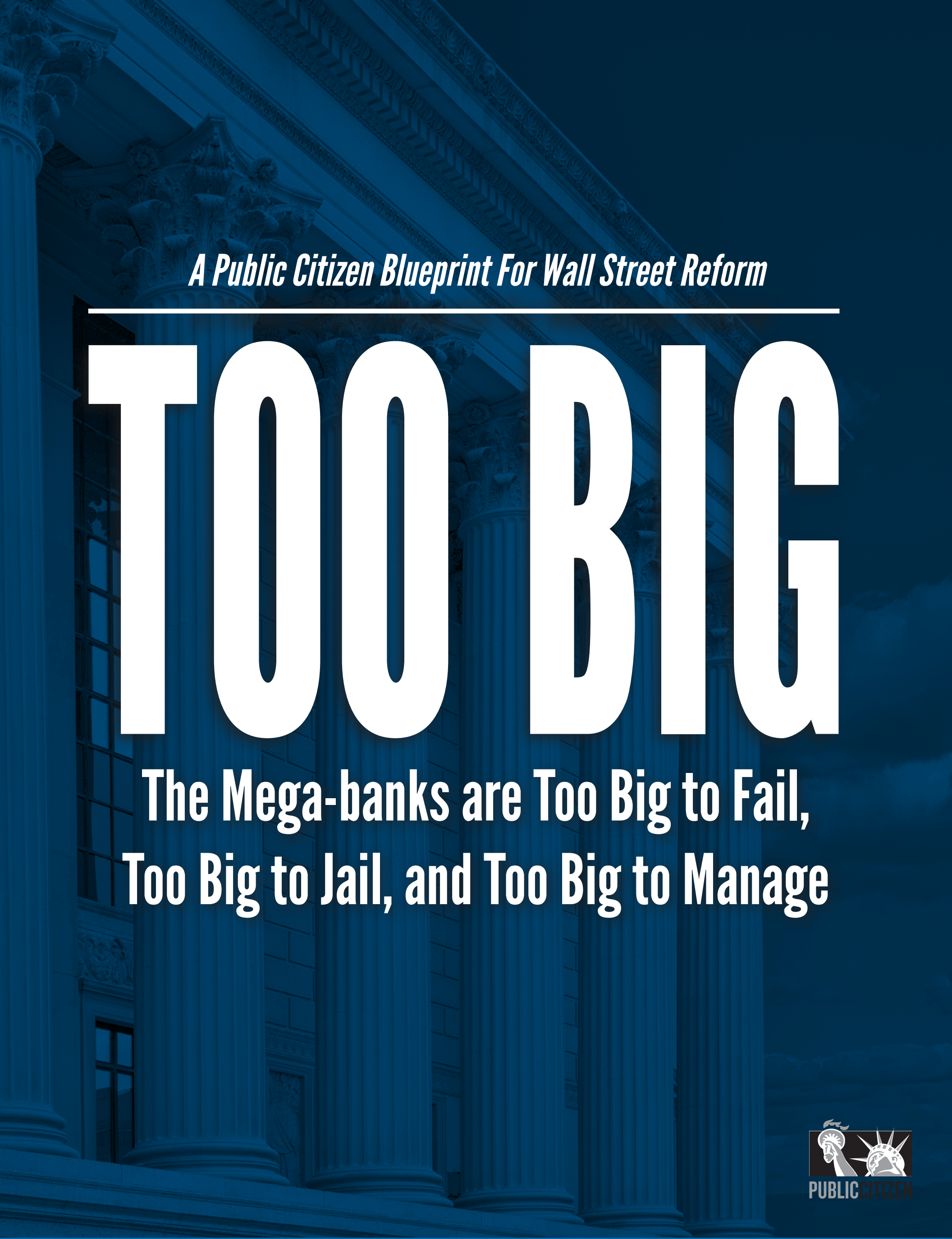

A Public Citizen Blueprint For Wall Street Reform

TOO BIG

The Mega-banks are Too Big to Fail, Too Big to Jail, and Too Big to Manage

PUBLIC CITIZEN

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About Public Citizen
Public Citizen is a national nonprofit organization with more than 400,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues, including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

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Prologue: London Whale

Daily, thousands of JPMorgan Chase & Co.'s 100 million customers deposit their paychecks in one of the bank's more than 5,000 branches.[1] For the customer, the bank offers a convenient and safe way to manage money by withdrawing funds through a teller, ATM, debit card or check. But there's also a darker side to this routine exercise.

Many depositors may be oblivious to the fact that they are actually lending JPMorgan money. Even if they understand this, they needn't be worried whether they will get their money back, as they might be if they lent money to a neighbor starting a business. They needn't worry about JPMorgan's management ability, or study the annual report. They don't need to inspect the bank building to ensure the vault is sound.

That's because of Federal Deposit Insurance Corporation (FDIC), a U.S. government guarantee that customers will be paid back their money, up to $250,000 per customer.[2] As long as JPMorgan or any bank features the letters "FDIC" outside, it's safe. In exchange for this government guarantee, the depositors expect little interest for their loans.

Customers choose a bank based on factors such as convenience, the proximity of branches or the terms of the bank account. But customers can afford to be blissfully ignorant of what the bank actually does with their money.

And what does JPMorgan do with these deposits for which they pay little interest?[3] At the end of 2012, JPMorgan, the world's largest bank, held about $1.2 trillion in deposits. With this, JPMorgan made about $733 billion worth of loans.[4] What about the other $300 billion? A sizeable portion was deployed to what the bank primly calls "other available-for-sale securities."[5]

CEO Jamie Dimon explained in congressional testimony, "Like many banks, we have more deposits than loans – at quarter end, we held approximately $1.1 trillion in deposits and $700 billion in loans."[6] So the bank "invests excess cash" in a variety of securities, he explained.[7]

These "other" securities, it turns out, include bets. The bank dignifies these bets with the term "derivatives." Former U.S. Rep. Brad Miller (D-N.C.) observed that JPMorgan's derivatives have "nothing" to do with actual credit. They "did not make it possible for more businesses to buy equipment, pay overtime or hire new employees; no household was able to buy a new car or replace its furnace. Instead, the trades were "synthetic" credit, bets on whether a borrower would default on debt to someone else."[8] JPMorgan did well on some of these bets. For example, it bet that American Airlines would go bankrupt. American Airlines did declare bankruptcy, and JPMorgan made $450 million in profits.[9,10] Derivatives traders earned handsome bonuses for this success. One made $11 million.[11] The traders' supervisor earned $14 million.[12]

Then some of JPMorgan's derivative bets went awry. A handful of traders in JPMorgan's London office handling the bank's $300 billion in "excess cash" apparently made mistakes. None of these traders were U.S. nationals. Exactly what went wrong, however, baffled JPMorgan's management. CEO Dimon initially dismissed the public discussion of the situation as a "tempest in a teapot." Several months later, after more careful scrutiny, Dimon revised his outlook and called it an "egregious" mistake.[13] The bank had lost more than $6 billion on the bets. The value of JPMorgan's stock fell by 24 percent, a sizeable decline for any firm, let alone the world's largest bank.[14]

JPMorgan commissioned outside investigators to probe and report on the mistake. But even these experts were baffled. An investigation by the U.S. Senate subsequently exposed a fundamental problem the outside investigators missed.[15] The JPMorgan-hired investigators had accepted information from JPMorgan management that the losing "bet" was billed as a hedge – a kind of insurance policy – against another position. But Senate investigators found no such position. Management didn't understand what their subordinates were doing. The management was apparently at the mercy of its "quants," a term referring to the highly skilled quantitative mathematicians responsible for the computer-dependent trading bets.

Fresh from bailing out Wall Street, the episode jarred Washington policy makers by raising the prospect of requiring another major bank bailout. If Washington couldn't prevent a well-managed bank from self-inflicting a loss that caused a 24 percent decline in its stock price, how could it prevent problems in less well-managed major banks? And if Washington couldn't allow these major banks to fail in 2008 for fear that doing so would trigger a major economic calamity, the government would likely need to use taxpayer funds to again bail out firms that might fail in the future.

The episode became known as the London Whale because of the locale of the trading and the size of the bets. The London Whale episode underscored five key lessons:

- JPMorgan was using taxpayer-backed depositor funds for socially dubious activities, such as betting on American Airlines to fail.
- A handful of foreign nationals trading outside United States' borders making millions in annual compensation could jeopardize the world's largest bank.
- JPMorgan's own management didn't understand these operations, even after inspection.
- Even after Congress passed a Wall Street reform law, worries remained that a mega-bank could fail.
- The failure of a large financial firm – and JPMorgan is the largest – would require a bailout in order to avoid seismic repercussions in the global economy.

Welcome to modern mega-banking.

Introduction

Americans suffered from the financial crisis of the 2008. Adding insult to injury, Americans were compelled to finance bailouts of banks responsible for the crash on the theory that permitting any to fail would cause a cascade of bankruptcies and inflict cataclysmic damage to the economy.

Yet today, the largest banks are even bigger than they were then.

JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, Morgan Stanley. These Wall Street banks are the largest in the nation. JPMorgan, Bank of America and Citi each hold around $2 trillion in assets each. For context, the net wealth of all Americans is $80 trillion.[16] Exxon, the world's largest oil company, has $350 billion in assets, a fraction of those held by each of the largest banks.[17] There are more than 6,000 banks (most with multiple branches) in the United States in which customers can deposit funds with a guarantee from the federal government that they can withdraw their money even if the bank fails. These taxpayer-backed deposits amount to $11 trillion. More than a third of this $11 trillion resides in four banks: JPMorgan, Bank of America, Wells Fargo and Citi.[18]

Largest Banks in the United States by Assets

NAME[19]	HEADQUARTERS	ASSETS[20]	DEPOSITS[21]	DEPOSIT SHARE*[22]
JPMorgan	New York City	$2.4 trillion	$1.1 trillion	10%
Bank of America	Charlotte, N.C.	$2.2 trillion	$1.2 trillion	11%
Citigroup	New York City	$1.8 trillion	$0.468 trillion	4%
Wells Fargo	San Francisco, Calif.	$1.8 trillion	$1.1 trillion	11%
Goldman Sachs	New York City	$ 0.880 trillion	$0.078 trillion	0.7%
Morgan Stanley	New York City	$ 0.884 trillion	$0.138 trillion	1%
Total		$9.91 trillion	$4.08 trillion	38%

** Refers to share of all deposits in the United States held by institution.*

These mega-banks are actually the combinations of other banks that they have acquired. JPMorgan is really also Manufacturers Hanover, Chemical, First Chicago, NBD Bank, Chase Manhattan, Banc One, Bear Stearns and Washington Mutual.[23] The names have either been absorbed – JPMorgan Chase – or dropped.

