precipitated by the Great Depression of the 1930s.[5] "Congress enacted [Gramm-Leach-Bliley] to address the need for increased competition in the financial services industry."[6] Graham-Leach-Bliley explicitly repealed the Glass-Steagall Act which was passed in the 1930s and designed to stamp out commercial speculation and other perceived evils that lawmakers at the time viewed as causing the Great Depression.[7] Thus, "[t]he [Gramm-Leach-Bliley Act] redesigned the regulatory structure that had been in place since the Great Depression."[8]

The year 2009 is a momentous year: it marks the ten-year

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[1] Dan Fitzpatrick, *Three Banks Complete Deals*, WALL ST. J., Jan. 2, 2009, at C3.

[2] Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

[3] As one commentator has noted: "Enactment of the GLBA, also known as the Financial Services Modernization Act of 1999, was a revolutionary event in the world of financial services." Jolina C. Cuaresma, *The Gramm-Leach-Bliley Act*, 17 BERKELEY TECH. L.J. 497, 497 (2002). Another commentator has noted:

> [T]he Gramm-Leach-Bliley Act, commonly referred to as the Financial Services Modernization Act . . . provides sweeping revisions to the Glass-Steagall Act restrictions that prohibited broad affiliations among the banking, securities and insurance industries. [Gramm-Leach-Bliley] practically eliminates most all of the federal and state law barriers to affiliations among banks, securities firms, insurance companies and other financial service providers.

W. Christopher Barrier & John O. Moore, *Bank on It: The Financial Services Modernization Act of 1999*, ARK. LAW., Summer 2000, at 23, 23 (citations omitted).

[4] Cuaresma, *supra* note 3, at 497 (citations omitted).

[5] *Id.*; Glass-Steagall Act, Pub. L. No. 73-66, 48 Stat. 162 (1933), *repealed by* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 101, 113 Stat. 1338, 1341 (2001).

[6] Cuaresma, *supra* note 3, at 497.

[7] In enacting Glass-Steagall, Congress was primarily concerned about banks engaging in securities underwriting. As one commentator has noted:

> Passed during the Roosevelt administration, the Glass-Steagall Act directly responded to the belief that the stock market crash [of 1929] resulted from the lack of separation between lending and underwriting activities that had allowed banks to engage in speculative investments. Under the Glass-Steagall Act, Congress separated commercial banking from investment banking, thereby prohibiting commercial banks from underwriting most securities. With the goal of eliminating conflicts of interest, Congress sought to prevent these firms from engaging in similar activities.

Id. at 498–99 (citations omitted).

[8] *Id.* at 498.

anniversary of the passage of the Gramm-Leach-Bliley Act. This article posits that the passage of the Gramm-Leach-Bliley Act in 1999, the Republican push for deregulation, and—most importantly—the repeal of the firewalls by the Glass-Steagall Act help to explain and account for why we find ourselves in the midst of one of the worst and deepest financial crises in our nation's history. Admittedly, the passage of the Gramm-Leach-Bliley Act is not the sole cause of the current capital markets crisis.[9] To assert so is elementary and fails to acknowledge a multifaceted web of mystery and intrigue that has led us to the position we find ourselves in today. Solving and accounting for all of the causes of the current capital markets crisis is like solving a good murder mystery: there are many potential killers with motive and opportunity, and several unsuspected twists and turns. To solve the financial crisis completely, it would take the likes of Angela Lansbury[10] or Agatha Christie[11] to determine the true culprit.

Unwrapping the shell surrounding the current capital markets crisis is a complex undertaking. Interestingly, some key policy-makers in Washington D.C. predicted storm clouds growing on the

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[9] For instance, a New York Times Editorial noted:

> But does anyone understand with specificity what brought on the financial meltdown? Can the lawmakers and other officials charged with writing the new rules explain the transactions, interactions, norms, products and relationships that got us in this mess? Can anyone parse how much of the crisis is due to regulatory failure, how much to recklessness and greed, how much to fraud and manipulation? Why, exactly, did Goldman Sachs get $12.9 billion in the A.I.G. bailout?
>
> Without the answers, which we do not yet have, Congress and the administration cannot be confident that they are coming up with the right reforms. It is clear, however, that there is bipartisan resistance to a thorough investigation of what caused the collapse. There have been hearings galore. But they are often little more than hazings of corporate executives and government officials. Even the illuminating hearings have not been connected in a meaningful way that will help us all understand what went wrong.
>
> Without an investigation, the reform effort will be at best, hit or miss, and at worst, a charade. Congress should start now to gear up for an investigation, using as its model the 1930s Pecora inquiry into the stock market crash, or the Watergate hearings of the 1970s. The investigation should not be performed by outside experts, like the 9/11 commission, whose report Congress is free to accept or reject. It should be part of the Congressional process and include an investigator with subpoena power and the right to participate in the questioning of witnesses, as well as to prep lawmakers for the hearings.
>
> A real investigation might serve as a channel for the public anger now used by politicians to score quick populist points on television without tackling the real issues.

Editorial, *Questions for Reform*, N.Y. TIMES, Mar. 29, 2009, at WK8.

[10] The *Murder, She Wrote* television series ran from 1984–1996 and starred Angela Lansbury as Jessica Fletcher, a writer who solved murder mysteries. *See* The Internet Movie Database, http://www.imdb.com/title/tt0086765/ (last visited Mar. 14, 2010).

[11] Agatha Christie was the author of numerous novels that centered on murder mysteries. *See* Agatha Christie, http://www.agathachristie.com/ (last visited Mar. 14, 2010).

horizon in the debate leading up to the passage of Gramm-Leach-Bliley. Some of these predictions were actually quite prophetic. This article examines the Senate debates leading up to the passage of the Gramm-Leach-Bliley Act. Ironically, a number of politicians at the time issued powerful criticisms, predictions, and forecasts that should have been taken seriously as warning of what was to come. Most notably, Senators Byron Dorgan (D-ND), Russell Feingold (D-WI), and Barbara Mikulski (D-MD) stood out as vocal and articulate critics.

To gain further insight into the reach and effect of the Gramm-Leach-Bliley Act, this article examines the deregulatory effect of the legislation on two corporations in particular: Citigroup and Bank of America. Furthermore, this article examines whether firewalls are necessary in the financial services industry. As the TARP Program has demonstrated, many have made the argument that some institutions are "too big to fail." Hence, this article addresses regulatory approaches that serve as an alternative to full reimplementation of Glass-Steagall type firewalls. Finally, this article explores whether we should let financial service industry institutions fail from a market efficiency standpoint, in the absence of strong regulation in the form of firewalls. Thus, this article presents an alternative to strong regulation, namely allowing some institutions that are "too big to fail" to do just that. Is the alternative to strong regulation (i.e., failure of "too big to fail" institutions) a dose of medicine we are willing to take?

This article proceeds to examine the Gramm-Leach-Bliley Act in six parts. Part II provides a brief and abbreviated history of the legal and legislative landscape for banks in America that existed from 1933 through 1999.[12] Part III examines the arguments made for and against Gramm-Leach-Bliley in the 1980s, when banks started to lobby strongly for the repeal of the Glass-Steagall Act of 1933.[13] Part IV examines the legislative history surrounding the passage of Gramm-Leach-Bliley.[14] Part V examines the present day impact of Gramm-Leach-Bliley on banks, its main beneficiaries, by conducting case studies of two large banks created in the wake of Gramm-Leach-Bliley:[15] Citigroup and Bank of America.[16] Part VI

[12] *See infra* Part II.
[13] *See infra* Part III.
[14] *See infra* Part IV.
[15] *See infra* Part V.
[16] I have examined Citigroup and Bank of America because they are representative of banking institutions that were heavily affected by the current capital markets crisis. Critics

explores arguments for "re-regulation" of the financial services industry.[17] Finally, Part VII explores an alternative to "re-regulation," the notion that market efficiency should prevail, and thus the market should dictate who wins the battle of the fittest.[18]

II. THE LEGISLATIVE LANDSCAPE FOR BANKS IN AMERICA 1933–1999: A BRIEF HISTORICAL OVERVIEW

In many ways, even in 1933, the nation's financial system was still reeling from the stock market crash of October 1929.[19] In search of a response, Congress passed the Glass-Steagall Act, which was to have an enormous impact on American banking laws and regulations for the next sixty-six years.

Congress's response to the financial crisis of the Great Depression included extensive legislative activity between 1932 and 1934.[20] Designed to restore confidence in the banking system, "[t]his period saw the enactment of laws providing federal deposit insurance for accounts in banks and savings associations, federal charters and a

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will say that this represents a form of selection bias. I will admit that some banking institutions have fared relatively well in the midst of the current capital markets downturn. JP Morgan Chase and Wells Fargo are ready examples of somewhat "healthy" banks in a sea of contagion. Critics say that Gramm-Leach-Bliley is not all that bad, and therefore deregulation is not a bad thing, because we have JP Morgan Chase and Wells Fargo to look to as examples of large banks that benefitted from the Gramm-Leach-Bliley Act. I think this assertion misses the point. On a whole, if one looks at the net effect of Gramm-Leach-Bliley, *see infra* Part V, the demolition of firewalls under the Gramm-Leach-Bliley Act allowed banks like Citigroup and Bank of America arguably to dabble in banking, securities, and insurance, to their detriment. One salient point that is important to remember is that banks generally are good at providing banking services, but not so good at assessing risk in the securities market, and forecasting insurance losses and risk exposure. From a corporate governance standpoint, once banks stray away from their core mission of banking, the corporate entity assumes great risk unless management and the board of directors have skill and knowledge about conducting business outside of banking; skills like risk assessment and evaluation are crucial in the securities and insurance industries. This brings us back to fundamental duties of due care from a corporate law perspective. *See, e.g.*, Regina Burch, *Director Oversight and Monitoring: The Standard of Care and the Standard of Liability Post-Enron*, 6 WYO. L. REV. 481, 485–86 (2006).

[17] *See infra* Part VI.

[18] *See infra* Part VII.

[19] KENNETH R. BENSON ET AL., FINANCIAL SERVICES MODERNIZATION: GRAMM-LEACH-BLILEY ACT OF 1999: LAW AND EXPLANATION 25 (1999) ("The Glass-Steagall Act was a response to the stock market crash of 1929, which in today's figures was equivalent to a more than 1,300 point one-day drop in the Dow Jones Industrial Average. Following the crash, the Senate Banking Committee convened a hearing headed by its chief counsel Ferdinand Pecora. The Pecora investigation provided detailed testimony on the self-dealing and other market abuses engaged in through securities affiliates by some officers of certain large money center banks.").

[20] HARDING DE C. WILLIAMS, FEDERAL BANKING LAW AND REGULATIONS: A HANDBOOK FOR LAWYERS 11 (2006) (citations omitted).

federal liquidity facility for savings associations, and extensive amendments [to] the National Bank and Federal Reserves Acts."[21] As one commentator has noted:

> The Banking Act of 1933 created the FDIC, prohibited member banks from paying interest on demand deposits, authorized the Federal Reserve to set interest rate ceilings on time deposits, and added section 23A, relating to transactions with affiliates, to the Federal Reserve Act. The Act also adopted the four sections known as the Glass-Steagall Act, which prohibited banks from engaging in certain securities activities.[22]

In the mid-1930s, Congress tried in multiple ways to attack the financial crisis which was brought on by the 1929 crash of the stock market and which spiraled into the Great Depression. For Congress, a multipronged approach was necessary to root out perceived evils that brought the economy to a grinding halt. Between 1933 and 1935, Congress passed four major pieces of legislation that had an immediate and lasting impact on the banking and securities industries. First, Congress passed the Glass-Steagall Act of 1933 to create "separate rooms" for bankers and securities brokers.[23] As he was signing the Glass-Steagall Act, President Roosevelt remarked that this was "the most important and far-reaching legislation ever enacted by the American Congress."[24] Second, Congress passed the Securities Act of 1933 to regulate the trading of securities at the registration stage.[25] Third, in tandem with the Securities Act of 1933, Congress passed the Securities Exchange Act of 1934, to require ongoing reporting, disclosure, and transparency in the trading of securities.[26] Fourth,

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[21] *Id.*

[22] *Id.*

[23] BENSON ET AL., *supra* note 19, at 25 ("The barrier between banking and commerce sought by the Glass-Steagall Act was intended to restore confidence in the country's financial system. By placing bankers and brokers in 'separate rooms,' it was thought that the insider abuses, which were felt to be the cause of the 1929 Crash, would be reduced. In addition, the separation acted as a safe harbor for ordinary Americans, under which they could deposit their money safely, protected by deposit insurance and shielded from the more speculative nature of stocks. . . . Merely two years after the enactment of the Glass-Steagall Act, one of its primary sponsors, Senator Carter Glass, sought to soften the barriers during consideration of the Banking Act of 1935. He subsequently withdrew his efforts to revise the Glass-Steagall Act in deference to the wishes of President Roosevelt."); *see also* FDIC, Important Banking Legislation, http://www.fdic.gov/regulations/laws/important/index.html (last visited Mar. 14, 2010) [hereinafter FDIC].

[24] *Id.*

[25] Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933).

[26] Securities Exchange Act of 1934, Pub. L. No. 73, 291, 48 Stat. 881 (1934).

and finally, Congress passed the Banking Act of 1935 to establish the Federal Deposit Insurance Corporation ("FDIC") as a permanent agency of the federal government.[27]

Even though the barrier between banking and commerce remained largely intact for the next twenty years, change was inevitable.[28] The Bank Holding Company Act of 1956 "[r]equired Federal Reserve Board approval for the establishment of a bank holding company."[29] Further, the Act "[p]rohibited bank holding companies headquartered in one state from acquiring a bank in another state."[30] This prohibition, however, was altered by the passage of the Bank Holding Company Act Amendments of 1970, which "established a structure to regulate the permissible non-banking activities of companies that owned banks."[31] The Bank Holding Company Act of 1956 also "[p]rohibit[ed] bank holding companies from engaging in most nonbanking activities and making most interstate banking acquisitions,"[32] and "empower[ed] the Federal Reserve to regulate and supervise bank holding companies."[33]

Other legislation aided in chipping away at some of the barriers established by the Glass-Steagall Act. For instance, the Savings and Loan Holding Company Act of 1967 further eroded the protections of the Glass-Steagall Act by permitting any company to "own a single savings and loan institution."[34] This Act "authorize[ed] the Federal Reserve to monitor non-depository-related businesses of savings and loan holding companies."[35] Similarly, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 "create[d] the Office of Thrift Supervision to regulate federal and most state-chartered thrifts and their holding companies."[36] And the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 "repeal[ed] [the] ban on interstate

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[27] Banking Act of 1935, Publ. L. No. 74-305, 49 Stat. 684 (1935); *see also* http://www.fdic.gov/regulations/laws/important/index.html (last visited Mar. 14, 2010).

[28] BENSON ET AL., *supra* note 19, at 25.

[29] FDIC, *supra* note 23; *see also* Bank Holding Company Act of 1956, 12 U.S.C. § 1842(a) (2001).

[30] FDIC, *supra* note 23.

[31] BENSON ET AL., *supra* note 19, at 25.

[32] Suzanne Barlyn, *Future of Finance (A Special Report): Regulation—How the Rules Developed*, WALL ST. J., Mar. 30, 2009, at R2.

[33] *Id.*

[34] BENSON ET AL., *supra* note 19, at 25.

[35] Barlyn, *supra* note 32.

[36] *Id.*

banking in [the] U.S."[37]

Finally, the Gramm-Leach-Bliley Act of 1999 "repeal[ed] the Glass-Steagall Act's wall between banks and securities firms, allowing some institutions to engage in commercial banking, securities underwriting and dealing, and insurance underwriting."[38] Insurance regulation largely had been left to state regulators since the time of the United States Supreme Court's ruling in *Paul v. Virginia*.[39] Table One, below, illustrates the major banking legislation in the United States passed in the period between 1933 and 1999.

TABLE ONE: MAJOR BANKING LEGISLATION IN THE UNITED STATES FROM 1933-1999[40]

Year of Passage	Name of Legislation
1933	Banking Act 1933 (Glass-Steagall Act)
1935	Banking Act of 1935
1956	Bank Holding Company Act of 1956
1967	Savings & Loan Holding Company Act of 1967
1977	Community Reinvestment Act of 1977
1989	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
1994	Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994
1999	Financial Services Modernization Act of 1999 or Gramm-Leach-Bliley Act

III. GLASS-STEAGALL: ARGUMENTS FOR AND AGAINST MAINTENANCE AND REPEAL LEADING UP TO PASSAGE OF GRAMM-LEACH-BLILEY

Since its enactment, Congress has attempted, on a number of occasions, to repeal the Glass-Steagall Act.[41] Between 1988 and 1997, both the House of Representatives and the Senate considered a number of measures to modernize the American financial services

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[37] *Id.*

[38] *Id.*

[39] 75 U.S. 168 (1869). In *Paul v. Virginia*, the Supreme Court held that the federal government could not regulate insurance under the Commerce Clause of the United States Constitution. *See id.* at 183, 185. In 1944, "[t]he high court overturns its 1869 Paul Decision, holding that insurance is 'interstate commerce' and [thus] subject to federal regulation." Barlyn, *supra* note 32. In 1945, Congress passed the McCarran-Ferguson Act which returned jurisdiction over insurance to the states. *Id.*

[40] FDIC, *supra* note 23; *see also* Barlyn, *supra* note 32.

[41] BENSON ET AL., *supra* note 19, at 26.

industry.[42] In the November 4, 1999 Senate debates leading up to the passage of Gramm-Leach-Bliley, a number of distinguished and long-serving Senators lamented about the previous efforts to repeal and undo the effects of the Glass-Steagall Act, and how it had consumed their Senate careers.[43]

The Congressional Research Service undertook a study of the impact of the repeal of the Glass-Steagall Act in 1987. Entitled "Glass-Steagall: Commercial vs. Investment Banking,"[44] the Congressional Research Service presented the case in support of preserving Glass-Steagall as follows:

> 1. Conflicts of interest characterize the granting of credit—lending—and the use of credit—investing—by the same entity, which led to abuses that originally produced the Act.
> 2. Depository institutions possess enormous financial power, by virtue of their control of other people's money; its extent must be limited to ensure soundness and competition in the market for funds, whether loans or investments.
> 3. Securities activities can be risky, leading to enormous losses. Such losses could threaten the integrity of deposits. In turn, the Government insures deposits and could be required to pay large sums if depository institutions were to collapse as a result of securities losses.
> 4. Depository institutions are supposed to be managed to limit risk. Their managers thus may not be conditioned to operate prudently in more speculative securities businesses. An example is the crash of real estate investment trusts sponsored by bank holding companies a decade ago.[45]

In this same 1987 study, the Congressional Research Service presented the case against preserving the Glass-Steagall Act with the following counter-arguments:

> 1. Depository institutions now operate in "deregulated"

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[42] *Id.* at 26–28 (describing in detail the legislative initiatives to repeal Glass-Steagall); *see also* Proxmire Financial Modernization Act of 1991, S. 263, 102nd Cong. (1991); Financial Services Act of 1993, H.R. 458, 103rd Cong. (1993); Financial Services Competitiveness Act of 1995, H.R. 18, 104th Cong. (1995); Financial Services Competitiveness Act of 1995, H.R. 1062, 104th Cong. (1995); Financial Services Competitive Enhancement Act, H.R. 2940, 105th Cong. (1997); Financial Services Competitive Enhancement Act, H.R. 823, 106th Cong. (1999).

[43] *See* 145 CONG. REC. 13883, 13886, 13903, 13906, 13908, 13909 (daily ed. Nov. 4, 1999) (statements of Sen. Lott, Sen. Dodd, Sen. Kerry, Sen. Mack, Sen. Lugar, and Sen. Domenici).

[44] WILLIAM D. JACKSON, CONGRESSIONAL RESEARCH SERVICE REPORT FOR CONGRESS, GLASS-STEAGALL ACT: COMMERCIAL VS. INVESTMENT BANKING (1987), *available at* http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-9065:1.

[45] *Id.* at 5.

financial markets in which distinctions between loans, securities, and deposits are not well drawn. They are losing market shares to securities firms that are not so strictly regulated, and to foreign financial institutions operating without much restriction from the Act.
2. Conflicts of interest can be prevented by enforcing legislation against them, and by separating the lending and credit functions through forming distinctly separate subsidiaries of financial firms.
3. The securities activities that depository institutions are seeking are both low-risk by their very nature, and would reduce the total risk of organizations offering them—by diversification.
4. In much of the rest of the world, depository institutions operate simultaneously and successfully in both banking and securities markets. Lessons learned from their experience can be applied to our national financial structure and regulation.[46]

IV. GRAMM-LEACH-BLILEY: A JOURNEY THROUGH THE LEGISLATIVE DEBATE AND RECORD IN THE SENATE

A. *Gramm-Leach-Bliley: The Legislative Journey to Passage*

The Gramm-Leach-Bliley Act was enacted in the first session of the 106th Congress. The act passed the Senate on November 4, 1999 by a 90 to 8 vote,[47] and passed the House of Representatives the same day by a 362 to 57 vote.[48] Proponents of the Gramm-Leach-Bliley Act celebrated their success.[49] Table two, below, shows

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[46] *Id.* at 6.

[47] *See* United States Senate, U.S. Senate Roll Call Votes 106th Congress—1st Session, http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=106&session=1&vote=00354 (last visited Mar. 14, 2010); *see also* Tara L. Meltzer, *A Sign of the Times: President Signs Historic Banking Bill*, 18 No. 23 BANKING POL'Y REP. 1 (Dec. 1, 1999).

[48] *See* Office of the Clerk of the U.S. House of Representatives, Final Vote Result for Roll Call 570 (Nov. 4, 1999), http://clerk.house.gov/evs/1999/roll570.xml (last visited Mar. 14, 2010); *see also* Meltzer, *supra* note 47.

[49] On the day the Gramm-Leach-Bliley passed, Senator Phil Gramm, chairman of the Senate Banking Committee issued the following statement:

> I believe we have passed what will prove to be the most important banking bill in 60 years. It overturns the key provision of the Glass-Steagall act that divided the American financial system.
>
> Over time, the market and the regulators have used a variety of innovations to try to undo this separation. As a result, we have substantial competition occurring, but it is competition that is largely inefficient and costly, it is unstable, and it is not in the public

TABLE TWO: MAJOR LEGISLATIVE ACTIONS LEADING TO THE PASSAGE AND ENACTMENT OF THE GRAMM-LEACH-BLILEY ACT[50]	
Date	Action Taken
4/28/1999	Introduced in Senate by Senator Phil Gramm (R-TX).
4/28/1999	Taken up by Senate Banking Committee
5/6/1999	Senate Bill 900 passes Senate with amendments by 54 to 44 Vote.
7/1/1999	House of Representatives approves House Resolution 10.
10/22/1999	Conference committee holds final meeting; names bill the Gramm-Leach-Bliley Act.
11/2/1999	Conference report signed by a majority of conferees, clearing the path for votes in the House and Senate.
11/4/1999	Gramm-Leach-Bliley Act passes the Senate by 90 to 8 Vote.
11/4/1999	Gramm-Leach-Bliley Act passes House of Representatives by 362 to 57 Roll Call Vote.
11/4/1999	Gramm-Leach-Bliley Act cleared for presentment to the White House.
11/9/1999	Presented to President William J. Clinton.
11/12/1999	Signed by President William J. Clinton.
11/12/1999	Becomes Public Law No: 106-102.

the major dates and actions taken that were key to the passage of the Gramm-Leach-Bliley Act.

> interest for this situation to continue.
>
> The Gramm-Leach-Bliley Act strikes down these walls and opens up new competition. It will create wholly new financial services organizations in America. It will literally bring to every city and town in America the financial services supermarket.
>
> Americans today spend about $350 billion on financial services—on fees and charges and interest. Most people who have looked at the potential for providing financial services under a more rational system believe, as I believe, that there are tens of billions of dollars of savings for the American consumer that will be produced by the reforms of this bill.

Press Release, Senate Banking Committee, Senate Approves Gramm-Leach-Bliley Act: Vote Paves Way for Financial Services Modernization (Nov. 4, 1999), *available at* http://banking.senate.gov/prel99/1104grm.htm.

[50] Library of Congress, Major Actions–S.900, http://thomas.loc.gov/cgi-bin/bdquery/z?d106:SN00900:@@@R (last visited Mar. 14, 2010); *see also* Press Release, Senate Banking Committee, Time Line of Gramm-Leech-Bliley Act (Nov. 5, 1999), *available at* http://banking.senate.gov/prel99/1105tme.htm; Meltzer, *supra* note 47.