Bank of America (which is also CountryWide, Merrill Lynch, MBNA, SeaFirst, Security Pacific, Continental Illinois, NationsBank, Shawmut, Fleet, Bank of Boston, Baybank, Summit Bancorp, and others, with most brand names dropped[24]) can be found throughout the nation in nearly 5,000 branches.[25]

Mega-bank operations span the nation and the globe. As financial firms, their interests are vast. JPMorgan CEO Jamie Dimon observed, "Our company employs more than 220,000 people, serves well over 100 million customers, lends hundreds of millions of dollars each day and has operations in nearly 100 countries.[26,27] Citi operates in 71 countries.[28] Wells Fargo holds $11 billion worth of loans to businesses in the United Kingdom.[29] Their interests expand beyond simple loan-making. Morgan Stanley recently owned a large oil firm.[30] Goldman Sachs' portfolio has included mines in Columbia and aluminum warehouses in Detroit.[31] These banks are vessels of American history. JPMorgan, which traces history back 170 years,[32] helped finance the transcontinental railroads.[33] The bank has operated for 95 years in China.[34] Citigroup claims 200 years of history.[35]

These mega-banks also exercise political influence. They count among the most generous of all donors to local, state and federal politicians. Their alumni populate key positions in Washington. U.S. President Barack Obama's treasury secretary, Jack Lew, worked for Citi. Former U.S. President George W. Bush's treasury secretary, Henry Paulson, worked for Goldman Sachs, where four current presidents of the 12 regional Federal Reserve banks also once worked.

Americans have long understood that monopolies and giant companies can harm the economy. Consumers suffer from unrivaled giant corporations in the form of possible price gouging and poor customer service, as evidenced by the cable industry.[36] The need to combat industry concentration of the market is well recognized by economists and embedded in law.[37] "We should not endure a king over the production, transportation and sale" of what the nation produces, observed U.S. Sen. John Sherman

(R-Ohio). Sen. Sherman authored the eponymous cornerstone anti-trust law of 1890.

The financial crash of 2008 highlighted other problems of size:[38] Some banks had become too big. Americans came to learn that these banks were "too big to fail" (TBTF). Government leaders plunged into taxpayer wallets to satisfy the debts of the largest financial institutions so they could avoid bankruptcy. Failure to pay their debts would have led to ramifications for the entire economy, leaders argued.

As new financial catastrophes became daily events through 2008 and 2009, the problem of too-big-to-fail banks made clear the moral hazard of size. Moral hazard generally refers to a circumstance in which insurance against loss can motivate an actor to take on more risk. Calculating they would be bailed out in the case of failure, managers of mega-banks could gamble recklessly; worse, they were invited to gamble by the prospect of a bailout; worse still, they were mandated to gamble recklessly so as to compete with the other too-big-to-fail bankers. Citigroup CEO Charles Prince affirmed this risk-taking mandate in 2007: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."[39]

Another problem emerged as the nation coped with the damage from the financial crisis: Even as subsequent investigations revealed that much of the loan-making involved fraud, prosecutors sent no banker to jail, and closed no institution. To do so, Attorney General Eric Holder argued at one point, would have a "negative impact" on the United States, and possibly, world economy. The banks were too big to jail (TBTJ).

As the large banks stumbled to recover, it also became clear they were too big to manage. The $2 trillion in assets that each of the largest banks held proved too much for their respective managements to control. Operational mistakes abounded. Bank of America reported a $4 billion accounting error.[40] JPMorgan lost $6 billion from a single London trading outpost of a dozen employees.

And finally, while regulators were supposed to prevent banks from committing frauds or veering off the guardrails of banking rules, the spectacular missteps of bankers that caused the financial crisis revealed regulatory inadequacy. The banks had become too big to regulate.

The mega-banks are too big to fail, too big to jail, too big to manage, and too big to regulate.

Public Citizen supports efforts to bring sanity to this madness of size. We support legislative reform, regulatory approaches and private sector methods to accomplish this important goal.

What follows is a deeper discussion of each facet of the “too big” problem. In the following chapters, we discuss these four separate “too big” problems in turn. First, we provide background about the problem. Then we discuss solutions. Some of these solutions require an act of Congress. That requires citizens to press their lawmakers to support the needed legislation. In some cases, Congress has already approved a law, but Washington regulators must fully advantage that law. That requires public pressure as well. In some cases, banks have violated rules, but Washington law enforcers have failed to prosecute with the full force of available penalties. Again, public pressure is required. In still other cases, shareholders should press for reforms. Further, we support some partial reforms because they’re already on the books and would do some good. But we also support more rigorous reforms that would render these half-steps redundant. Finally, in some cases, we support belt and suspenders approaches. Washington, we understand, won’t always deliver what’s really needed.

I. Problem: Too Big to Fail (TBTF)

For decades, the American government rescued large banks because of fears that failure would lead to widespread economic calamity. In 1984, U.S. Rep. Stewart McKinney (D-Conn.) coined the phrase "too big to fail" in reference to the bailout of Continental Illinois Bank.[41] In the spring of 2008, the government again rescued a financial institution by arranging the government-subsidized sale of Bear Stearns to JPMorgan. Then, in the fall of 2008, federal officials deviated from this TBTF policy by electing against a taxpayer rescue of Lehman Brothers.[42] At the time, Lehman was one of the largest Wall Street firms. As with other teetering financial firms, its debts to its funders were real, but the asset values it claimed on its balance sheet proved illusory. They were largely investments in securities connected to the housing markets, which was plunging. For months, Lehman sought financial help from Japanese investors, American investor Warren Buffett and through a merger with Britain's Barclays Bank. Whereas Washington officials had facilitated such deals with federal funding in the past, it withheld that help for Lehman. Instead, Lehman declared bankruptcy on September 15, 2008.

That decision hardly ended the TBTF policy. In fact, the policy soon became even more entrenched. The Lehman bankruptcy sparked financial contagion. It revealed that many major banks suffered from the same intrinsic problem as Lehman – assets that were worth less than they had reported, and worth less than their liabilities. (Assets are what are owned; liabilities are what are owed.) The financial sector, in short, was insolvent. Federal officials reversed course after the Lehman bankruptcy and launched the biggest bailout in global history beginning in September 2008. They claimed a Hobson's choice; while a bailout was deplorable, economic devastation would be worse. The government deployed $45 billion to Bank of America, $45 billion to Citigroup, and billions even to major nonbanking firms, including $180 billion to AIG, an insurance company. Through various mechanisms, the federal government made more than $20 trillion available to financial institutions to stabilize the flow of credit.[43]

Compounding the problem, the financial regulators merged the failing banks: JPMorgan obtained Bear Stearns and Washington Mutual; Wells Fargo obtained Wachovia.

Meanwhile, the economic calamity caused by the financial meltdown cost millions of Americans their jobs, their homes and their savings. Reckless lending practices left Americans holding mortgages that were a collective $700 billion more than the value of the homes.[44] The government estimated that the crisis cost more than $12 trillion — the equivalent of shuttering the entire national economy for a year.[45]

How can TBTF be ended? Three major safeguards can reduce failures: 1. Require greater bank capital, which means a larger portion of bank funding from shareholders; 2. Restrict activities, or the types of operations that lead to failure; and 3. Break up the largest banks through asset sales.

Congress approved the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Dodd-Frank). Reformers sought more sweeping change, such as breaking up the largest banks. But Wall Street resisted them. This law generally strengthened the ability of regulators to use any or all of these basic tools; it did not, however, strictly mandate necessary changes.

A. Reform Option: Increase Capital Requirements for Financial Institutions

The financial crisis revealed that major banks operated with woefully scant capital. Capital, in banking, is a front line accounting measure of safety. Capital does not refer to cash held in a vault. Instead, it refers to the net value of a bank, also known as shareholder equity.

Large banks typically use about 5 percent shareholder equity in making loans, with the other 95 percent coming from depositors, bond holders and short-term lenders. To put this practice in perspective, it's analogous to a home buyer putting in a 5 percent down payment and borrowing the rest.

In good times, a 5 percent down payment may be safe. Home values often rise. Consider a home buyer who puts $5,000 of her own money down to purchase a $100,000 house, and borrows the remaining $95,000. After a year, the home may be worth $110,000. The home buyer should want to make good on her monthly mortgage payment both to remain in the home, and to preserve the appreciated value she now enjoys. A house flipper might sell after a year, making a $10,000 profit (less interest paid). In bad times, however, home values might decline. If her community is beset with a bad economy, such as a factory closure, not only might her home decline in value, but values of neighborhood homes might decline as well. If she loses her job and hopes to move to another city for a job, she may be forced to sell her house for a loss.

In this case, the down payment for the home buyer is equivalent to the capital at a bank. A bank borrows money, such as from depositors, joins it with the bank's capital, and then makes investments in assets such as home loans or other real estate. (Understanding bank accounting requires an inversion of conventional thinking. While most people might consider a loan a liability, these are the bank's "assets." A bank customer may think of deposits as cash, or an asset. When a bank accepts a customer's deposit, this is really a customer's loan to the bank, and the bank accounts for this as a liability. So a bank loan is an asset, and a deposit is a liability.) What is the bank's "own" money? These are the earnings that the bank has accumulated over the course of its operations. It can also include the money invested by the original stock investors in the bank.

It is critical to understand what bank capital is, and what it is not. Bank capital should not be confused with cash a bank might hold in a vault. Bank capital is deployed in loans and other investments along with deposits entrusted to the bank by customers. Again, bank capital is an accounting difference between assets and liabilities, better understood as the net worth of the bank.[46] FDIC Vice Chair Thomas Hoenig explains:

> *Capital is not "set aside," unavailable for lending or other activities. Rather, capital is a source of funding for a bank's activities, just like deposits or borrowings. It is funding provided by the bank's owners, and it benefits the bank in important ways. Equity owners cannot withdraw funds on demand and therefore do not*

> *present a risk of unexpectedly draining the bank's liquidity. Equity owners cannot throw the bank into default if their dividend is too small. Capital reassures counterparties, helping the bank to fund itself at a reasonable cost. Ample capital gives banks the financial flexibility to take advantage of business opportunities.*[47]

The home buyer's scenario points out both why bankers prefer low capital, and why low capital can be dangerous. If a bank uses mostly borrowed money from depositors and other lenders to the bank, then any gain from its operations becomes a greater multiple of the bank's own money. But if the bank's operations falter, such as when those who owe the bank money can't repay it, then the bank's own capital soon disappears. When a bank's liabilities – what it owes depositors and other creditors – are greater than its assets, which are the value of the loans it has made, the bank is insolvent.

Washington Mutual was the largest failure in savings-and-loan history.[48] Going into the crisis of 2007-08, Washington Mutual reported that it had about $17 billion in capital. That capital as a share in the total value of all its assets was 4.8 percent. The crisis exposed that many of its assets were "liar loans" made to people where the borrower's income was grossly overstated. These were "bad" loans that the borrowers could not repay. In the end, more than $35 billion worth of Washington Mutual's loan portfolio was bad. That was more than 11 percent of its total loan portfolio – that is, more than double its capital. In other words, Washington Mutual's reported capital of almost 5 percent was, in reality, negative 5 percent.[49]

Citigroup faced the same problem of having insufficient capital during the financial crisis. It reported capital going into the financial crisis of about 3 percent. That, too, proved not only too little, but illusory. In reality, it had negative capital; its liabilities were greater than its assets. To make sure that Citi could pay its own creditors, the federal government deployed $45 billion in taxpayer dollars in the form of preferred stock.[50]

What should capital levels be in order to forestall another bailout?

Dodd-Frank empowered regulators to raise capital requirements. Through a series of rule-makings to implement the law, the largest banks will be required to maintain a capital level of 9.5 percent.[51]

As of now, according to FDIC Vice Chair Thomas Hoenig's estimates, JPMorgan capital is at 5.56 percent, Bank of America is at 5.42 percent, and Citi is at 6.05 percent. Well Fargo is at 8.29 percent.[52] These figures are not much different than what the banks reported before the crash.

A proposal introduced by U.S. Sens. Sherrod Brown (D-Ohio) and David Vitter (R-La.) would raise bank capital to 15 percent. The "Terminating Bailouts for Taxpayer Fairness Act'' requires the six American banks with more than $500 billion in assets to maintain 15 percent shareholder equity capital.[53]

The bill also would prevent the mega-banks from disguising the value of their assets through "risk-weighting." Risk-weighting means that some assets are not counted at full value. Since the capital ratio is the bank's net worth divided by its assets, reducing the value of assets artificially improves the ratio. Risk weighting formulas can permit banks to report sound balance sheets that do not reflect reality. For example, sovereign debt – that is, debt from countries – carries a lower risk-weight than other kinds of debt. If a bank holds U.S. government debt, it only needs to retain a little capital to back up these assets. But the same formula also applies when banks hold Greek government debt, even though Greek debt is much riskier than U.S. Treasury debt.[54]

Additionally, the bill distinguishes between those institutions whose failures are more likely to create systemic repercussions. Medium-sized regional banks would only be required to deploy at least 8 percent shareholder equity to finance their loans, compared to the 15 percent for large banks.[55] And community banks, which were victims, not perpetrators of the Wall Street-induced crash, are exempted from increased capital requirements.[56]

Finally, the Brown-Vitter bill requires greater capital for derivatives, now a $700 trillion market dominated by the mega-banks.[57] Derivatives are bets[58] based on the outcome of another real event. They are not loans that help build factories, but simply a gamble that, say, the price of oil will end above $50 a barrel at a certain date. If a bank bets oil will end above $50 a barrel in three months with one partner (or "counterparty") and below $50 with another, those bets offset, and the banks face significantly lower capital requirements at present. But that ignores the possibility that some betting partners (counterparties) may renege on the bets. The Brown-Vitter bill requires capital backing for all derivative bets.[59]

Bank lobbyists claim that stricter capital requirements would raise the cost of credit for bank customers. But empirical evidence disproves this. Banks with better capital standards do not charge higher fees than those with lower standards.[60]

Stanford Professor Anat Admati has led the effort to improve capital standards.[61] *TIME* magazine named her one of the 100 most influential people in 2014.[62] The same year she co-authored the book *The Bankers' New Clothes: What's Wrong With Banking and What To Do About It*. The book explores the arguments surrounding capital. "We can have a safer and healthier banking system without sacrificing any of the benefits of the system, and at essentially no cost to society. Banks are as fragile as they are not because they must be, but because they want to be — and they get away with it."[63]

The Federal Reserve Board found that losses of some of major financial institutions during financial crises reached 19 percent of their assets.[64] Based on this, Public Citizen believes capital levels should be higher than this.

The Wall Street reform law authorizes regulators to increase capital standards. To date, regulators have adopted several new capital rules. These represent progress. Given the stakes, however, the gap between assets and liabilities remains precariously thin.

Public Citizen supports raising minimum capital levels for the largest banks to 20 percent.

B. Reform Option: Impose Restrictions on Banks' Activities to Minimize Risk

The broad concept of banking encompasses various activities. The traditional activity involves attracting deposits and then redeploying these as loans. This is known as commercial banking. This fuels the economy because it matches savers with users of capital. There are risks, such as if the borrower doesn't repay. Another type is known as investment banking. This can involve speculation, including derivatives trading. Derivative bets, unlike a bank loan to build a factory, depend on the whims of myriad market forces that determine future prices. Further, some banking ventures bring more social benefit than others. A loan for a factory can promote employment; the social benefit may be unclear for derivatives bets. As noted, JPMorgan used some deposits to bet that American Airlines would declare bankruptcy. Because it bet correctly, the bank earned more than $400 million.[65] But the bet certainly didn't help American Airlines. Such activity serves no social purpose.

Congress responded to the last major Wall Street crash in 1929 with a series of laws passed in 1933. President Franklin Roosevelt signed one of these laws, the National Banking Act, on June 16, 1933. Known as "Glass-Steagall" in reference to chief sponsors U.S. Sen. Carter Glass (D-Va.) and U.S. Rep. Henry Steagall (D-Ala.), this act established a federal guarantee for the loans given to banks from depositors. But Congress also decided that banks should constrain their risk-taking to loan-making to customers such as businesses and home buyers. Congress deemed such activities to be socially useful. The 1933 act banned banks with FDIC-insured deposits from engaging in riskier, socially dubious activities associated with the financial crash of 1929. The Independent Community Bankers of America (ICBA), consisting of more than 5,000 member banks, articulated the policy rationale behind this division as recently as 2013: "Banks are accorded access to federal deposit insurance and liquidity facilities because they serve a public purpose: facilitating economic growth by intermediating between savers and borrowers, i.e., taking deposits and making loans, and by maintaining liquidity in the economy throughout the economic cycle. These activities constitute the fundamental business of banking."[66]

Glass-Steagall forced the mega-banks of the day to sell off their investment divisions. For instance, JPMorgan split into JPMorgan (a commercial bank) and Morgan Stanley (an investment firm). It split the Bank of Boston into a bank and an investment bank named First Boston (which later became part of Credit Suisse.) The government insured the depositors of JPMorgan and Bank of Boston, but not the creditors of Morgan Stanley and First Boston. Although the banking industry had naturally resisted the 1933 legislation, selling off their securities businesses did not deprive the firms of substantial income immediately because the 1929 crash had soured America's interest in stocks.

As interest in investing reawakened in the aftermath of World War II, regulatory and court decisions gradually eroded the firewall between commercial and financial services, such as investment banking and insurance. Money market funds and brokerage firms such as Merrill Lynch began offering checking account services. Commercial banks increasingly lost market share to other financial institutions.

Pressure grew from commercial banks to allow them greater flexibility to compete. In the 1980s, the Comptroller of the Currency, which regulates national banks, allowed commercial banks to engage in derivatives activity, interpreting a statute to declare that some derivatives are part of loan-making.[67] (For example, a bank might offer a borrower a floating rate loan, which is a loan with rates that change according to prevailing interest rates. Then the bank could hedge its bet by purchasing an interest-rate derivative (a.k.a. "swap") from a counterparty that agrees to pay the bank the difference in interest should it fall below the rate at the time it issued the loan.)

Regulators approved additional powers for traditional commercial banks. In 1989, the Federal Reserve permitted JPMorgan to underwrite a certain volume of corporate bonds. Around the same time, regulators allowed commercial banks to offer a wide variety of insurance, securities and investment-related services through subsidiaries. On the other side of the street, brokerage firms found loopholes to own bank subsidiaries under certain conditions. In 1998, Citicorp, with the help of a temporary exemption from the Glass-Steagall prohibition on mixing banking with insurance, merged with the giant insurance firm Travelers Group to form Citigroup.[68] Then Congress ratified this merger when it approved the Gramm-Leach-Bliley Financial Services Modernization Act of 1999. This formally repealed the Glass-Steagall firewall. This punctuation to the end of Glass-Steagall most conspicuously provided the main provision that Citigroup sought, namely housing banking and insurance under one corporate roof.