The American Bankers Association played a significant role—and had a significant interest—in the passage of the Gramm-Leach-Bliley Act.[51] Hjalma E. Johnson, president of the American Bankers Association, noted at the time that aside from bringing consumers more choice, the bill also "ensures the continued health and success of America's banking industry by giving it the tools it needs to operate efficiently and competitively in the new millennium."[52] On November 12, 1999, after many years and numerous setbacks,[53] deregulation of the financial services industry became a reality. At the signing ceremony to mark the passage of Gramm-Leach-Bliley, Senator Phil Gramm (R-TX), the principal proponent of financial services deregulation, stated affirmatively that government was not the answer in regulating financial markets.[54] In the minds of proponents of the act, "[f]inancial markets were . . . deregulated in the 1980s and 1990s in an attempt to make them more market oriented."[55] Gramm-Leach-Bliley was intended to create one-stop-shopping for financial consumers.[56] It

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[51] *See* Meltzer, *supra* note 47.

[52] *Id.*

[53] Senator Connie Mack noted: "It has been at least twenty years since determined efforts began in the Congress to repeal this outdated law and modernize the country's banking code. Today—finally—we have come to the end of the road." 145 CONG. REC. S28353 (daily ed. Nov. 4, 1999) (statement of Sen. Mack). Additionally, Senator Lincoln observed: "After decades of unsuccessful tries, it appears that financial modernization legislation may finally become a reality." 145 CONG. REC. S28,355 (daily ed. Nov. 4, 1999) (statement of Sen. Lincoln).

[54] In a statement on November 12, 1999 to mark the passage of the Gramm-Leach-Bliley Act, Senator Phil Gramm (R-TX), made the following observations:

> The world changes, and Congress and the laws have to change with it.
>
> Abraham Lincoln used to like to use the analogy that old and outmoded laws need to be changed because it made about as much sense to continue to impose them on people as it did to ask a man to wear the same clothes he did when he was a child.
>
> In the 1930s, at the trough of the Depression, when Glass-Steagall became law, it was believed that government was the answer. It was believed that stability and growth came from government overriding the functioning of free markets.
>
> We are here today to repeal Glass-Steagall because we have learned that government is not the answer. We have learned that freedom and competition are the answers. We have learned that we promote economic growth and we promote stability by having competition and freedom.
>
> I am proud to be here because this is an important bill; it is a deregulatory bill. I believe that that is the wave of the future, and I am awfully proud to have been a part of making it a reality.

Press Release, Senate Banking Committee, Senator Gramm's Statement at Signing Ceremony for Gramm-Leach-Bliley Act (Nov. 12, 1999), *available at* http://banking.senate.gov/prel99/1112gbl.htm.

[55] RESTRUCTURING REGULATIONS AND FINANCIAL INSTITUTIONS 344 (James Barth et al., eds. 2000).

[56] Senator Patrick Leahy (D-VT) noted: "Modernizing current law will make the financial services industry more competitive, both at home and abroad. This legislation will make it easier for banking, securities, and insurance firms to consolidate their services, allowing them

was to be what Costco and Wal-Mart are to retail shoppers.

B. Storm Clouds Gathering: Senatorial Expressions of Caution and Concern

In the Senate debate leading up to the passage of Gramm-Leach-Bliley, both advocates and opponents of the legislation expressed some concern. Senator Jack Reed (R-RI), a supporter of Gramm-Leach-Bliley, raised the following concern:

> As we celebrate passage today, we should also underscore and point out areas that bear close watching. Fundamental changes as we are proposing today include consequences which may have adverse effects if they are not anticipated and watched carefully. Among those is the issue of the consolidation of our financial services industry. We are witnessing the megamergers that are transforming our financial services industry from small multiple providers to large providers that are very few in number. We run the risk of the doctrine "too big to fail;" that the financial institutions will become so large we will have to save them even if they are unwise and foolish in their policies. We have seen this before. We have to be very careful about this.[57]

Thus, even proponents of Gramm-Leach-Bliley noted the "too big to fail" issue brewing beneath the surface of the legislation. In addition, Senator Richard Shelby (R-AL), one of the few Republican critics of Gramm-Leach-Bliley, opposed the legislation because he thought that it did not contain sufficient measures to maintain the privacy and confidentiality of customer information, and that it unnecessarily expanded the Community Reinvestment Act of 1977.[58]

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to cut expenses and offer more products at a lower cost to businesses and consumers." 145 CONG. REC. S28,342 (daily ed. Nov. 4, 1999) (statement of Sen. Leahy). Senator Bryan (R-NV) echoed the notion of one-stop shopping when he noted: "We will provide new convenience to the American public, we will have one-stop shopping for insurance and banking and securities; that it will be less expensive; that more options will be provided. That may, in fact, be the case." 145 CONG. REC. S28,337 (daily ed. Nov. 4, 1999) (statement of Sen. Bryan).

[57] 145 CONG. REC. S28,334 (daily ed. Nov. 4, 1999) (statement of Sen. Reed).

[58] 145 CONG. REC. S13,893–95, (daily ed. Nov. 4, 1999) (statement of Sen. Shelby) ("I don't understand why no one is willing to stand up and oppose the expansion of CRA when it is very clear that this bill does, indeed, expand CRA. Why else would the administration support the bill? Why else would Rev. Jesse Jackson support the bill? We all know why. The bill expands CRA. . . . [T]he price the American people are going to pay—their privacy—if we pass this bill for only a few large financial conglomerates. . . . I have said it before and I will say it again here, we are paying a very high price, a very dear price for this bill. The American people are paying a very dear price for this bill, and they will continue to pay it. It

The most vocal critic of Gramm-Leach-Bliley was Senator Byron Dorgan (D-ND). Senator Dorgan's comments are worth examining extensively:

> In the final hours of the Congress, they bring a piece of legislation to the floor—it is called financial services modernization. I know they feel passionately and strongly it is the right thing to do. For other reasons, I feel very strongly it is the wrong thing to do. I do not come to denigrate their work. We have a philosophical disagreement about this legislation, and I want to describe why.
>
> This legislation repeals some of the major provisions of the Glass-Steagall Act named after Senator Carter Glass from Virginia, and Henry Steagall, a Congressman from Alabama, the primary authors. It will allow banks and security underwriters to affiliate with one another. It also repeals similar provisions in other banking laws to allow banks and insurance firms to marry up. It will permit many new kinds of financial services to be conducted within a financial holding company or a national bank subsidiary.
>
> I want to describe why I think in many ways this effort is some legislative version of back to the future. I believe when this legislation is enacted—and it is expected it will be—we will see immediately even a greater level of concentration and merger activity in the financial services industries.
>
> When there is this aggressive move toward even greater concentration—and the concentration we have seen recently ought to be alarming to all of us—but when this increased concentration occurs, we ought to ask the question: Will this be good for the consumer, or will it hurt the consumer? We know it will probably be good for those who are combining and merging. They do that because it is in their interest. But will it be in the public's interest? Will the consumer be better served by larger and larger companies? Bank mergers, in fact, last year held the top spot in the value of all mergers: More than $250 billion in bank mergers deals last year. That is $250 billion out of $1.6 trillion in merger deals. *Of the banks in this country, 10 companies hold about 30 percent of all domestic deposits and are expected to hold more than 40 percent of all domestic assets should the pending*

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is very difficult for me this afternoon to celebrate this landmark achievement of financial modernization when I know we did so at the expense of every American.").

bank mergers that now exist be approved.

After news that there was a compromise on this financial services modernization bill in the late hours, a compromise that there was going to be a bill passed by Congress, I noted the stock values of likely takeover targets jumped in some cases by more than $7 a share. That ought to tell us what is on the horizon.

Clearly this legislation is not concerned about the rapid rate of consolidation in our financial services industries. The conference report that is before us dropped even a minimal House bill provision that would have required an annual General Accounting Office report to Congress on market concentration in financial services over the next 5 years. Even that minimal step that was in the House bill was dropped in this conference report.

What does it mean if we have all this concentration and merger activity? The bigger they are, the less likely this Government can allow them to fail. That is why we have a doctrine in this country with some of our larger banks—and that "some" is a growing list—of something called "too big to fail." A few years ago, we had only 11 banks in America that were considered by our regulators so big they would not be allowed to fail. Their failure would be catastrophic to our economy and so, therefore, they cannot fail.

The list of too big to fail banks has grown actually. Now it is 21 banks. There are 21 banks that are now too big to fail in this country.

We are also told by the Federal Reserve Board that the largest megabanks in this country, so-called LCBOs, the large complex banking organizations, need customized supervision because their complexity and size have reached a scale and diversity that would threaten the stability of financial markets around the world in the event of failure.

Let me read something from the Federal Reserve Bank president from Richmond. This is a Fed regional bank president saying this:

> Here's the risk: when a bank's balance sheet has been weakened by financial losses, the safety net creates adverse incentives that economists usually refer to as a "moral hazard." Since the bank is insured, its depositors will not necessarily rush to withdraw deposits even if knowledge of the bank's problems begin to spread.

Because the bank is too big to fail.

> In these circumstances, the bank has an incentive to pursue relatively risky loans and investments in hope that higher returns will strengthen its balance sheets and ease the difficulty. If the gamble fails, the insurance fund and ultimately taxpayers are left to absorb the losses. I am sure you remember that not very long ago, the S&L bailout bilked taxpayers for well over $100 billion.

Again, quoting the president of the Richmond Federal Reserve Bank:

> The point I want to make in the context of bank mergers is that the failure of a large, merged banking organization could be very costly to resolve. Additionally, the existence of such organizations could exacerbate the so-called too-big-to-fail problem and the risks it prevents. Consequently, I believe the current merger wave has intensified the need for a fresh review of the safety net—specifically the breadth of the deposit insurance coverage—with an eye towards reform.

This bill addresses a lot of issues. But it does nothing, for example, to deal with megabanks engaged in risky derivatives trading. I do not know if many know it, but we have something like $33 trillion in value of derivatives held by U.S. commercial banks in this country.

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. I offered amendments on the floor of the Senate when this bill was originally here to stop bank speculation in derivatives in their own proprietary accounts and also to take a look at some sensible regulation of risky hedge funds, but those amendments were rejected. 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.

Fusing together of the idea of banking, which requires not just safety and soundness to be successful but the perception of safety and soundness, with other inherently risky speculative activity is, in my judgment, unwise.

I do not usually quote William Safire. I guess I have done it a couple times on the floor of the Senate. I suppose we all look for things that are comforting to our point of view. But William Safire wrote a piece 3 days ago in the New York Times:

"Americans are unaware that Congress and the President have just agreed to put us all at extraordinary financial and personal risk."

Then he talks about the risk. The risk of allowing the coupling of inherently risky enterprises with our banking system, that requires the perception of safety and soundness, I personally think is unwise. I do not denigrate those who believe otherwise. There is room for disagreement. I may be dead wrong.

It may be that I am hopelessly old-fashioned. But I just do not think we should ignore the lessons learned in the 1930s, when we had this galloping behavior by people who believed nothing was ever going to go wrong and you could do banking and securities and all this together—just kind of put it in a tossed salad; it would be just fine—and then we saw, of course, massive failures across this country. And people understood that we did something wrong here: We allowed the financial institutions, and especially banks in this country, to be involved in circumstances that were inherently risky. It was a dumb thing to do.

The result was that we created barriers saying: Let's not let that happen again. Let's never let that happen again. And those barriers are now being torn down with a bill called financial services modernization.

I remember a couple of circumstances that existed more recently. I was not around during the bank failures of the 1930s. I was not around for the debate that persuaded a Congress to enact Glass-Steagall and a range of other protections. But I was here when, in the early 1980s, it was decided that we should expand the opportunities for savings and loans to do certain things. And they began to broker deposits and they took off. They would take a sleepy little savings and loan in some town, and they would take off like a Roman candle. Pretty soon they would have a multibilliondollar organization, and they would decide they would use that organization to park junk bonds in. We had a savings and loan out in California that had over 50 percent of its assets in risky junk bonds.

Let me describe the ultimate perversion, the hood ornament on stupidity. The U.S. Government owned nonperforming junk bonds in the Taj Mahal Casino. Let me say that again. The U.S. Government ended up owning nonperforming junk bonds in the Taj Mahal Casino in Atlantic City. How did that happen? The savings and loans were able to buy junk bonds. The savings and loans went belly up. The junk bonds were not performing. And the U.S. Government ended up with those junk bonds.

Was that a perversion? Of course it was. But it is an example of what has happened when we decide, under a term called modernization, to forget the lessons of the past, to forget there are certain things that are inherently risky, and they ought not be fused or merged with the enterprise of banking that requires the perception and, of course, the reality—but especially the perception—of safety and soundness.