Nine years later, in 2008, the financial system collapsed. Complex investments involving mortgages packaged as mortgage-backed securities, which were widely held by both commercial and investment banks, proved rotten. Derivatives, once justified as a product to reduce risk, instead amplified risk. For example, credit default swap derivatives pay when a bond goes into default. But unlike risk hedging using fire insurance, for which the insured must own the home, a purchaser of a credit default swap need not own the bond. These are known as “naked” credit default swaps. Worse, multiple investors could make claims on the default of a single bond.

Naked credit default swaps marked an evolution in the purpose of derivatives from their traditional risk-management function to sheer gambling. When the financial crisis struck in 2008, three-to-four times as many naked credit default swaps were in circulation as were credit default swaps held by investors who owned the underlying asset. This is equivalent to many investors buying fire insurance on the same house. If one such house burned down, it might even jeopardize the insurance company, as happened to AIG. In this case, AIG’s potential failure reverberated back to the firms it owned money to, such as mega-bank Goldman Sachs.[69]

i. Activity restriction: Reduce risky practices by banks by vigorously enforcing Volcker Rule

In response to federally-insured banks engaging in risky activities unrelated to traditional banking, Congress approved Section 619 of Dodd-Frank, commonly known as the Volcker Rule. In brief, it declares that banks may not engage in proprietary trading. That means the bank cannot attempt to gain a profit the way speculators do – through the frequent purchase and sale of securities.

The rule is named for Paul Volcker, former chair of the Federal Reserve. Volcker argued that banks should restrict themselves to using funds they borrow from depositors to engage in traditional loan-making. Deposits are an inexpensive, abundant source of money because the government guarantees repayment even if the bank fails. Using that cheap, taxpayer-subsidized money to gamble is inappropriate, he contended.

Volcker’s original concept suffered inevitable compromises in the legislative process. One of the complexities embedded in the statute is that while banks may not make proprietary trades, they may still purchase and sell securities (such as stocks and bonds) provided that these transactions are in the service of their customers. This is known as market making. Again, proprietary trading refers to a trader, in this case a bank, buying or selling for its own account. Market making occurs when the bank buys a security from one customer with intent to sell it to another, earning a profit not on the change in price, but the bid-ask spread, or perhaps a commission. The bid-ask spread is the difference between what the bank is willing to pay for a security and the price it wants to sell it. Think of a grocer who buys (bids) apples for $1 per pound and sells them (asks) for $1.25 per pound.

Regulators are establishing tests intended to distinguish between proprietary trading and market-making. Federal agencies formally began enforcing the ban on proprietary trading in July 2015. However, it's difficult to determine whether the banks are truly complying.

For example, Goldman Sachs CEO Lloyd Blankfein claimed in 2013 that "we shut off that activity," referring to proprietary trading.[70] But the institution's public statements raise the question of whether it had changed its business, or simply its terminology. Goldman Sachs currently lists "market making" as one of six major sources of revenue, along with such other items as "investment banking" and "commissions and fees." In 2014, it reported $8.3 billion in revenue from "market making." This is down somewhat from 2013, where it reported $9.3 billion, and from 2012, when it reported $11.3 billion.[71] Before these years, Goldman Sachs did not describe revenue from market making at all. Instead, it described such activities as "trading and principal investments." These values were similar to those now reported under "market making." In 2007, for example, Goldman reported $13 billion from "trading and principal investments."[72]

JPMorgan, for its part, claimed its derivatives trading in the London Whale case simply served as a risk-mitigating hedge, which is permitted under the Volcker Rule. A hedge is a type of insurance, such as a position that will pay off in the case that the primary investment does not. A U.S. Senate investigation, however, found that the bank could produce no document to show what, precisely, was being hedged.[73]

One of the blatant arenas where banks have engaged in proprietary trading is through their hedge funds, which are different than individual investments that are termed "hedges." Hedge funds are investment vehicles that pool capital from investors and are augmented with borrowed money. Unlike mutual funds, hedge fund investments can be complicated and are usually much riskier. For the most part, the Volcker Rule called for banks to shed these funds. The statute, however, allows banks to own as much as 3 percent of the funds, provided they do not count equity in these funds toward meeting capital requirements. Besides the 3 percent limit, the statute also granted banks a lengthy time to exit their hedge fund investments and that timeline has been extended further. In December 2014, regulators extended the deadline two years, until 2022 to exit this gambling arena. Volcker himself resorted to thinly veiled sarcasm following announcement of this reprieve: "It is striking that the world's leading investment bankers, noted for their cleverness and agility in advising clients on how to restructure companies and even industries however complicated, apparently can't manage the orderly reorganization of their own activities in more than five years."[74]

Because proprietary trading has been a source of great profit for the banks, the industry lobbied fiercely to soften the regulators' implementation of the Volcker Rule. This full-court press included meetings with regulators and congressional hearings. In 2009, at the height of the debate over the Wall Street reform bill, commercial banks spent $49.4 million lobbying.[75] In 2012, with agencies implementing the Volcker and other rules, the number jumped to more than $60 million.[76] Although these figures include the banks' lobbying on all issues, the Volcker Rule was among their key concerns. On the Volcker Rule, industry representatives met with regulators 337 times in 2011 before regulators had even fashioned a proposal. Public interest groups, including Public Citizen, met with these same regulators just 19 times.[77]

Public Citizen supports a vigorously enforced Volcker Rule. This should include better public reporting of compliance.

ii. Activity restriction: End risky activities by banks by reinstating Glass-Steagall

The Volcker Rule, while significant, restricts rather than prohibits the sort of trading that led to the crisis. This has led many to call for reinstating the more formidable restrictions of Glass-Steagall in a modernized form to supplement the Volcker Rule.

Those who object to the restoration of the Glass-Steagall restrictions point out that Lehman Brothers was strictly an investment bank, not also a FDIC-insured commercial bank. And CountryWide, which flooded the mortgage-backed securities market with defaulting mortgages, was not an investment bank. It was a commercial bank. Massive fraud figured at the center of the crash, not the mixture of activities, opponents of Glass-Steagall contend.

Pointing to Lehman, however, ignores the fact that "some of the greatest threats in 2008 were posed by banks – such as Citigroup – built on the premise that integrating commercial and investment banking would bring stability and better service," notes Simon Johnson, an MIT professor.[78]

Moreover, the absence of Glass-Steagall did affect Lehman. Repeal of Glass-Steagall enabled commercial banks, with their funding advantage from federal deposit insurance, to threaten Lehman's business. FDIC insurance means that those who loan money to commercial banks in the form of deposits expect a lower interest rate from the bank than if they loan money to a borrower without such a federal guarantee.

Lehman attempted to grow rapidly to protect its market share. The size of its liabilities swelled from $400 billion in 2006 to more than $600 billion in 2007 because of the investment bank's urgent rapid-growth imperative. "Lehman Brothers was an old line investment bank ... [that] now had to compete in the investment banking arena with federally insured commercial banks," observed Robert Downey, a former partner with Goldman Sachs who once led the Securities Industry Association.[79] Here is how Lehman explained it to shareholders in its 2005 annual report:

> *We Face Increased Competition Due to a Trend Toward Consolidation ... In recent years, there has been substantial consolidation and convergence among companies in the financial services industry. In particular, a number of large commercial banks ... have established or acquired broker-dealers or have merged with other financial institutions. Many of these firms ... have the ability to support investment banking and securities products with commercial banking, insurance and other financial services revenues in an effort to gain market share.*[80]

To finance this rapid growth and fortify their balance sheets, investment banks also tapped the equity markets. They raised money in the stock market and became publicly traded firms. Observed *The New York Times*, "The plan to go public is ... about how to prepare the [investment banks] for a new era – one in which only the most global banks with the resources to fight for business in any major economy will prosper."[81]

This change brought a new culture to Wall Street investment banks. Previously, firms such as Lehman and Goldman Sachs were partnerships. They funded operations through retained earnings (owned by partners) and debt. This meant that senior partners could only pocket the equity when they sold their partnerships back to the firm upon retirement. This partnership organization translated into a different manner of dealing with customers. As former Goldman banker Wallace Turbeville observed, this arrangement made the partners "long term greedy."[82]

After the investment banks transformed from partnerships into publicly traded firms to fortify their balance sheets and better compete with the traditional commercial banks now invading their turf, they could pay annual bonuses in the form of stock options tied to the stock market price. That meant a trader could gain riches sooner than retirement. They became "short-term greedy," explained Turbeville. In his March 2012 resignation letter from Goldman Sachs, Greg Smith, a former head of Goldman Sachs U.S. equity derivatives business, described this culture change. He said there once was a "secret sauce that made this place great and allowed us to earn our clients' trust for 143 years."[83] But now that Goldman Sachs could reward its managers with generous annual bonuses, there was a "toxic and destructive" environment in which "the interests of the client continue to be sidelined."

Meanwhile, the banks that once employed only risk-wary loan makers now housed traders who brought a different temperament. Bankers transformed from hate-to-lose officers focused on reducing risk into love-to-win speculators, said derivatives industry observer Nicholas Dunbar.[84] John Reed, former Citigroup CEO, affirms this culture shock, which he describes as "very serious." When investment and traditional bankers mix:

> *It makes the entire finance industry more fragile ... As is now clear, traditional banking attracts one kind of talent, which is entirely different from the kinds drawn towards investment banking and trading. Traditional bankers tend to be extroverts, sociable people who are focused on longer term relationships. They are, in many important respects, risk averse. Investment bankers and their trad-*

ers are more short termist. They are comfortable with, and many even seek out, risk and are more focused on immediate reward. In addition, investment banking organizations tend to organize and focus on products rather than customers. This creates fundamental differences in values.[85]

International Monetary Fund Managing Director Christine Lagarde affirmed, “The industry still prizes short-term profit over long-term prudence, today’s bonus over tomorrow’s relationship.”[86]

Whether Glass-Steagall would have prevented the financial crash of 2008 may be unprovable. But what about the other side of the coin? What do proponents of the 1999 Gramm-Leach-Bliley Financial Services Modernization Act (Gramm-Leach-Bliley), which completed the repeal of Glass-Steagall, claim as benefits of the law? After all, merely claiming that Gramm-Leach-Bliley may not have caused widespread devastation hardly amounts to a vigorous defense of the law. What *good* did the Gramm-Leach-Bliley Financial Services Modernization Act do? How is the economy better because of repeal of Glass-Steagall?

The chief sponsors of repeal did not actually promise many measurable benefits. Explained U.S. Sen. Phil Gramm (D-Texas), chairman of the Senate Banking Committee and chief architect of the repeal, “The world changes and we have to change with it ... Glass-Steagall, in the midst of the Great Depression, came at a time when the thinking was that the government was the answer. In this era of economic prosperity, we have decided that freedom is the answer.”[87]

The statute is similarly broad on promises. The most concrete are:

To enhance competition in the financial services industry, in order to foster innovation and efficiency; ... To enhance the availability of financial services to citizens of all economic circumstances and in all geographic areas; ... To enhance the competitiveness of United States financial service providers internationally...[88]

The Senate committee report continued to say:

It is important that the statutes regulating financial services promote these goals because of the crucial role that financial services

> *play in the American economy. Not only does the financial services industry account for about 7.5 percent of our nation's gross domestic product and employ approximately 5 percent of our workforce, it is vital to the growth of the rest of the economy by serving as a channel for capital and credit. The financial services industry provides opportunities for savers, investors, borrowers, and businesses to realize their goals.*[89]

So how have the claims that Gramm-Leach-Bliley would "enhance competition" and foster "innovation" and "efficiency" worked out? In broad brush terms, the financial crash of 2008, which drained more than $12 trillion from the American economy, suggests that whatever competition, innovations and efficiencies that the act may have fomented failed to serve the public's interest.[90] Meanwhile, some economists have concluded that the financial sector has become less efficient. Generally, the financial sector is supposed to match savers with users of capital, a purpose abbreviated as "intermediation." The cost of "intermediation" is the measure of the financial sector's efficiency.[91] Yet this intermediation cost measure has burgeoned, not declined. Bankers matched savers with users of capital for the construction of railroads in the 19th century, development of the automobile industry in the middle of the 20th century and innovations in pharmaceuticals and technology in the 1970s and 1980s for lower capital costs than the financial sector offers today. Computers, which have made many sectors more efficient, have not had the same impact on the financial sector despite the widespread use of the latest technology at the mega-banks.

Consumers experience this costlier banking system in the form of higher fees. Between 2007 and 2013, fees for basic checking accounts rose 21 percent.[92]

What are banks doing with the new powers authorized by the repeal of Glass-Steagall? One of the principal new powers for commercial banks authorized by the repeal was insurance. After all, the combination of Travelers, which specialized in insurance, and mainstream banking giant Citicorp, precipitated the final repeal of Glass-Steagall with the 1999 Gramm-Leach-Bliley Act. Yet, not long after Citi and Travelers merged, they separated in 2002. (Citi continues to sell insurance, but it no longer underwrites the insurance.)

Is a large, full-service, commercial and investment bank necessary for large firms that use both commercial and investment banking services? No. Large firms continue to use "pure" investment banks for investment banking and insurance. Boutique investment bank Lazard Freres arranged the sale of Heinz to Berkshire Hathaway. Goldman Sachs, which remains essentially an investment bank despite its bank charter, often leads the industry in underwriting initial public offerings and underwrote more than 40 times the amount that Citi and Bank of America underwrote in 2014.[93]

Nor are retail investors shopping exclusively at the mega-banks. Schwab, which is not a mega-bank, boasts some eight million customers.[94] Morgan Stanley, which provides few traditional banking services, continues to satisfy brokerage customers. Since many investors and bank customers advantage the Internet, it matters little if the providers on the other side have one or more corporate parents. Many customers simply use multiple financial firms, just as grocery shoppers may patronize several grocery store chains regularly.

John Reed, former CEO of Citigroup, says that it was a mistake to believe that "combining all types of finance into one institution would drive costs down." Based on his experience, he says, "We now know that there are very few cost efficiencies that come from the merger of functions — indeed, there may be none at all. It is possible that combining so much in a single bank makes services more expensive than if they were instead offered by smaller, specialized players."[95]

Is it important that the financial sector grow? While none argue that the industry should disappear, many wonder why financial services should become an increasing part of the economy. After all, a service business success should be measured by efficiency. If the trucking industry became a bigger share of the economy, one would wonder if the trucks are moving half-full, or getting lost.

The financial system has indeed grown, a trend studied in a special project of the Roosevelt Institute led by Michael Konczal. "In the 1950s, the financial sector accounted for about 3 percent of U.S. gross domestic product. Today, that figure has more than doubled, to 6.5 percent." It has also become "disproportionately more profitable" than the real economy. Whereas Wall Street profits accounted for 8 percent overall U.S. profits in the 1950s, they grew to 20 and even 40 percent of all profits during several years in the 2000s, Konczal reports.[96]

iii. Activity restriction: Prohibit banks from engaging in commerce

Another part of the 1999 Glass-Steagall repeal eroded the traditional wall that separates banking from commerce.[97,98] Commerce refers to the Main Street economy, of grocery stores, car manufacturers, computer makers, oil companies, etc. Contained in laws since the inception of the nation, Congress affirmed the principle of a wall between banking and commerce in the 1956 Bank Holding Company Act: "No bank holding company shall ... acquire direct or indirect ownership or control of any voting shares of any company which is not a bank."[99] This policy reflected problems when banking spilled into commerce. JPMorgan monopolized railroads in the 19th century, driving up rates. Similarly, bankers attempted to corner the copper market leading to the panic of 1907.[100] In the 1980s, real estate developers exploited a Reagan-era loophole that allowed them to easily obtain credit by acquiring savings-and-loan firms, which are essentially banks. Unbridled by sound banking principles, they erected so many buildings without signing tenants that the structures were dubbed "see through" buildings.[101] As a result, an oversupply of office space caused real estate markets to collapse.

The principle of separating banking and commerce enjoys wide support. Progressive organizations have long championed the separation of banking and commerce.[102] Labor representatives call the separation "bedrock economic policy."[103] The National Grocers Association and the National Association of Convenience Stores support separation,[104] as mixing the two can "lead to systemic problems."[105] The National Association of Realtors observes that banks can become "powerful, concentrated conglomerates" that harm small businesses and consumers.[106] Many bankers themselves endorse the policy, including the Independent Community Bankers of America.[107] Paul Volcker, when he served as Federal Reserve chairman in 1987, summarized: "Widespread affiliations of commercial firms and banks [carry] the ultimate risk of concentrating banking resources into a very few hands, with decisions affecting these resources influenced by the commercial ownership links, resulting in inevitable conflicts of interest."[108]

For decades, managers of some of the largest banks have sought to repeal restrictions on the types of firms they can own. In 1999, they succeeded with three little noticed provisions in the Gramm–Leach–Bliley Act. One section[109] permits the bank holding company to engage in any activity that the Federal Reserve Board finds to be "complementary to a financial activity."[110] A second permits a bank holding company to engage in "merchant" banking.[111] Merchant banking generally refers to providing capital to a company in the form of investment ownership, as opposed to a loan. A third, a "grandfather" clause[112] provides that a firm that was not a bank holding company in 1999 (when Congress approved Gramm-Leach-Bliley), but becomes one thereafter with Federal Reserve approval, may continue to engage in activities "related to the trading, sale, or investment in commodities." In September 2008, at the height of the financial crisis, the Federal Reserve opened the full largesse of its bailout powers to Goldman Sachs and Morgan Stanley by awarding them status as bank holding companies. They owned prodigious volumes of commodities and other commerce-type assets (hotels, airports, etc.), and were permitted to retain them by the 1999 grandfather clause.

These new permissions have led to a number of problems. It seems that some financial firms were more interested in commodity prices than in providing services. For example, a Goldman Sachs subsidiary owned 27 industrial warehouses in the Detroit area to store customers' aluminum. But it seems that the warehouse workers simply shuffled the metal, without delivering it to customers. "They load in one warehouse. They unload in another. And then they do it again," according to one account. Since Goldman bought the warehouses, the wait time grew more than tenfold.[113] Summarized *The New York Times:*

> *Hundreds of millions of times a day, thirsty Americans open a can of soda, beer or juice. And every time they do it, they pay a fraction of a penny more because of a shrewd maneuver by Goldman Sachs and other financial players that ultimately costs consumers billions of dollars.*

U.S. regulators and the Department of Justice have reportedly launched initial investigations into the metals warehousing business.[114]

Meanwhile, JPMorgan Chase was fined $410 million in an energy rate-manipulation case.[115] "JPMorgan's brazen, Enron-style market manipulation cost California ratepayers over $120 million," said former U.S. Rep. Henry Waxman (D-Calif.).[116]

In conclusion, erosion of the wall between banking and commerce, speculation in high-risk derivatives transactions, and corrosion of the culture of investment banking are but a few of the problems that followed financial law deregulation of the late 20th century. In sum, there is much to condemn and little to celebrate in the repeal of Glass-Steagall and the regulatory decisions allowing banks greater powers.

The call to restore this law comes from a broad swath of individuals and organizations. As creators and managers of the Citigroup merger, the signature transgression of Glass-Steagall, John Reed and Sanford Weill provide compelling testimonial. They attempted to run a sound, sustainable, growing business combining commercial and investment banking. They now call for Glass-Steagall-style reform. "What we should probably do is go and split up investment banking from banking, have banks be deposit takers, have banks make commercial loans and real estate loans, have banks do something that's not going to risk the taxpayer dollars, that's not too big to fail," Weill said.[117]

Many others call for a return to Glass-Steagall-style financial industry architecture. See Appendix I.