Last year, we had a failure of a firm called LTCM, Long-Term Capital Management. It was an organization run by some of the smartest people in the world, I guess, in the area of finance. They had Nobel laureates helping run this place. They had some of the smartest people on Wall Street. They put together a lot of money. They had this hedge fund, unregulated hedge fund. They had invested more than $1 trillion in derivatives in this fund—more than $1 trillion in derivatives value.

Then, with all of the smartest folks around, and all this money, and an enormous amount of leverage, when it looked as if this firm was going to go belly up, just flat out broke, guess what happened. On a Sunday, Mr. Greenspan and the Federal Reserve Board decided to convene a meeting of corresponding banks and others who had an interest in this, saying: You have to save Long-Term Capital Management. You have to save this hedge firm. If you don't, there will be catastrophic results in the economy. The hit will be too big.

You have this unregulated risky activity out there in the economy, and you have one firm that has $1 trillion in derivative values and enormous risk, and, with all their brains, it doesn't work. They are going to go belly up. Who bears the burden of that? The Federal Government, the Federal Reserve Board.

We have the GAO doing an investigation to find out the circumstances of all that. I am very interested in this no-fault capitalism that exists with respect to Long-Term Capital Management. Who decides what kind of capitalism is no-fault capitalism? And when and how and is there a conflict of interest here?

The reason I raise this point is, this will be replicated again and again and again, as long as we bring bills to the floor that talk about financial services modernization and refuse to deal with the issue of thoughtful and sensible regulation of things such as hedge funds and derivatives and as long as we bring bills to the floor that say we can connect and couple, we can actually hitch up, inherently risky enterprises with the core banking issues in this country.

I hear about fire walls and affiliates, all these issues. I probably know less about them than some others; I admit that. But I certainly know, having studied and read a great deal about the lessons of history, there are some things that are not old-fashioned; there are some notions that represent transcendental truths. One of those, in my judgment, is that we are, with this piece of legislation, moving towards greater risk. We are almost certainly moving towards substantial new concentration and mergers in the financial services industry that are almost certainly not in the interest of consumers. And we are deliberately and certainly, with this legislation, moving towards inheriting much greater risk in our financial services industries.

I regret I cannot support the legislation. But let me end where I began because this is not one of those issues where I don't respect those who have a different view. I said when I started—I say as I close—there was a great deal of legislative skill exhibited on the part of those who put this together. I didn't think they were going to get this done, frankly. I wish they hadn't, but they did. That is a testament to their skill.

I don't know whether I am right or wrong on this issue. I believe fervently that 2 years, 5 years, 10 years from now, we will look back at this moment and say: We modernized the financial services industry because the industry did it itself

> and we needed to move head and draw a ring around it and provide some guidance, some rules and regulations. I also think we will, in 10 years time, look back and say: We should not have done that because we forgot the lessons of the past; those lessons represent timeless truths that were as true in the year 2000 or 2010 as they were in the year 1930 or 1935.
>
> Again, I cannot vote for this legislation. My hope is that history will prove me wrong and that this will not pose the kind of difficulties and risks I fear it will for the American people.
>
> One final point: With respect to the regulation of risky hedge funds, and especially the issue dealing with the value of derivatives in this country—$33 trillion, a substantial amount of it held by the 25 largest banks in this country, a substantial amount being traded in proprietary accounts of those banks—we must do something to address those issues. That kind of risk overhanging the financial institutions of this country one day, with a thud, will wake everyone up and lead them to ask the question: Why didn't we understand that we had to do something about that? How on Earth could we have thought that would continue to exist without a massive problem for the American people and for its financial system?[59]

Ten years after these prophetic comments, America has gone through close to one year of bank bailouts. Indeed, financial institutions became "too big to fail" and therefore turned to the government to bail them out when they failed. Senator Dorgan's comments concerning risk-taking behavior were clearly on point. Again, Senator Dorgan was not the only person concerned about Gramm-Leach-Bliley: eight voted against the legislation.[60]

Senator Russell Feingold (D-WI) focused his opposition to Gramm-Leach-Bliley on three important grounds: (1) he took keen note of political contributions and lobbying efforts by the banking, securities, and insurance industries to ensure the passage of Gramm-Leach-Bliley; (2) he underlined many of the fears of conglomeration expressed by Senator Dorgan; and (3) he felt that the Community Reinvestment Act of 1977 had been undermined. In the debate leading up to the passage of Gramm-Leach-Bliley,

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[59] 145 CONG. REC. S13,896–98 (daily ed. Nov. 4, 1999) (statement of Sen. Dorgan) (emphasis added).

[60] Meltzer, *supra* note 47.

Senator Feingold made the following observations:

> Mr. President, after years of persistent lobbying and a flood of political donations, three industries may soon have a lot to celebrate—the insurance, banking and securities industries will have a huge victory if we pass this conference report today
>
> . . . .
>
> Nevertheless, with this legislation, this Congress is declaring the ultimate bank holiday—giving banks, insurance companies and securities firms a permanent vacation from the Glass-Steagall Act and other Depression-era banking law reforms.
>
> Advocates of this legislation will tell you that it is terrific for consumers, offering them one-stop shopping for all their financial and insurance needs.
>
> But the reality is far more complicated and far less appealing—it is likely to cause a merger-mania in the industry that could severely limit consumer choice and spur a rise in banking fees.
>
> This conference report also raises serious issues about consumer privacy. Privacy advocates worry that it will give bankers, insurers and securities firms virtually unlimited license to share account data and other sensitive information.
>
> To top it all off, this legislation undermines the Community Reinvestment Act.
>
> Higher bank fees, reduced consumer choice and fewer protections for low-income loan assistance—these don't sound very good to most consumers, Mr. President. But they sound good to the industries that will benefit from this legislation. This conference report is music to the ears of the industries that have been lobbying for these changes for decades.
>
> *And this lobbying campaign has left a trail of political contributions that is nothing short of stunning. A recent study by Common Cause put the political contributions of these special interests at $187.2 million in the last ten years.*
>
> That is why I am going to take this opportunity to call the Bankroll. This lobbying effort for so-called financial services modernization is truly breathtaking, because it combines the clout of three industries that on their own are giants in the

campaign finance system, particularly the soft money system.

Together the power of their combined pocketbooks were a powerful force propelling this legislation through Congress.

One of these industries, the securities and investment industry is a legendary soft money donor, and I will just highlight a few such firms that have lobbied on behalf of this legislation.

Merrill Lynch has long called for banking deregulation. The company, its subsidiaries and executives gave more than $310,000 in soft money during the 1998 election cycle.

Morgan Stanley Dean Witter, which gave more than $145,000 in soft money in 1997 and 1998, was also a key part of the lobbying team on this issue. In fact the Washington Post reported that the company's chairman, along with several other corporate heads, made calls to White House officials the very night the conference hammered out an agreement on this bill.

Lobbyists lined the halls outside the room where the conference met to reconcile the House and Senate version of the bill, and as we know, that is standard procedure on Capitol Hill.

As usual, corporate lobbyists lined the halls, while the consumers who will bear the impact—and consumer advocates agree it will be an adverse impact—of this bill, were left out in the cold.

The banking industry was also there that night, of course, since this legislation is a bonanza for them too, revolutionizing the kinds of services that banks can offer.

Citigroup was there, and so was the presence of the more than $720,000 that Citigroup and its executives and subsidiaries gave in soft money to the political parties in the 1998 election cycle.

That is a huge sum, Mr. President, especially for an election cycle in which there was not even a presidential election.

And in the current election cycle Citigroup is off to a running start with $293,000 in soft money from Citigroup, its executives and subsidiaries.

That is more than $1 million from Citigroup, it's [sic] executives and subsidiaries in just two and a half years.

> The powerful banking interest BankAmerica, its executives and subsidiaries also weighed in with more than $347,000 in soft money in the 1998 election cycle, and more than $40,000 already in the current election cycle.
>
> And let's not forget the insurance industry. They have a massive stake in this legislation as well, an interest that is well-reflected by the size of the industry's soft money contributions.
>
> For instance, there is the Chubb Corp. and its subsidiaries, which gave nearly $220,000 in soft money contributions in 1997 and 1998, and has given more than $60,000 already in 1999.
>
> Then there is the industry lobby group, the American Council of Life Insurance, which also gave heavily to the parties with more than $315,000 in soft money contributions in 1997 and 1998, and more than $63,000 so far this year.
>
> In the end, what do all these contributions add up to? They add up to tremendous access to legislators and broad influence over the process by which this legislation was crafted—access and influence that the average consumer can't even begin to imagine, let alone afford.
>
> This is a serious problem, and I think everyone in this Chamber knows it.
>
> The American people certainly know it.
>
> They think our votes are on the auction block, and who can blame them.
>
> Who can blame them, and more than that, who can show them why they should think otherwise?
>
> That is a question I ask my colleagues, and I think we all know the answer.[61]

Finally, Senator Barbara Mikulski (D-MD) voiced what she characterized as "yellow flashing lights" or "warning signals" concerning Gramm-Leach-Bliley.[62] Senator Mikulski observed:

> Mr. President, I rise today to oppose the Financial Services Modernization Conference Report.
>
> . . . .
>
> Despite the significant improvements Senator Sarbanes

[61] 145 CONG. REC. S13,897–98 (daily ed. Nov. 4, 1999) (statement of Sen. Feingold) (emphasis added).

[62] 145 CONG. REC. S13,898 (daily ed. Nov. 4, 1999) (statement of Sen. Mikulski).

fought so hard for, there are still a number of what I call "yellow flashing lights" or warning signals that force me to oppose this legislation.

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.

Marylanders used to have savings accounts with local banks where the teller knew their name and their family. We have already seen the trend toward mega-mergers, accompanied by higher fees, a decline in service, and the loss of neighborhood financial institutions. This bill accelerates that trend.

With a globalization of financial resources, the local bank could be bought by a holding company based in Thailand. Instead of the friendly teller, consumers will be contacting a computer operator in a country half-way around the globe through an 800 number. Their account will be subject to financial risks that have nothing to do with their job, their community, or even the economy of the United States. I know impersonalized globalization is not what banking customers want when we talk about modernization of the financial services.

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.

. . . .

Finally, the bill does not have the safeguards we need against bank failures. Banks will now be venturing out to engage in new and risky industries. If a bank fails during

> one of those ventures, thousands of people and businesses who have worked hard and invested their money with that bank fail too. Let's not forget about the taxpayers who will be left to pick up the pieces. These failures could set off a chain reaction and threaten the stability of our entire economy.
>
> Mr. President, I am not opposed to a necessary reform of our financial services laws. But I believe the American people need greater protection before a global financial plan is enacted.[63]

One thing is certain: opponents of Gramm-Leach-Bliley were, from an early date, articulating concerns about the legislation in the debate leading up to its passage. The concerns expressed centered on the issues of conglomeration and complexity of scope of the financial services industry. Moreover, with increased complexity and extension of services, both advocates and opponents were beginning to worry about risk-taking and the problem of bailout for complex and intertwined financial services institutions. This journey through the legislative debate in the Senate shows us that a number of Senators had a vision and foretold a future that others could not see or simply failed to recognize.

V. BANKING CASE STUDIES: A LOOK AT THE IMPACT OF GRAMM-LEACH-BLILEY ON CITIGROUP AND BANK OF AMERICA

A. *Citigroup: The Rise and Fall of an American Banking Giant*

> The story of Citigroup is very much the story of American banking over the past century. It owes much of its success—as well as missteps—to its emphasis on size and innovation and a penchant for going around or getting rid of regulations in its way. If there was a business that was earning money for competitors, be it making loans to developing countries or selling stocks to individual investors, Citi wanted to be bigger and better than it.[64]

The attitude that "bigger and better" was desirable fueled Citigroup's business model and strategy. This attitude "also landed Citibank in the midst of every major financial crisis over the past

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[63] *Id.* at 13,898–99 (emphasis added).

[64] Annys Shin, *Citi's Relentless Quest for Growth; History of Innovation Has Led Bank to Milestones, Missteps*, WASH. POST, Nov. 25, 2008, at D1.

century, including the stock market crash of 1929, the Latin American debt crisis of the 1980's, and the current financial meltdown."[65] Charles R. Geisst, the author of a *History of Wall Street*, speaking in reference to Citigroup noted: "A banker would have admired it in the 1990s as forward-looking. It used to have a reputation as an aggressive bank looking for new profit centers. That changed to more reckless . . . . [I]t's an institution that is no longer in control of its own destiny."[66]

The story of how Citigroup come into existence is a study in American history:

> Citi traces its roots to City Bank of New York, a merchant bank chartered in 1812. It later changed its name to National City Bank and by 1894 was the largest bank in the country. During the bull market of the 1920s, National City became a leading seller of securities to individual investors, even though national banking laws prohibited commercial banks from getting into the investment banking business. National City and others got around that prohibition by opening subsidiaries.[67]

This is precisely the type of commercial speculation that the Glass-Steagall Act of 1933 was designed to prevent.[68] Charles Mitchell, National City's Chairman at the time, was a key instigator in encouraging salesmen to sell securities.[69] Mr. Geisst and others have noted the similarities between Citi's problems today and what happened to National City many years ago. When the stock market crashed in 1929, National City's stock value plummeted, leading to a rescue by the federal government in excess of tens of millions of dollars.[70] Indeed, lawmakers blamed Mr. Mitchell's aggressive sales tactics as a key cause of the stock bubble and resulting market crash of 1929. In February 1933, Mr. Mitchell was summoned to Washington to appear before the Senate Committee on Banking and Currency in the famous Pecora Hearings and Report. At that hearing, Mitchell admitted to "evading taxes and unloading

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[65] *Id.*

[66] *Id.* (citation omitted).

[67] *Id.*

[68] *See supra* Part III.

[69] Shin, *supra* note 64, at D1 ("National City Chairman Charles Mitchell 'personally rode herd [sic]' on his salesmen, exhorting them to make sales. He would even take salesmen to lunch at the top of skyscrapers and muse aloud how many people walking below had yet to buy their securities.").

[70] *Id.*

worthless bonds on unsuspecting investors."[71] On the heels of the Pecora Report, and largely as a result of it, the Glass-Steagall Act was passed in 1933 to address the separation of banking and securities activities.[72]

National City made it through the Great Depression and World War II. In 1955, the bank changed its name to First National City Bank of New York.[73] In the late 1960s, the bank set its sights on conquering global finance. At the turn of the twentieth century, Citigroup, as we know it today, was one of the first American banks to open branches overseas.[74] Walter Wriston, Citi's chairman from 1970 to 1984, eventually extended the reach of the bank to more than one hundred countries.[75] Officially it changed its name to Citibank in 1976 to reflect its "global footprint."[76]

As a result of looser enforcement of banking laws, Citibank was able to diversify its business into other forms of banking.[77] Regulations never seemed to get in the way of its innovation and expansion. And even when restrictions and regulations obstructed expansion, Wriston found ways around them.

Citicorp's growth did not come without costs. In the 1980s, Citicorp and a number of other banks were rocked by defaults and insolvencies on sovereign debt extended to a number of Latin American nations. Citicorp faced billions of dollars in losses when Mexico became insolvent in 1982. Thus, the federal government bailed Citicorp out in the 1980s under the auspices of the Brady Plan.[78]

In the early 1990s Citicorp was once again shaken by the American recession under President George H. W. Bush.[79] Again, the federal government offered a bailout of sorts by coming to the rescue with several interest rate cuts. Big moves at Citicorp were on the horizon in the late 1990s and Citigroup executives believed that the company needed to become larger and more diversified. Citicorp was preparing to change the face of banking in the United States in major ways by becoming a "one-stop financial services firm where consumers could go for checking, brokerage, and insurance

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[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*

services."[80] Certainly, the game of banking in the United States was about to change.

In 1998, that big change came with a merger that redefined finance—the Citicorp merger with Travelers Insurance. There was still one extremely major barrier or hurdle to overcome: technically Glass-Steagall did not allow for a combination between a commercial bank and an insurance company.[81] Armed with boatloads of cash, "Citi spent millions of dollars lobbying for the change, and Congress passed the Gramm-Leach-Bliley Act in 1999."[82]

Citigroup was the entity that emerged from the marriage of Citicorp and Travelers Insurance.[83] The merger was driven by then-CEO of Travelers Insurance, Sanford Weill, who had long believed in the potential for cross-selling, or offering a range of products to customers within one entity.[84] Proponents of this model noted that the primary benefits would be diversification and cost savings. Such an entity would provide an "array of financial services including commercial and investment banking, retail banking and consumer finance (e.g., credit card lending), investments (e.g., mutual funds), securities brokerage, and insurance."[85] Nevertheless, the merits of this "supermarket model" were, at the time, not universally accepted.[86]

Many of the investors in the newly formed Citigroup took solace in its size.[87] But scale doesn't always bring comfort. "[S]igns eventually emerged that Citi was too big to manage well."[88] As Jerry Markham, the author of *A Financial History of the United States* observed: "Their business model—a complete financial

[80] *Id.*

[81] *Id.* ("For the merger to succeed, Glass-Steagall would have to be repealed, an idea that in the intervening decades had gained support among academics and, most importantly, from Fed chief Alan Greenspan.").

[82] *Id.*

[83] *Id.*

[84] Clayton Rose & Aldo Sesia, *What Happened at Citigroup?*, Harv. Bus. Sch. Case Study No. 310-004, July 20, 2009, at 1.

[85] *Id.*

[86] *Id.* at 2 ("There were many doubters within the business and academic communities. Citigroup, after all, was not the first company to aspire to be a large cross-selling financial services firm. In the late 1970s, American Express had been intent on becoming a global conglomerate, with huge, multifaceted businesses and diversified income streams that could protect the company in the event of hard times in one of its core businesses. American Express made several large acquisitions . . . . The synergies between the subsidiaries did not, however, come to pass. By 1985, American Express had revised its strategy: It shifted its focus to developing its core businesses while shedding its non-core activities.").

[87] Shin, *supra* note 64, at D1.

[88] *Id.*

services firm—is nothing but trouble . . . . There is always some unit having a crisis."[89] Ironically, in 2002, Citigroup spun off Travelers because it was dragging down its stock price.[90]

Reflecting back over the past decade, what has the marriage and merger of Citigroup and Travelers Insurance, which touched off unprecedented bank consolidations and mergers in America, truly meant for our economy? Particularly, over the past couple of years, what sort of mischief has Citigroup created for the American economy and taxpayers in general? Fundamentally, the short answer to these questions is that the emergence of Citigroup has been an utter disaster. Before the current financial crisis, "[a]t year-end 2006[, Citigroup] had a market capitalization of $274 billion, with $1.9 trillion in assets and $24.6 billion in earnings."[91] For Citigroup and its investors, "[t]en years after the merger it ended in tears. In July of 2009, the firm [Citigroup] was effectively nationalized, with billions of dollars in bailout money converted into a 34% ownership stake for the U.S. government."[92] Moreover, "Citigroup was worth less than $16 billion, having lost more than $250 billion in value from its peak."[93]

Largely, a quest to fuel further mergers and acquisitions, overbreadth, and exposure to misunderstood and unmanageable risks caused Citigroup's troubles. Notably, while cross-selling lending and investment banking products to corporate and institutional clients was successful, there were only small gains in retail investment.[94] Many argued that the lack of gains was due to the flawed nature of the strategy since "customers did not want to buy all financial products from a single source."[95] In 2005, as part of an effort to boost earnings, Citigroup increasingly upped its risk profile.[96]

> An important area of growth was in the creation, management, and sale of securitized instruments related to home mortgages, in particular collateralized debt obligations (CDOs). . . . There was insufficient investment in systems, incorrect assumptions were built into the risk models, and there was inappropriate segregation of duties between those

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[89] *Id.*
[90] *Id.*
[91] Rose & Sesia, *supra* note 84, at 1.
[92] *Id.*
[93] *Id.*
[94] *Id.* at 4.
[95] *Id.*
[96] *Id.* at 6.

> charged with overseeing risk and those who had revenue responsibility and took the risk in the fixed income division.[97]

The spring of 2007 made the reality clear: the declining American housing market was finally catching up with the broader financial markets.[98] In August, 2007, two important hedge funds managed by Bear Stearns and containing mortgage related securities, failed. The result was the beginning of a significant decline in the value of mortgage related securities having a huge impact "on the profitability of Wall Street firms that held significant amounts of these securities in their inventory, and it marked the start of the historic crisis that would grip the financial markets and global economy."[99]

Citigroup, then the market leader in the issuance of CDOs, held large subprime and mortgage related positions on its balance sheet thus "creating the potential for substantial losses as the markets for mortgage related securities collapsed."[100] Adding to these problems, "Citigroup's substantial involvement with structured investment vehicles ("SIVs") was presenting the firm with major challenges."[101] Although only a tiny fraction of Citigroup's SIVs were related to subprime mortgages, these problems related to their funding arrangements.[102] When the credit markets began to freeze due to the financial crisis, "the SIVs faced significant difficulty refinancing

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[97] *Id.* at 6–7. CDOs are:

> [S]ecurities . . . created when mortgage-backed securities were pooled into a special purpose company, and 'tranches' (or slices) of obligations were created that were backed by the mortgages. Each tranche was designed to appeal to a different type of investor. The most senior tranche had the first call on the pool's cash flows, was rated AAA (the highest credit rating available), and carried the lowest risk and return. Progressively lower rated, higher return, and higher risk tranches were also created, including an equity tranche. The risk in each of the tranches and the rating that each obtained from the rating agencies was determined in part by the assumed default rate of the underlying mortgages, which was based on the historical experience of similar pools of underlying assets.

Id. at 7 n.b.

[98] *Id.* at 9.

[99] *Id.*

[100] *Id.*

[101] *Id.* at 10 ("SIVs are special purpose investment companies that seek to generate attractive risk-adjusted floating rate returns through the use of financial leverage and credit management skills, while hedging interest rate and currency risks and managing credit, liquidity and operational risks. The basic investment strategy is to earn a spread between relatively inexpensive short-term funding (commercial paper and medium-term notes) and high quality portfolios with medium term duration, with the leverage effect providing attractive returns to junior note holders, who are third party investors and who provide the capital to the SIVs.").

[102] *Id.*

the commercial paper funding, raising the specter of having to repay the commercial paper lenders."[103]

In September 2008, the wheels began to fall off the wagon of the American economy. The financial crisis came to its nadir. Lehman Brothers filed for bankruptcy—the largest in American history.[104] Merrill Lynch was forced to merge with Bank of America to save itself.[105] Goldman Sachs and Morgan Stanley converted themselves from investment banks to bank holding companies.[106] The federal government committed close to $70 billion dollars to AIG to avoid its collapse.[107] Things were falling apart at the seams.

In the face of chaos, Citigroup was not content to sit still. Instead of managing the crisis, Citigroup wanted to grow larger. In September 2008, feeling somewhat rejuvenated, Citigroup weighed a possible takeover bid of troubled Washington Mutual.[108] Citigroup made an offer to purchase its troubled rival Wachovia for roughly $2 billion in a government-engineered "shotgun" wedding.[109] In the end, Wachovia spurned Citigroup and accepted a $15.4 billion takeover offer from Wells Fargo & Co.[110] As a result of a failed strategy and execution, Citigroup's executives, known as the "Keystone Cops" of Wall Street.[111]

In October of 2008, the Treasury Department injected a "total of $125 billion into nine large banks."[112] At that time, Citigroup received $25 billion.[113] All nine banks were told that they had to accept "the capital to avoid stigmatizing the neediest" banks.[114] In

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[103] *Id.*

[104] Andrew Ross Sorkin, *Bids to Halt Financial Crisis Reshape Landscape of Wall St.*, N.Y. TIMES, Sept. 15, 2008, at A1.

[105] *Id.*

[106] Susanne Craig et al., *The Weekend That Wall Street Died: Ties That Long United Strongest Firms Unraveled as Lehman Sank Toward Failure*, WALL ST. J., Dec. 29, 2008, at A1.

[107] Pro Publica, Bailout Recipients, http://bailout.propublica.org/main/list/index (last visited Mar. 14, 2010).

[108] David Enrich, Robin Sidel & Dan Fitzpatrick, *Citi, Looking Rejuvenated, Weighs a WaMu Takeover Bid*, WALL ST. J., Sept. 19, 2008, at C1.

[109] David Enrich & Matthew Karnitschnig, *Citi, U.S. Rescue Wachovia: Latest Shotgun Deal Creates Nation's Third-Largest Bank*, WALL ST. J., Sept. 30, 2008, at A1.

[110] David Enrich & Dan Fitzpatrick, *Wachovia Chooses Wells Fargo, Spurns Citi: Deal Avoids Need for Taxpayer Cash; Pandit Vows a Fight*, WALL ST. J., Oct. 4, 2008, at A1; *see also* Dan Fitzpatrick & David Enrich, *Wells Fargo Grabs Wachovia as Citi Walks: Quality of Assets Concerned Bank; Legal Fight up Next*, WALL ST. J., Oct. 10, 2008, at C1.