In Congress, U.S. Sens. Elizabeth Warren (D-Mass.), a Democrat, and John McCain (R-Ariz.), a Republican and former GOP presidential candidate, along with U.S. Rep. Marcy Kaptur (D-Ohio) champion reinstatement of a modified version of Glass-Steagall. Kaptur's bill has been introduced in several Congresses. A congressional term lasts two years. In the current Congress, the bill is co-sponsored by 70 other representatives, with less than one year left in this term.[118] In the 112th Congress, the Kaptur bill drew 124 co-sponsors.

Public Citizen supports a reinstatement of a strengthened version of Glass-Steagall that includes a limitation on bank derivatives activities and a *clear separation between banking and commerce.*

C. Reform Option: Reduce the Size of Mega-Banks

Even with higher capital standards and activity restrictions, the largest banks would still be too large. Bank of America, Citi, JPMorgan and Wells Fargo each report more than $1 trillion in deposit liabilities. Even if they limited their activities to simple loan-making with these deposits, the failure of a $1 trillion bank could have serious repercussions. Consider the equivalent in smaller bank failures. Of the nation's 6,000 banks, the smallest 4,500 have less than a collective $1 trillion in assets.[119] It is likely that a simultaneous failure of 4,500 banks would be notable.

Those who find government bailouts to be unacceptable should be anxious to compel the breakup of $1 trillion banks. Consider this: Continental Illinois, which the government bailed out in 1984 because officials believed it was too big to fail, had just $40 billion in assets. Even adjusting for inflation that would only be $90 billion today, a fraction of the size of the $1 trillion mega-banks.[120]

A mega-bank failure may result from mismanagement, such as bad-loan making. For example, failure of a loan-maker may signal a failure of underwriting, the process by which the bank decides whether a borrower is credit worthy. If 20 percent of a mega-bank's borrowers can't repay their loans, forcing the mega-bank failure, that signals $200 billion (20 percent of $1 trillion) in business failures. (For context, 37 percent of CountryWide's loans were found to be defective.[121]) Bad loans totaling $200 billion would be equivalent to the bankruptcy of Wal-Mart, which has roughly $200 billion in assets.[122] That would lead to unemployment or dislocation of employees, which in Wal-Mart's case, is the largest private sector employer in the nation.

Another reason a mega-bank might fail could be concentrated lending in a sector such as office buildings. This was the case with thrifts in the savings-and-loan crisis of the 1980s. Thrifts are similar to banks but originally focused only on home loans. That means an overbuilt office building market, the collapse of which would mean a collapse in office rents throughout all the overbuilt regions, not just for the unrented offices funded by the failed bank. Since office building rent is a major source of taxable revenue for municipalities, to name one repercussion, that loss of value might strain all municipalities where office rents collapse.

Beyond what real economy problems a mega-bank failure might reveal, the failure itself can ignite repercussions. Consider the bank's bond holders. Mega-banks buttress their balance sheets with bond loans as well as loans from depositors. Some of those bonds in a failed bank might be held by a state pension fund. That could force the pension fund to reduce benefits if the fund is insufficiently robust.

Then there are psychological impacts, such as panic.[123]

Given these real problems, regulators have and will feel compelled to bail out a mega-bank before permitting it to fail.

Defenders of the Dodd-Frank reform legislation contend that it already provides a vehicle for regulators to break up the largest banks. This provision in Dodd-Frank turns on how well the major banks can use standard bankruptcy laws.

The $600 billion Lehman Brothers bankruptcy revealed that some banks were so large and interconnected with other firms so as to frustrate a bankruptcy proceeding where repercussions are limited. Normally, bankruptcy serves as an orderly means to either close or reorganize a business. Creditors suffer a reduction – if not complete loss – of the funds lent to the bankrupt company. Lehman's bankruptcy, however, triggered contagion throughout the economy. Its size, complexity and interconnections touched too many creditors. Lehman Brothers owed creditors $600 billion. Its declaration of bankruptcy, for example, deprived payments to the Reserve Primary money market mutual fund, which, in turn, deprived everyday clients in this fund of some of their investment.[124] Panic immediately spread to other firms, some of which were otherwise safely managed. (It is possible that the contagion might have abated had so many other giant firms not suffered the same problems as Lehman, but this theory is not easily tested.) When some of the same internal problems Lehman suffered became manifest at other mega-banks, Washington responded with bailouts for them rather than triggering more unmanageable contagion from bankruptcies. What's more, the government's crisis managers actually made the TBTF problem worse by consolidating some of the failing firms with other failing firms. To JPMorgan's sprawling empire, for example, the government added Bear Stearns and Washington Mutual.

Section 165 of Dodd-Frank requires mega-banks to adopt "credible" provisional bankruptcy plans colloquially known as "living wills." To be credible, they must prove to regulators that their failure could be handled in an orderly fashion and would not trigger financial contagion or require public funding assistance. If regulators determine they are "not credible," regulators can order changes, including divestiture of assets – a break-up.

In 2014, the Federal Reserve and FDIC declared that the "living will" plans by 11 large banks submitted in 2013 were "not credible."[125] The 11 banks were Bank of America, Citigroup, JPMorgan, Goldman Sachs, Morgan Stanley, Bank of New York Mellon, State Street, and the United States units of Barclays, Credit Suisse, Deutsche Bank and UBS.

FDIC Vice Chair Tom Hoenig explained that the mega-banks' derivatives portfolios should be altered to make them part of the bankruptcy process.[126] Currently, derivatives can be settled immediately with the declaration of bankruptcy even as other credit relations must wait for the court. About a third of the world's $700 trillion in outstanding derivatives bets are held by just four American banks.[127]

The JPMorgan living will for 2015 is 200,000 pages long.[128] Such a length is unfathomable. Further, the lion's share of these plans are not public and can't be exposed to the discipline of the market forces that would re-price bond and stock values, undermining the chance for markets to force reforms.[129]

Clearly, the regulators can and should order a break-up. That they have not done so may be due to a belief that improved capital standards, discussed above, will be sufficient to prevent a mega-bank from insolvency. Strong capital standards could conceivably prevent a bank failure. Yet these depend on accounting oversight that can prove difficult. As discussed, regulators failed to recognize that Washington Mutual's loans were grossly overvalued, since too many were "liar loans" void of documentation that the borrower could repay them. And the London Whale episode showed that rogue trading desks can lead to abrupt, catastrophic losses. Finally, the Wall Street banks exercise consequential political influence in Washington, stifling efforts by regulators to use existing tools. They contribute generously to congressional and presidential campaigns, they lobby prodigiously, and their senior executives populate pivotal regulatory posts, which is explored later in this discussion. All this argues that Congress must be more explicit.

i. Pass legislation requiring break-up of TBTF banks

Short of waiting for regulators, what's necessary then, is to break up the largest banks. "No single financial institution should have holdings so extensive that its failure could send the world economy into crisis," said U.S. Sen. Bernie Sanders (I-Vt.) said by way of introducing a break-up bill, named the "Too Big to Fail" act.[130] "If an institution is too big to fail, it is too big to exist."

The biggest banks in the United States are now 80 percent bigger than they were one year before the financial crisis in 2008, noted Sanders.[131]

"Never again should a financial institution be able to demand a federal bailout," added U.S. Rep. Brad Sherman (D-Calif.), the chief House sponsor of the measure. Sherman's bill originally came from former U.S. Rep. Brad Miller (D-N.C.). "They claim; 'If we go down, the economy is going down with us,' but by breaking up these institutions long before they face a crisis, we ensure a healthy financial system where medium-sized institutions can compete in the free market," explained Rep. Sherman.[132]

Added Neel Kashkari, President of the Minneapolis Federal Reserve Bank, "Given the enormous costs that would be associated with another financial crisis … we must consider … breaking up large banks into smaller, less connected, less important entities."[133] Kashkari is a Republican, former Goldman Sachs executive, and one of the principal authors of the government's bailout when he served in the Treasury Department in 2008 under the administration of U.S. President George W. Bush.

The Sanders and Sherman legislation would give banking regulators 90 days to identify commercial banks, investment banks, hedge funds, insurance companies and other entities whose "failure would have a catastrophic effect on the stability of either the financial system or the United States economy without substantial government assistance."

The list mandated by the Sanders/Sherman legislation would include Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and Wells Fargo.[134] These eight institutions already have been deemed "systemically important banks" by the Financial Stability Board, the international body that monitors the global financial system. Under the legislation, the U.S. Treasury Department would be required to break up those and any other institutions deemed too big to fail by the Treasury Secretary. Any entity on the TBTF list would no longer be eligible for a taxpayer bailout from the Federal Reserve and could not use their customers' bank deposits to speculate on derivatives or other risky financial activities.

A break-up would introduce true market discipline. Former U.S. Rep. Brad Miller (D-N.C.), the original author of the break-up bill, explained, "Market participants cannot realistically assess the assets and liabilities of a megabank any more than a regulator can." He argues for a break-up so that the market can properly value banks. "If market participants knew they could be paid only from the assets of the specific subsidiary with which they did business, they would consider that subsidiary's assets and potential liabilities. That diligence is part of 'market discipline,' a drastic change from the unlimited liquidity for every line of business."[135]

Finally, a break-up would promote marketplace competition, which is the engine of efficiency. Just as the consolidations following the repeal of Glass-Steagall and the forced mergers as part of the 2008 bailout have led to higher consumer fees and less efficient capital mediation, a break-up can reverse this trend.

Public Citizen supports a break up of systemically important financial institutions.

II. Problem: Too Big to Jail (TBTJ)

Massive frauds led to the financial crash of 2008. In November 2013, the U.S. Department of Justice (DoJ) announced a "record $13 billion global settlement with JPMorgan" for misconduct leading to the financial crisis.[136] In July 2014, the DoJ announced "a record $7 billion global settlement with Citigroup for misleading investors about securities containing toxic mortgages" that were central to inflation of the housing bubble.[137] In August 2014, Bank of America agreed to pay a "record" $16.65 billion "for financial fraud leading up to and during the financial crisis."[138]

Massive fraud also caused the savings and loan crisis of the 1980s. Whereas prosecutors sent about 1,000 savings and loan officers to prison in the 1990s, the DoJ has failed to imprison a single senior banker or even secure a criminal plea from a bank for the frauds it identified in the 2008 white-collar crime spree.