[111] David Enrich, *Citi Weighs Options After Deal Torn Asunder: 'Keystone Cops' of Wall Street Seethe as Wells Fargo Swoops in for Wachovia*, WALL ST. J., Oct. 4, 2008, at B1.

[112] David Enrich & Damian Paletta, *U.S. Ratchets Up Citi Oversight: After Bank's Latest Infusion, Regulators Seized More Management Say*, WALL ST. J., Dec. 18, 2008, at C1.

[113] *Id.*

[114] *Id.*

November 2008, the Treasury Department infused another $20 billion into Citigroup.[115] In Citigroup's second rescue plan, the federal government agreed to insure $306 billion of Citigroup's assets to avoid total collapse.[116] But Citigroup's trouble had not yet ended. In February 2009, Citigroup and the United States government reached a third bailout agreement under which the United States government agreed to guarantee more Citigroup losses and to take 36% equity in Citigroup.[117]

The company's woes were apparent. Citigroup was hemorrhaging. Enormous pressure on the part of the United States government was brought to bear on Citigroup to downsize.[118] Its empire was crumbling and wasting away. Citigroup took steps to spin-off its once coveted Smith Barney brokerage unit to Morgan Stanley.[119] The realization that Citigroup was too large to manage was setting in. At Citigroup, "[s]ome key executives . . . concluded that some of the supposed 'synergies' associated with Citigroup's current structure, such as the ability to 'cross-sell' financial products to consumers of different units of the company, are overstated."[120] Instead of trying to be everything to everyone, Citigroup's orientation changed dramatically. Citigroup decided to shrink itself by one-third.[121] What will the new Citigroup look like?

> If successful, the new Citigroup will feature an all-purpose corporate and investment bank that provides businesses worldwide with loans, advice on mergers and acquisitions, capital-markets services, and trading and payments services . . . . Another part of the company would serve wealthy individuals through a private bank and provide retail-banking and credit-card services in places such as the U.S., Latin America, Central Europe and Asia.[122]

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[115] *Id.*; *see also* David Enrich et al., *U.S. Agrees to Rescue Struggling Citigoup: Plan Injects $20 Billion in Fresh Capital, Guarantees $306 Billion in Toxic Assets*, WALL ST. J., Nov. 24, 2008, at A1.

[116] *Id.*

[117] David Enrich & Deborah Solomon, *Citi, U.S. Reach Accord on a Third Bailout: Government Puts Itself on Hook for More Losses; Stake of Up to 36% Stops Short of Nationalization*, WALL ST. J., Feb. 28, 2009, at B1.

[118] David Enrich, *Citigroup Takes First Step Toward Breakup: Pushed by Federal Government, Beleaguered Giant Pushes Brokerage Venture With Morgan Stanley; Robert Rubin to Retire*, WALL ST. J., Jan. 10, 2009, at A1.

[119] *Id.*

[120] *Id.*

[121] David Enrich, *Citigroup Ready to Shrink Itself by a Third: Financial Giant to Shed Units, Curtail Trading to Return to Size Before Its Merger Spree; Deal to Spin Off Smith Barney Sealed*, WALL ST. J., Jan. 14, 2009, at A1.

[122] *Id.*

The deal that formed Citigroup in 1998, at the time one of the largest in history, was initially championed as "precedent-setting."[123] But all that glitters is not gold. In reality, consumers were not as interested in one-stop shopping as originally anticipated, and Citigroup executives "failed to get their arms around the sprawling global company."[124] As a result, the Federal Reserve and Office of the Comptroller of the Currency urged Citigroup to take "steps to drastically shrink."[125] Robert Lamb, a New York University finance professor and former adviser to Sandy Weill, speaking about the eventual "end of an era" at Citigroup, noted: "It's a testament to how a conglomerate has difficulties when the management fails to oversee all of the pieces, people and systems professionally."[126]

In recent months, faced with government pressure, Citigroup has pursued a strategy of divestment. Executives have come to realize that Citigroup—as it exists today—is too big to manage. The lesson that we learn in the Citigroup story is that the desire to grow for growth's sake can sometimes lead to disaster. A bank with too many businesses strays far off path in fulfilling its primary mission: banking. Over the last decade, Citigroup has changed the game of banking in this country. The lesson of Citigroup is the lesson of a company that has become too far-flung to manage itself. When a bank becomes too big to manage itself for taxpayers it becomes too big to fail.

B. Bank of America: A Failure All Too Big

Bank of America's history, which can be traced back more than two hundred years, is proudly recounted on the company's Web site.[127] The story of Bank of America's rise to the top of American capital begins a long time ago.[128] The pace of that story intensifies beginning in the 1970s and through the 1990s.

North Carolina National Bank ("NCNB") of Charlotte, North Carolina, implemented a series of mergers that resulted in the creation of for NationsBank.[129] In 1982, NCNB acquired First

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[123] *Id.*
[124] *Id.*
[125] *Id.*
[126] *Id.*
[127] Bank of America: Our Heritage, http://newsroom.bankofamerica.com/heritagecenter/#/ourheritage (last visited Mar. 14, 2010).
[128] *Id.*
[129] Bank of America Heritage: Timeline http://newsroom.bankofamerica.com/

National Bank of Lake City, Florida.[130] Proudly, the history tells us "[t]he bank succeeds in using a little-known provision of Florida law to exempt itself from the prohibition against out-of-state banks doing business there. Having gained a firm foothold on the path to interstate banking . . . NCNB grows through a string of sensible mergers."[131]

In 1983, Hugh McColl took over as CEO of NCNB, upon the retirement of Tom Storrs.[132] NCNB grew into a national organization under McColl's leadership.[133] In 1991, NCNB acquired Atlanta-based C&S/Sovran and took on the new name of NationsBank.[134] In 1994, due to the influence of Hugh McColl, federal legislation was lifted that restricted interstate banking and made national banking a prospect. In 1998, NationsBank's acquisition of BankAmerica Corp. created the first coast-to-coast retail banking business, with banking centers in 22 states and the District of Columbia. Bank of America was the name of the entity created by this merger. In 2004, Bank of America purchased FleetBoston Financial Corporation, extending its reach throughout the Northeast, to create the "first truly nationwide bank."[135] In 2006, Bank of America acquired MBNA to make it the largest credit card issuer in the banking industry. Then, in 2007, it acquired US Trust to extend its reach into the private banking business for "ultra high net worth" individuals. Finally, in January 2009, Bank of America acquired Merrill Lynch[136] for $19.36 billion, thus taking the title of largest bank in the United States—with assets of $2.7 trillion.[137]

Bank of America's chairman during the 2009 merger, Kenneth D. Lewis, was famous for gambling on bold acquisitions—turning what was once a regional institution into a national power.[138] Traditionally an acquisition bank, Bank of America was known for imposing its will and cost discipline on companies acquired.[139] Still, its dream of competing in the brokerage business was never

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heritagecenter/#/timeline (last visited Mar. 14, 2010).

[130] *Id.*

[131] *Id.*

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] *Id.*; *see also Business Briefing*, WASH. POST, Jan. 2, 2009, at E8.

[137] Dan Fitzpatrick, *Three Banks Complete Deals*, WALL ST. J., Jan. 2, 2009, at C3.

[138] Eric Dash, *Purchase of Merrill Fulfills Quest for a Bank*, N.Y. TIMES, Sept. 15, 2008, at A18.

[139] *Id.*

realized, even after becoming a consumer banking powerhouse through two decades of acquisitions.[140]

Bank of America's merger with Merrill Lynch was a "shotgun" merger, and turned "Bank of America into the nation's largest player in wealth management."[141] Before the merger, Bank of America already held the biggest branch network, and was the largest issuer of credit cards, home equity loans, and auto loans in the United States. Bank of America had become the largest mortgage lending and payment collection operation in the country in 2008, when it merged with Countrywide Financial for $4 billion.[142]

But the Bank of America merger with Merrill Lynch soon proved to be a disaster.

> The history of finance is littered with disastrous tales of commercial banks acquiring their Wall Street cousins. In good times, the investment bankers with their Hermes ties often sell high, then wave goodbye to their unglamorous new owners. Merrill Lynch's snookering of Bank of America seems to show it's no different in bad times. That these marriages [between investment and commercial banks] rarely work is not altogether surprising. After the Glass-Steagall Act of 1933 banned banks from underwriting securities, the investment banks of Wall Street developed a distinct culture, one in which risk-taking flourished and the personal profit principle reigned supreme.[143]

The dichotomy was distinct:

> Commercial banks were supposed to be more conservative, and consequently safer. As restrictions on the activities of commercial banks began loosening some 20 years ago, the desire to grab lucrative investment banking business electrified bank boardrooms. So much so that banking industry executives regularly overlooked the continuing, and potentially fatal, cultural and philosophical differences.[144]

The bad marriage of the investment bank to the commercial bank was immediately apparent. Critics indicated that Bank of America paid too much for Merrill Lynch.[145] Moreover, "Merrill . . . revealed

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140 *Id.*
141 *Id.*
142 *Id.*
143 Rob Cox, *A History Lesson with Merrill Deal*, N.Y. TIMES, Jan. 23, 2009, at B2.
144 *Id.*
145 *Id.*

giant losses that have forced [Bank of America] to plead for a government bailout; its executives have fled or been pushed out; and it has paid out what looks like outsize bonuses under [Bank of America's] nose."[146] Even as history cautioned against traditional lenders buying an investment bank, Bank of America thought it could avoid previous pitfalls.

Within weeks of closing the Merrill Lynch acquisition, Bank of America had to return to the Treasury Department for a second helping of TARP funds and suspend its dividend.[147] Indeed, in light of surfacing troubles at Merrill Lynch prior to the close of the merger and reconsideration of the deal, in December of 2009, Treasury Secretary Henry Paulson and Federal Reserve Chief Ben Bernanke pressured Bank of America Chairman Ken Lewis to consummate the deal in fear that an already fragile economy might suffer more loses from a failed deal.[148] In January of 2009, over the previous one year period of time, Bank of America's share price had declined eighty-five percent.[149] Its declining share price cost shareholders over $250 billion in equity.[150] To date, Bank of America has been forced to take $45 billion in TARP funds from the United States government.[151] In October 2008, Bank of America received $25 billion from the Treasury Department's TARP program.[152] In January 2009, the Treasury Department poured $20 billion of additional TARP funds into Bank of America, and agreed

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[146] *Id.*

[147] Rob Cox et al., *Bank of America's Difficult Choice*, N.Y. TIMES, Jan. 27, 2009, at B2.

[148] Dan Fitzpatrick, Deborah Solomon & Susanne Craig, *Crisis on Wall Street: Bank Stress: BofA's Latest Hit: Treasury to Inject $20 Billion More; Stock at 1991 Level*, WALL ST. J., Jan. 16, 2009, at C1. ("By Dec. 17, Mr. Lewis went to Washington to discuss what he had already disclosed to Mr. Bernanke in an earlier phone call -- that his bank was having trouble digesting Merrill's loses. Mr. Lewis described the losses as monstrous, according to a person familiar with the matter. At that 6 p.m. meeting, Mr. Bernanke and Mr. Paulson both told Mr. Lewis that failing to complete the Merrill acquisition would be disastrous. The policy makers said abandoning the deal would further destabilize markets, and would hurt the bank, potentially setting off a ripple effect that would exacerbate a fragile situation. Messrs. Bernanke and Paulson also urged Mr. Lewis to finish the deal and not invoke a material-adverse change clause, saying it was in his interest to finish the deal. If they walked away, it would reflect poorly on the bank and suggest it hadn't done its due diligence and wasn't following through on its commitments. The policy makers told Mr. Lewis that if conditions were really as bad as he believed, then the government could step in with a rescue similar to that used for Citigroup Inc. in November. In such an arrangement, the government would provide cash and guarantee against part of the firm's losses.").

[149] Cox et al., *supra* note 147.

[150] *Id.*

[151] ProPublica.com, Eye on the Bailout, http://bailout.propublica.org/entities/27-bank-of-america (last visited Mar. 14, 2010).

[152] Julie Creswell et al., *Bank of America May Get More Bailout Money*, N.Y. TIMES, Jan. 15, 2009, at B1.

to limit the company's losses on $118 billion of troubled assets.[153] In exchange for the second round of TARP funds, Bank of America agreed to issue the government $24 billion in shares of preferred stock, slated to pay an annual interest rate of eight percent.[154] Bank of America also agreed to reduce its dividend to one cent per share for three years, impose limits on executive compensation, and adopt a mortgage modification program to limit foreclosures.[155] When Bank of America received its second TARP fund infusion, the federal government became Bank of America's largest shareholder, with about a 6% equity stake.[156]

Bank of America's downfall in the current American capital markets crisis largely stems from an over-exuberance to grow larger and larger through acquisitions. Along with its drive for largesse, Bank of America was squeezed by the subprime mortgage crisis and issuance of mortgage-backed securities.[157] "The Countrywide and Merrill Lynch acquisitions have turned Bank of America increasingly into the type of financial supermarket model that Citigroup is now being forced to dismantle. Some analysts warn that the next two years could be challenging for Bank of America . . . ."[158] Paul Miller, an analyst with Friedman Billings Ramsey warned:

> Citi is being dismantled because it's too big and the government wants it smaller . . . I think Bank of America, either a year or two out, is going to be dismantled also because its returns are going to be too weak. No management has the expertise or brain power to provide the right required return for investors with institutions that are this size.[159]

The problems at Bank of America mirror the problems at Citigroup in many ways. Like Citigroup, Bank of America—through its mergers—has become too big to manage. The lessons of Citigroup and Bank of America we should alert Americans that

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[153] Binyamin Appelbaum & Neil Irwin, *Bank of America Gets New Round of U.S. Aid*, WASH. POST, Jan. 16, 2009, at D1.

[154] *Id.*

[155] *Id.*

[156] Eric Dash, Louise Story & Andrew Ross Sorkin, *Bank of America to Receive $20 Billion More*, N.Y. TIMES, Jan. 16, 2009, at B1.

[157] *See generally* James Hagerty & Dan Fitzpatrick, *B of A Feels Bite of Move Into Mortgage-Backed Securities—Delinquency Rates Among the Highest in Banking Industry; Pain in California*, WALL ST. J., Feb. 25, 2009, at C8.

[158] Creswell et al., *supra* note 152, at B1.

[159] *Id.*

many of the fears in the Senate debate leading up to the passage of Gramm-Leach-Bliley surrounding the "too big to fail" problem have manifested themselves. Lessons from America's past show that it is unwise to let banks get too big in the first place; instead, American law should reform to limit the scope and reach of banks.

VI. FOR SAFETY'S AND SOUNDNESS'S SAKE: GLASS-STEAGALL'S REINCARNATION AND THE CASE FOR "RE-REGULATION"

Time Magazine compiled a list of the "25 People to Blame for the Financial Crisis."[160] Phil Gramm, the chief architect of the Financial Services Modernization Act, made this list.[161] For the most part, Phil Gramm has remained unapologetic with respect to taking responsibility for the financial crisis.[162] Professor James Cox of Duke University School of Law, a noted corporate and securities law scholar, commented on Gramm's deregulatory role: "'Phil Gramm was the great spokesman and leader of the view that market forces should drive the economy without regulation . . . . The movement he helped to lead contributed mightily to our problems.'"[163]

Mr. Gramm responded to his critics by arguing that there is no evidence that fifteen years of deregulation had anything to do with the current financial crisis.[164] In fact, he argued that the looser regulation played a negligible role in the current crisis, and is merely an easy argument against deregulation. He noted: "'There is this idea afloat that if you had more regulation you would have fewer mistakes . . . I don't see any evidence in our history or anybody else's to substantiate it.'"[165] Furthermore, he added that "'[t]here is always a revisionist history that tries to claim that the system has failed and what we need to do is have government run things . . . [t]he markets have worked better than you might have

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[160] *See* Time.com, 25 People to Blame for the Financial Crisis, http://www.time.com/time/specials/packages/completelist/0,29569,1877351,00.html (last visited Mar. 14, 2010).

[161] *Id.*

[162] *See* Justin Fox, *Phil Gramm Says the Banking Crisis Is (Mostly) Not His Fault*, TIME, Jan. 24, 2009, http://www.time.com/time/printout/0,8816,1873833,00.html#; *see also* Phil Gramm, *Deregulation and the Financial Panic*, WALL ST. J., Feb. 20, 2009, at A17.

[163] Eric Lipton & Stephen Labaton, *A Deregulator Looks Back, Unswayed*, N.Y. TIMES, Nov. 17, 2008, at A1.

[164] *Id.*

[165] *Id.*

thought.'"[166]

Certainly, the markets have not worked better for Americans on Main Street who have lost their jobs, their homes, and their retirement savings. Nevertheless, Gramm still argues that regulatory oversight of the financial services industry is not the answer. But many experts, including some of Mr. Gramm's former allies in Congress, disagree with Gramm, and argue that the lack of oversight left the system vulnerable.[167] How do we address this lack of oversight moving forward?

One thing is certain: over the course of time in this country, we have seen a cycle of boom and bust.[168] Often, the "busts" have been precipitated by overextension of credit.[169] In a crisis, we often respond by over-regulating.[170] In our current financial crisis, a return to the past and the measures that largely protected us for over sixty years is in order. At a minimum, we should return to a financial regulatory system that imposes Glass-Steagall type firewalls for banks and other participants in the financial services industry. This return to sensibility would not be an overreaction. Indeed, we would have at a baseline no more regulation than we had in the past. As one commentator noted:

> Supporters of Gramm-Leach-Bliley recognized that too-big-to-fail firms posed a risk of taxpayer bailouts. Their concerns were soothed by a belief that market discipline, combined with innovative ways to reduce risk—namely derivatives like credit default swaps—would mitigate the danger. We now know that discipline failed and the innovations actually amplified risk greatly. In some cases, these big firms allowed ever more financial risk to be piled

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166 *Id.*

167 *Id.*

168 Both Professor Timothy Canova of Chapman Law School and I touched on this point regarding cycles of boom and bust in remarks that we delivered on September 25, 2009, as part of a symposium on the financial crisis hosted by the University of Utah, S.J. Quinney College of Law. Video: Financial Crisis Symposium—Afternoon Session (ULaw.tv Sept. 25, 2009), http://www.ulaw.tv/watch/792/financial-crisis-symposium---afternoon-session.

169 *Id.*

170 Professor Steven Ramirez, of Loyola University Law School in Chicago, made this astute comment and observation on September 25, 2009, as part of his remarks at a Symposium on the Financial Crisis I participated in at the University of Utah, S.J. Quinney College of Law. Video: Financial Crisis Symposium—Morning Session (ULaw.tv Sept. 25, 2009), http://www.ulaw.tv/watch/791/financial-crisis-symposium---morning-session; *see e.g.*, *Questions for Reform*, *supra* note 9 ("What are we trying to fix, anyway? The urgency to repair the financial system is mainly political. Crises create intense public awareness and with it, the opportunity for change that reform-minded officials do not want to squander. Even lawmakers who would prefer the status quo feel the pressure to act.").

> on ever-thinner cushions of capital. That helped to juice Wall Street profits, but did it really outweigh the disadvantages that are now so painfully evident in taxpayer-funded bailouts?[171]

What would financial services industry regulation look like in a post-financial crisis world? First, in this new world order (or technically old world order depending on how you view the world), banks would have to once again choose to operate as commercial banks or investment banks. Second, commercial banks would have to affirmatively curtail their securities underwriting activities. Third, and finally, banks would be prohibited from selling or underwriting insurance products. In many ways, we would have to return to a system where we separate out and regulate banking, securities, and insurance activities. A post-financial crisis world should undoubtedly feature the prudential firewalls that existed before Gramm-Leach-Bliley. Regulatory responsibility would need to be allocated among state and federal regulators to ensure maximum protection of consumers and the general public. There would be a place at the table for state and federal bank regulators and monitors as well. State blue-sky laws would be administered in the various states by securities commissions. The Securities Act of 1933[172] and the Securities Exchange Act of 1934[173] should be vigorously enforced by the Securities and Exchange Commission to protect investors. State regulators would monitor the insurance industry and underwriting and policy issuance activities.

One-stop shopping in the financial services industry must be curtailed or eliminated completely. As a number of Senators recognized in the lead-up to the passage of Gramm-Leach-Bliley, the financial services industry in this country has become far too large, concentrated, and too risky to our economy.[174] Today, we have far too many "too big to fail" or "systemically important financial institutions" that threaten to pull the entire world economy down at any given moment. Much like the "trustbusters" of the past century, we need to minimize the scope of our largest

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[171] *See Questions for Reform*, *supra* note 9.

[172] Barlyn, *supra* note 32 ("[The Securities Act of 1933 was t]he first major federal securities law, still in effect, [that] prohibits securities fraud and requires registration or exemption of registration of securities offered for public sale. It also requires that investors receive financial and other significant information.").

[173] *Id.* ("[The Securities Exchange Act of 1934 established] the Securities and Exchange Commission and grants it broad authority over the nation's securities markets, brokerage firms, transfer agents, clearing agencies and self-regulatory organizations.").

[174] *See supra* Part V.B.

and most unwieldy financial services industry members.[175]

Returning to the past is not always easy. In *The Wizard of Oz*, Dorothy encountered an extremely difficult time returning home. For those who seek safety and soundness in our banking industry, and the financial services industry in general, a return to past regulation or some measure of regulation at all is to be valued. Without equivocation, American banking and finance laws and regulation should embrace "re-regulation" by returning to Glass-Steagall-type firewalls to separate banking, securities, and insurance activities in the financial services industry. The Obama Administration's regulatory reform proposals assume for the moment that "too big to fail" financial services industry firms will remain a part of the landscape moving forward.[176] The fundamental question that policymakers in Washington must ask is whether a financial services institution that is "too big to fail," is too big to even exist. The answer to that question should be, resoundingly, yes:

> If there is no proven way to reduce the systemic risk in big and interconnected firms, why should they be allowed to exist? It would take some time to dismantle them, so the government should, in the meantime, be granted the resolution authority to seize them if needed. But that should not substitute for a debate on whether such firms should be allowed to exist at all.[177]

The notion that "[a]dvocates of deregulation point to the failures as evidence that the government has no intrinsic ability to police markets" is incorrect.[178] "The nation's regulatory agencies have been allowed to languish, underfunded, understaffed—and too often headed by political appointees who are true believers only in the dogma of deregulation and not in their agencies' missions."[179] We must focus the attention of regulatory agencies in this country back to the American public and to the protection of its interests.

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[175] *See generally* Steve Schifferes, *Trustbusters: A History Lesson*, BBC NEWS, Feb. 15, 2000, http://news.bbc.co.uk/2/hi/in_depth/business/2000/microsoft/635257.stm (discussing the activities of trustbusters in the United States in the 19th Century).

[176] *See Questions for Reform*, *supra* note 9.

[177] *Id.*

[178] *Id.*

[179] *Id.*

VII. ALTERNATIVES TO THE REINCARNATION OF GLASS-STEAGALL AND "RE-REGULATION"

A. Is Stringent Regulation of "Too Big to Fail" Financial Institutions Needed?: A Three-Tiered Regulatory Approach

In recent months, the term "systemically important financial institution" has garnered a great deal of media attention and news coverage.[180] The term refers to a financial institution that is so large, interconnected with other institutions, or unique that its failure may be thought to lead to the demise of several other firms or the entire industry.[181]

The Federal Reserve Bank of Cleveland has proposed looking at the institution's size along with four additional criteria to determine systemic importance.[182] Cleveland calls these additional requirements the "four C's": contagion, correlation, concentration, and context.[183]

"Contagion" refers to the "'too connected to fail' syndrome."[184] For example, if you have swine flu and go to work, church, or a professional baseball game, the "bug" can spread rapidly.[185] The same goes for financial institutions: when one is failing, the failure can directly impact other institutions that are interconnected through loans, deposits, or insurance contracts.[186] "Correlation" refers to the "'too many to fail' syndrome."[187] If financial

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[180] Federal Reserve Bank of Cleveland: What to Do About Systemically Important Financial Institutions, http://www.clevelandfed.org/research/topics/finstability/three_tier_risk/print_story.cfm (last visited Mar. 14, 2010) [hereinafter Federal Reserve Bank of Cleveland]; JAMES B. THOMPSON, FED. RESERVE BANK OF CLEVELAND, ON SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS AND PROGRESSIVE SYSTEMIC MITIGATION (2009), *available at* http://www.clevelandfed.org/research/policydis/pdp27.pdf; Posting of Joseph Karl Grant to Corporate Justice Blog, http://corporatejusticeblog.blogspot.com/2009/08/systemically-important-financial.html (Aug. 22, 2009, 13:01 EST); *see also* RESTRUCTURING REGULATIONS AND FINANCIAL INSTITUTIONS, *supra* note 55, at 345 ("Although the term systemic risk seems widely used in discussion of banking and finance, there is no clear consensus regarding the precise definition of the term. There are a few aspects of its definition, however, on which there appears wide agreement. First, a systemic event involves some element of externality (i.e., it entails costs to parties other than the stockholders, depositors and other creditors whose financial decisions may have contributed to the event). Second, a systemic event must have a sizable effect on the real economy, resulting in a loss in aggregate output.").