Observers have hazarded several theories for this striking disparity in judicial response.[139] One of the more chilling explanations came from then Attorney General Eric Holder himself. In December 2012, the DoJ entered into a deferred prosecution agreement with the global mega-bank HSBC Inc. The company admitted to violations of money laundering laws covering $200 trillion worth of transactions. The bank admitted to the facts.[140] But the DoJ only required the firm to forfeit $1.256 billion.[141] That was about a month's profit at the bank. The DoJ charged no individuals with a crime. When asked why the DoJ did not seek stiffer penalties, such as a criminal admission, Attorney General Holder told a Senate committee that some firms had become "so large" that a criminal charge could endanger the world economy.[142] This led critics to charge that the DoJ applied unequal justice to the mega-banks, that they were immunized as too big to jail.

Holder's candid remarks unleashed criticism by a public suspicious that the government intentionally chose not to bring hardball enforcement actions against Wall Street for the obvious fraud leading to the crash of 2008.

The DoJ reinforced these suspicions in the two years after the HSBC non-prosecution with a succession of prosecutorial failures in the face of misdeeds by major banks directly related to the mortgage crisis. In each case, DoJ claimed that the banks engaged in massive fraud. At Bank of America, government attorneys claimed that “fraud pervaded every level” of the industry. The bank “caved to the pernicious forces of greed.”[143] But none of these cases resulted in a criminal plea, a criminal prosecution of an individual, or a material, punitive restriction on the firms’ business operations.

Deconstructing these “record” penalties by the DoJ reveals a number of weaknesses. Most importantly, in none of these cases did the government charge the banks with a crime, nor did it identify and charge any individual with a crime. Second, some of the “penalties” levied against the bank serve little or no practical effect because they merely compel the banks to forgive failed loans that they had no hope of ever collecting, according to observers.[144] Third, by settling for fines, prosecutors effectively forced the shareholders to pay. Arguably, shareholders may profit from the ill-gotten gains and as owners, have technical control over management. In practice, shareholder rights provide limited policing power. Executives themselves did not pay out of lost or foregone wages. Fourth, some of the fines could be deducted from the bank’s tax liability, effectively forcing other taxpayers to subsidize the payment. Finally, the government did not detail how the penalties compared with any ill-gotten gains. Where the gains may have exceeded the penalties, those penalties could be dismissed as a cost of doing business.

Nobody claims such crimes could be immaculate with no actual individuals responsible and accountable. Indeed, even the DoJ has claimed that it would hold individuals to account where it could prove a case. For example, in the JPMorgan settlement, the DoJ emphasized that the agreement “does not release individuals from civil charges, nor does it release JPMorgan or any individuals from potential criminal prosecution.”[145]

A. Reform Options

What should be the correct policy response to TBTF? Generally, the correct response falls into five categories: 1. Send offending individuals to prison; 2. Impose financial penalties on supervisors (in addition to shareholders); 3. Impose real penalties on companies, such as shuttering operations; 4. Require full public disclosure of settlements, including whether taxpayers are subsidizing them; and 5. End the use of deferred prosecution agreements except for systemically important institutions, and when such institutions are found to be systemically risky and prosecution is deferred, break up the bank.

i. Reform option: Convict and imprison bankers who commit serious fraud

It should be beyond debate that bank crime should be addressed with penalties that effectively deter criminal banking. Penalties serve as a deterrent, a principle repeated in virtually all DoJ press releases issued during settlements. For example, in a settlement with JPMorgan, the DoJ explains that it "should signal once again to banks ... that they cannot continue to flout legal requirements. Other servicers should take note."[146] The need for penalties as a deterrent is shared by the public, by bank regulators, by senior bankers themselves.[147] New York Federal Reserve President William Dudley explained that the "serious professional misbehavior" has led to "punishment ... to a lesser degree than I would have desired."[148] Added Federal Reserve Governor Daniel Tarullo: "It is difficult to imagine a more effective deterrent ... than prison."[149] Affirmed Ben Bernanke in his memoir, "[i]t would have been my preference to have more investigation of individual action, since obviously everything that went wrong or was illegal was done by some individual, not by an abstract firm."[150]

Without penalties, bankers confront the moral hazard that criminal operations become highly incentivized. Indeed, some of the cases revealed a parallel with the same moral hazard that applied to bank risk-taking, wherein officers felt compelled to take extraordinary risks to compete. In this context, successful competition required cheating. Loan-makers couldn't meet their quotas in feeding the securitization conveyer belt without fabricating the loan documents. An honest loan-maker could either begin cheating, or quit. Traders discovered that some of their peers were manipulating markets, such as with the London Interbank Offered Rate (LIBOR) or foreign currencies. Some of these traders decided they should either join in, or quit. “If you ain’t cheating, you ain’t trying,” said one foreign exchange trader.[151]

William Black, a professor at the University of Missouri/Kansas City, explains that milquetoast penalties invite, even demand crime. He describes this as a corollary to Gresham’s law.[152] On Wall Street, cheaters drive out honest bankers.

Granted, criminal prosecution requires an appropriately high standard for proof, which can be further challenging in a corporation with byzantine lines of responsibility. But in several cases, the DoJ has publicly identified few or sometimes no individuals as it describes the frauds. One is left to wonder if the DoJ doesn’t know of any suspects. But in at least one case, the DoJ knew exactly who committed the crime because the crime consisted of individuals committing perjury by signing documents. The DoJ found that JPMorgan Chase filed forms in bankruptcy court signed “under penalty of perjury” by “persons who had not reviewed the accuracy” of the forms. JPMorgan employees committed this perjury 50,000 times.[153] The DoJ described JPMorgan’s behavior as “shocking” and activity “we will not tolerate.”[154] Yet the DoJ elected not to charge any individual person at JPMorgan.

Such laxity stands in contrast with another case. At about the same time, federal officials arrested, prosecuted and sentenced Dallas woman Estela Martinez to 366 days in prison. The government said she made a false statement under penalty of perjury in her November 7, 2011 bankruptcy petition, in which she fraudulently concealed that she filed four other bankruptcy cases during the period 2009 through 2011.[155]

It is intuitive that punishment should fit the crime, and that a malefactor should face increasing penalties for repeat offenses.[156] If those who shoplift from a convenience store should serve time in prison, there can be no reason that a person who loots a bank should not join him. To provide for lesser penalties only invites greater crime.

The DoJ recently adopted what’s called the “Yates memo,” which directs federal prosecutors to prioritize individual accountability. It directs prosecutors not to grant leniency to company officials who cooperate with investigations unless they identify culpable employees.[157]

Public Citizen supports principles in the Yates memo and looks forward to concrete results that verify its use, namely, that with any identified bank misconduct, individuals are held to account, including any applicable jail sentences.

ii. Reform option: Impose financial penalties on supervisors

Banks that pay fines effectively make shareholders alone suffer the burden. That money comes from retained earnings that might otherwise be paid in dividends, or used to grow the business and generate more profit. Managers that committed the offenses, or failed to prevent them, do not pay the fines; fines adversely affect them only to the extent of their personal shares in the company.

The conservative Heritage Foundation concurs: "Shareholders pay huge fines, but the individuals who actually commit the fraud effectively get away with it," said David Burton, of Heritage.

> *They personally pay nothing, bear no criminal responsibility and keep working in the securities business. In practice, if you work for a large bank, commit fraud and get away with it, then you profit handsomely; if you work for a large bank, commit fraud and get caught, then the shareholders of your employer pay. This asymmetry* encourages *rather than deters fraud.*[158]

New York Fed President Dudley has proposed that part of senior bankers' pay be sequestered in a "performance bond." If the bank must pay a large fine, the bond would be forfeited and paid as part of the fine. "This would increase the financial incentive of those individuals who are best placed to identify bad activities at an early stage, or prevent them from occurring in the first place."[159] Federal Reserve Governor Tarullo supports the proposal. "If a financial firm's recruitment of young professionals is driven almost entirely by promises of the large amounts of money they can make and the speed with which they can make it, then the firm should not be too surprised when those same young professionals give short shrift to values such as respect for customers, or skirt risk-management guidelines, or perhaps even ignore regulatory and legal compliance requirements."[160]

There is basis in law to implement this proposal. One of the last remaining interagency rules required by the Dodd-Frank Wall Street Reform and Consumer Protection Act requires regulators to adopt compensation packages that remove incentives for bankers to take "inappropriate" risks. This is known in the law as Section 956. Tarullo made specific reference to this Section 956 in his speech. Criminal activity is certainly an "inappropriate" risk. In Dudley's view, high Wall Street pay attracts intelligent people whose skills are more richly compensated than if they pursue careers in other fields such as rocket science. Many are "risk-takers drawn to finance like they are drawn to Formula One racing."

Public Citizen asks regulators to ensure that senior bank pay is deferred for use in penalties for any bank misconduct carried out during the supervisor's tenure.

iii. Reform option: Stop granting waivers to penalties and other consequences called for in law

Washington's special leniency policy for Wall Street firms extends beyond the DoJ. Other agencies responsible for policing Wall Street also routinely have reduced punishments. Financial firms' daily operations are regulated by various agencies, depending on the activity. For example, conventional stock and bond trading comes under the purview of the Securities and Exchange Commission (SEC). Federal statutes and associated rules provide for penalties that the SEC oversees. Generally, these penalties can reduce dishonest activity. They serve as a deterrent. Methods include removing "bad actors" from the market, stopping the activity itself, and taking steps intended to deter those who might consider violations.