[181] Federal Reserve Bank of Cleveland, *supra* note 180.

[182] *Id.*

[183] *Id.*

[184] *Id.*

[185] *Id.*

[186] *Id.*

[187] *Id.*

institutions see their peers doing risky things, they decide to join them. Financial institutions assume that if everyone is doing something risky, then there is no way the government will let the entire industry fail; regulators will step in to offer a bail-out to all. "Concentration" refers to the "'dominant or essential player' syndrome."[188] If a financial institution dominates a particular business or has a high percentage of money leveraged in a particular area that is risky, this could make the financial institution a systemically important institution. AIG's dominance of the credit default swap market is a prime example. The final of the four C's stands for "context."[189] This is known as the "'conditions matter' syndrome."[190] Assume that the financial market is antsy or jittery. The failure of one large firm in the system might be interpreted by investors as a bad omen or sign of things to come, or as a harbinger that underlying market conditions will soon erode. Under such a scenario, the financial market collapses.[191]

James B. Thomson, a Vice President and Financial Economist at the Cleveland Federal Reserve Bank, proposes a three-tiered approach to deal with systemically important financial institutions.[192] Tier One would cover high-risk institutions. Potentially, the failure of these institutions would pose the greatest risk to the financial system. It would include "complex financial institutions such as large, interstate banks and multi-state insurance companies" and would be subject to the most stringent regulation.[193]

"Tier Two would include moderately complex financial institutions" that would be chosen based on their interconnectivity, involvement in critical market functions and activities and the effect of stress in the overall economy on their condition.[194] Large regional banks and insurance companies would be the market players regulated under Tier Two. In a sense, Tier Two financial institutions would undergo a more moderate level of regulatory scrutiny.[195]

Finally, Tier Three would cover remaining "non-complex financial

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188 *Id.*

189 *Id.*

190 *Id.*

191 *Id.*

192 *Id.*; Thompson, *supra* note 180.

193 Thompson, *supra* note 180.

194 *Id.*

195 *Id.*

institutions."[196] Community banks would make up the market participants covered by Tier Three. Tier Three institutions would fall outside the watchful eyes of systemic institutional regulators like the Federal Reserve. The notion is that if a Tier Three institution failed it would be unlikely to cause any "widespread ripples" in economic markets.[197]

The goal of the three-tiered system Thomson proposes is to equate oversight and regulatory activity with the degree of risk involved with the type of financial institution.[198] Thomson hopes that the risk of being a systemically important financial institution may be mitigated. This is an alternative approach to re-regulation under a Glass-Steagall matrix that might bear fruit. Stringent regulatory oversight of systemically important financial institutions is preferable to no oversight at all. The problem of bailing out "too big to fail" or "systemically important financial institutions" will probably never be abolished or obliterated. Thompson's proposal, however, may mitigate the damage to the American and international economies.

B. Too Big to Fail? An Examination of Market Efficiency and Moral Hazard

Over the past several decades, the "law and economics" movement has left an indelible impact on the way markets and market participants are analyzed and perceived.[199] In a sense, law and economic theory places primacy on the market's ability to reward the strongest and most efficient actors. There are parallels between Darwin's theory of evolution and this theory of the market. From

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[196] *Id.*

[197] *Id.*

[198] *Id.*

[199] *See* NICHOLAS MERCURO & STEVEN G. MEDEMA, ECONOMICS AND THE LAW: FROM POSNER TO POST-MODERNISM (2003); RICHARD A. POSNER, OVERCOMING LAW (1995); RICHARD A. POSNER, THE ECONOMICS OF JUSTICE (1983); Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. CIN. L. REV. 1023 (2000); Guido Calabresi, *An Exchange About Law and Economics: A Letter to Ronald Dworkin*, 8 HOFSTRA L. REV. 553 (1980); Bruce Chapman, *Trust, Economic Rationality, and the Corporate Fiduciary Obligation*, 43 U. TORONTO L.J. 547 (1993); Robert D. Cooter, *The Best Right Laws: Value Foundations of the Economic Analysis of Law*, 64 NOTRE DAME L. REV. 817 (1989); Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978); Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487 (1980); Thomas S. Ulen, *Rational Choice and the Economic Analysis of Law*, 19 LAW & SOC. INQUIRY 487 (1994); E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law*, 53 BUS. LAW. 681 (1998).

Darwin's theory of evolution refers to the "survival of the fittest," a phrase which applies with equal force to markets and market participants.

With respect to the financial services industry, how far are we prepared to go to insure and bail out firms that take on risks that they cannot handle or manage? Are we truly capitalists? If a bank or other financial services industry actor makes a poor decision in assessing and managing their risks, are we prepared for governmental actors to throw these institutions a lifeline? Or are we prepared to turn away from the actor who takes unmanageable risk and let that actor drown in the face of affirmatively attempting to rescue the actor?

These questions are reminiscent of the age-old problem of the burning house. If my house is on fire, as a risk-averse individual, I will take every measure necessary to put out the fire in order to avoid losing all of my earthly possessions. On the other hand, if my next door neighbor's house is on fire, do I take on the responsibility of helping him put out the fire if I can? If I can affirmatively help, and fail to do so, will the fire spread and burn down my house as well? Worse still, if I sit back and take no action, will the fire that started at my neighbor's house consume the entire city or town? At the heart of these questions is the underlying question of whether individuals have obligations beyond our own self-interest, to society.

At the end of the day, am I my sister's keeper when she makes poor decisions or mismanages her own individual risk? In judging the desirability of regulation in the financial services industry, these are all basic questions or considerations that we must ask and answer in order to determine and fully assess whether we want a world with some regulation or little or no regulation at all. These questions affect the true extent to which we are willing to embrace capitalism and act as proponents of efficient markets.

In 2008, during the implosions at Bear Stearns and Lehman Brothers, the federal government was faced with two stark choices. With regard to both firms (Bear and Lehman) the choices for the federal government were: (1) offer a bail-out; or (2) do not offer a bail-out, and let the respective firm fall victim to the market. In the case of Bear Stearns, the federal government decided to go with the bail out. Over the course of a pressure packed weekend, the Treasury Department brokered the merger and marriage of Bear Stearns with JP Morgan Chase. Similarly, in September 2008, a race was on to save Lehman Brothers.[200] As the financial picture at Lehman Brothers grew increasingly critical, the federal government decided not to bail out Lehman Brothers after desperate pleas and numerous entreaties.[201]

Perhaps the market dictated that Bear Stearns suffer failure due to poor and inefficient management of risk. Despite the market, the government made a decision to prop up Bear Stearns and avoid its imminent demise. Consciously, the government ignored Lehman Brothers' request for a bail-out. Both Bear Stearns and Lehman Brothers were institutions that were "too big to fail" in the minds of the public and regulators. What consequences can favoring one for bail-out and ignoring the other have on the overall economy?

The decision not to bail out Lehman Brothers in the fall of 2008 magnified the "context" problem or the "conditions matter" syndrome. The American capital market was jittery and antsy at the time. In many ways, the decision not to bail out Lehman Brothers arguably sent the American capital markets into a downward spiral. Investors took the failure of Lehman Brothers, a venerable and revered investment bank, as a bad omen of the state of the economy. For investors, the Lehman Brothers implosion signaled that market conditions were turning bad and that the economy was in the process of eroding. After the Lehman Brothers implosion, financial markets literally collapsed.

We can choose to bail out poorly performing companies, as we did in the case of Bear Stearns. This creates a moral hazard problem. Moral hazard can be loosely defined as "the lack of any incentive to guard against a risk when you are protected against it . . . by insurance."[202] For example, suppose that an individual homeowner purchases a homeowner's policy to insure against burglary. After obtaining the insurance policy, the homeowner will often become

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[200] For wonderful insight into the race to save Lehman Brothers, see Andrew Ross Sorkin, *The Race to Save Lehman*, N.Y. TIMES, Oct. 20, 2009, at B1.

[201] *See* Craig et al., *supra* note 106, at A1; Ianthe Jeanne Dugan, *Crisis on Wall Street: At Lehman, 25,000 People Worry About Their Futures*, WALL ST. J., Sept. 16, 2008, at C5; Jon Hilsenrath, *U.S. News: U.S. Now Must Plan Way to End Aid to Firms*, WALL ST. J., Sept. 11, 2008, at A4; Jon Hilsenrath & Sudeep Reddy, *Crisis on Wall Street: Fed Expands Lending Facilities in Bid for Stability: In Latest Move, Equities Accepted as Loan Collateral*, WALL ST. J., Sept. 15, 2008, at A18.

[202] WordNet, http://wordnetweb.princeton.edu/perl/webwn?s=moral%20hazard (last visited Mar. 14, 2010); *see generally* Ron Feldman & Gary Stern, *Methods For Addressing The Too-Big-To-Fail Problem: Where Does The Gramm-Leach-Bliley Act Of 1999 Fit?*, *in* BANKING LAW: FINANCIAL MODERNIZATION AFTER GRAMM-LEACH-BLILEY 31 (Patricia A. McCoy ed., 2002) ("Expanding the safety net exacerbates the well-known problem of moral hazard whereby the beneficiary of insurance is more likely to suffer loss after becoming insured.").

careless and perhaps might even leave doors or windows unlocked, knowing that his losses will be insured or covered. In most cases, the uninsured homeowner is incentivized to make sure that every window and door is closed because he squarely bears the risk of loss. From this example, it is easy to see that once an individual knows that there is a form of insurance to cover his losses, he in some ways may be discouraged from taking careless, unwarranted risks. Moral hazard exists in the banking industry. When the government bails out risk-takers, all too often those risk takers never adequately learn from their lessons. Sometimes it is important to mete out tough love.

In some instances, because of the moral hazard problem, we will have to make the tough decision to let an institution fail. We have to undertake this decision with great caution, because the consequences can be enormous and have a grave impact on the overall economy. Is the risk of taking down the entire economy one worth bearing by making an example of one or a handful of risk takers who get in over their heads? Are we willing to expand the safety net? Will we throw banks a lifeline in the future? Will we truly let the market govern? Can we trust and rely on the market? Essentially, are we truly guts and glory capitalists who believe in market primacy? These are all fundamental questions we must pose and ponder in the future when we are faced with the prospect of bailing out members of the financial services industry who have become too big to fail.

VIII. CONCLUSION

As this article has demonstrated, particularly through case studies of Citigroup and Bank of America, over the past decade we have allowed a handful of banks in this country to grow too large. Large banks have strayed from their core business mission of banking by extending their tentacles into increasingly complex lines of business, in an effort to become true "one-stop shops" for customers. The repeal of Glass-Steagall and passage of Gramm-Leach-Bliley in 1999 made possible the conglomeration and expansion of a handful of banks. If we are truly to learn a lesson from the Great Depression, in the midst of our current financial crisis, it is that banks tend to operate more safely with firewalls separating commercial and investment banking, securities, and insurance activities. The passage of Gramm-Leach-Bliley and repeal of Glass-Steagall led us down the road on which we are currently traveling. The problem can be fixed by returning to past laws, which functioned well for close to six decades. This is one of many measures to fix our broken economy. A number of proposals to "fix" the financial crisis have been floated in recent months.[203] Reform efforts are gaining traction among lawmakers and the Obama Administration. Only time will tell us whether we learn from our past, or are bound to repeat the failures of that past from which we should have learned. Policymakers in Washington could take a giant step forward by repealing Gramm-Leach-Bliley, and thus returning to a banking system with firewalls between banking, securities, and insurance activity as we had in our past under the Glass-Steagall Act of 1933. Is it prudent to let banks get too big in the first place? How big is too big to fail? To what extent will the government intervene when a financial services industry participant begins to melt down? These are all questions we must address before the next crisis hits.

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[203] *See generally Questions for Reform*, *supra* note 9; Cyrus Sanati, *From Rep. Frank, a To-Do List for Changing Wall Street*, N.Y. TIMES, Mar. 26, 2009, at F2; Eric Lipton & Raymond Hernandez, *A Champion of Wall Street Reaps the Benefits*, N.Y. TIMES, Dec. 14, 2008, at A1.