One deterrence device includes the mandatory loss of certain privileges when a firm commits a crime.[161] For example, Wall Street firms might ordinarily help a corporation sell shares to a limited number of sophisticated investors in what's called a "private placement." But if that Wall Street firm commits a crime, such as foreign exchange manipulation, the SEC automatically disqualifies it from intermediation in those private placements. The SEC explains that "the deterrent effect of a potential threat of disqualification" would ideally reduce "the number of bad actors in the securities markets."[162]

Yet with many criminal convictions and other settlements triggering these disqualifications, the SEC has waived the otherwise mandatory penalty.

For example, the government has determined that misconduct occurred at Bank of America in at least four cases since 2004.[163] The SEC might have upheld mandatory penalties, but instead waived these penalties.[164]

It is not clear exactly how many times firms have requested and received waivers as there is no standardized reporting system.[165] But waivers for penalties at the SEC have become common — the norm, in fact, explained Commissioner Kara Stein:

> *Our website is replete with waiver after waiver for the largest financial institutions. Some large firms have received well over a dozen waivers of one sort or the other over the past several years. One large financial firm alone, in a 10 year period, has received over 22 different waivers.*[166]

Commissioners Stein and Luis Aguilar have objected to these waivers, which must be approved by a majority of the five-person commission. "These disqualification and bad actor provisions have the potential for deterrence at large institutions that no one-time financial penalty could ever wield," noted Commissioner Stein. "Yet, we repeatedly relieve issuers of the supposedly automatic consequences of their misconduct."[167] U.S. Rep. Maxine Waters (D-Calif.), ranking member of the House Financial Services Committee, observed that "the SEC has granted waivers on a seeming automatic basis and done so disproportionately for large financial firms." This has led "to the public perception that these firms are 'too-big-to-bar,' " said Waters.[168]

The SEC's decisions aren't rendered separate from the DoJ actions, but form part of the negotiations with the criminal firms. The SEC's Office of Inspector General shed light on this inter-agency coordination when it examined a 2010 waiver granted to Bank of America after it was accused of lying to shareholders during its acquisition of Merrill Lynch. Before the SEC informed the public about the waiver request, SEC staff held meetings with bank attorneys and their DoJ counterparts.[169]

The Department of Labor provides the same soft-landing from sanctions for criminal mega-banks. This government agency oversees management of pension funds and other retirement savings that enjoy tax privileges. Congress approved the Employee Retirement Income Security Act (ERISA) against a backdrop of pension fund abuse.[170] The overriding mandate of ERISA is to hold pension fund managers to a high standard. In administering ERISA, the Department of Labor appropriately restricts managers of pension funds from investing in certain complex and higher risk investment strategies that may enable unscrupulous fund managers to engage in harmful activities. Such strategies may also include the managers' own investment products, an arena rife with conflict. One exception is when the asset manager wins certification as a qualified professional asset manager (QPAM). A QPAM and its affiliated firm must demonstrate financial acumen and integrity. When a QPAM or an affiliate is convicted of a crime, the QPAM automatically loses that blanket authority to invest in these complex and higher risk options. The reasons are self-evident. Convicted criminal operations should not be permitted to engage in risky investments (if they are permitted to manage money at all). A clean criminal record constitutes a bottom line requisite for sound money management. Loss of business protects beneficiaries and serves as an appropriate penalty and necessary deterrent for the industry at large.

In 2014, the Department of Justice found that Credit Suisse engaged in widespread criminal activity involving tax evasion. According to the DoJ's Statement of Facts filed in the criminal case, Credit Suisse admitted to "decades" of "knowingly and willfully" helping U.S. clients escape U.S. taxes.[171] As a result, the QPAM rule required Credit Suisse to forfeit certain QPAM privileges.[172] The DoL rules expressly name "income tax evasion" as one of the various crimes that demonstrate a loss of integrity.[173] The rule explicitly identifies infractions by both the QPAM and "any affiliate thereof."[174] Despite the criminal conviction, despite the bright lines of its own QPAM rule, the DoL excused Credit Suisse from the mandatory penalties.[175]

Confirming the joint effort by the DoJ with these other regulatory agencies, Holder explained that United States prosecutors consulted extensively with American bank regulators to ensure that the ramifications would not endanger Credit Suisse. "Because criminal charges involving a financial institution have the potential to trigger serious follow-on actions by regulatory agencies, this coordination was imperative. … The bank will move forward."[176] The prosecutors' meetings with regulators were not public, but were nevertheless central to the application of justice at these large financial institutions.

Beyond the DoJ and bank regulators, federal housing authorities have also cushioned the blow of criminal penalties. The Department of Housing and Urban Development has attempted to "sneak through" a policy change that would enable big banks convicted of felonies to continue lending through a federal mortgage program, according to critics. The housing agency has deleted a requirement for lenders to certify they haven't been convicted of violating federal antitrust laws or committing other serious crimes.[177] Though Holder has borne the brunt of public castigations in the HSBC case, culpability for the too-big-to-jail policy also rests on the shoulders of regulators and their supervisory discretion.

After the government investigated and threatened prosecution of Drexel Burnham in the mid-1980s, the firm ceased to operate. While large, the industry suffered little systemic repercussion from Drexel's demise. After the prosecution of Riggs Bank for money laundering, the bank was shuttered (and sold to PNC). Enron closed its business as well. The broader economy little noticed these events. Some criticize the government prosecution of Enron's alleged accomplice Arthur Andersen. By some accounts, this led to the firm's demise. Critics claim it caused unfair dislocation of thousands of employees innocent of the Enron accounting scandal, and the loss of a firm in an already concentrated industry.[178] Yet as soon as the Enron/Andersen "scandal broke, clients left the accounting firm in droves," according to Rena Steinzor, a professor of law at the University of Maryland and author of "Why Not Jail?"[179] And the decision to face trial rested with Arthur Andersen, which declined the government's settlement offer. At HSBC, the DoJ might have insisted on a criminal plea. If convicted, the Office of the Comptroller of the Currency would have been forced to review the charter of HSBC's American bank subsidiary. If revoked, HSBC would have been forced to disgorge that bank. While a loss to HSBC, customers would have been unaffected, as they would be served by new management, perhaps by another existing bank. For example, when Wells Fargo took over Wachovia, Wachovia customers simply became Wells Fargo customers.

Subsequent cases have served to contradict Holder's original warning that criminal pleas by a major bank would spark financial contagion. The DoJ secured criminal pleas from Credit Suisse (tax evasion)[180] and BNP Paribas (international sanctions violations).[181] No financial panic ensued. These cases subsequent to the too-big-to-jail HSBC settlement serve only to intensify concern that mega-banks enjoy judicial privilege.

Public Citizen believes regulatory agencies should enforce, not waive, mandatory penalties for banks. A bill introduced by U.S. Rep. Maxine Waters (D-Calif.) would require all five SEC commissions to agree to a waiver, a measure that effectively gives each commissioner a veto.

iv. Reform option: Prohibit corporations from taking tax deductions for fines

The tax code allows corporations to deduct any settlement payments classified as restitution or compensation, but prohibits them from deducting payments classified as penalties or fines. A bill introduced by U.S. Sen. Elizabeth Warren (D-Mass.) would require prosecutors to detail precisely what can be deducted in any settlement.[182] The Senate cleared the bill in September 2015.

Public Citizen calls for an end of deductions for any restitution or compensation associated with penalties.

v. Reform option: Require bank break-up where deferred prosecution finds that a criminal prosecution would lead to systemic repercussions

Though then-Attorney General Holder subsequently denied that any bank was "too big to jail," it is irrefutable that the DoJ communicates with other agencies regarding the various penalties that apply following misconduct. As such, it is difficult to dismiss the possibility that deferred prosecution agreements reflect advice by regulators that a prosecution and criminal conviction would lead to systemic repercussions. If such a policy exists, Congress should take steps to require the DoJ to publicly disclose if and when it is providing favorable treatment under the law to financial institutions. That way, the DoJ's charging decisions will be transparent to the public, and Congress will be able to appropriately exercise its oversight authority over the DoJ.

Ideally, deferred prosecution agreements should be banned. Where government officials believe a full prosecution would lead to systemic repercussions, which they should disclose publicly, Congress should provide that the agreement requires corporate dismantlement so that the remaining parts of the firm are no longer "too big to jail."

Public Citizen calls for an end to deferred prosecution agreements except in cases where the government finds a full prosecution would lead to systemic repercussions, in which case, the agreement must require a bank break-up.

III. Problem: Too Big to Manage (TBTM)

The most charitable defense for why the U.S. Department of Justice (DoJ) has not charged, tried and jailed senior bankers (such as any of the 100 most senior officials of a major bank) for the massive financial frauds leading to the mortgage crisis and subsequent London Interbank Offered Rate (LIBOR), foreign exchange, and money laundering cases is that these executives were neither responsible nor aware of this activity. In other words, they were incapable of detecting this widespread internal misconduct. The banks were too big to manage.

By any measure, the major banks are enormous. This size defies the ability of any manager or management team to comprehend and control all aspects of operations, or even keep them within legal boundaries. "They are so big and complex that top management cannot understand, manage and control what is happening," concluded MIT professor Simon Johnson.[183]

The assets of the three largest banks — JPMorgan, Bank of America, and Citigroup — are each around $2 trillion. That's two thousand billion dollars. By contrast, Warren Buffet's Berkshire Hathaway conglomerate which controls all or parts of Heinz, Geico, Clayton Homes, Johns Manville, General Electric, Coca Cola, American Express and many others, has total assets of $530 billion.[184] The mega-banks operate through thousands of subsidiaries. Even short of total failure and massive fraud, operational mistakes are inevitable and abundant.

Bank of America acknowledged an accounting error of $4 billion. *The New York Times* wrote that "the disclosure of the accounting error will most likely add fuel to the debate over whether the nation's largest banks are too big and complicated to manage."[185] Bank of America has consistently ranked low in customer satisfaction.[186] Former Citigroup CEO Charles Prince was not even aware his bank was holding a large book of mortgages, let alone that they ultimately proved toxic.[187] JPMorgan, once considered the best-managed bank in the nation, lost $6 billion from a single London swaps trading desk.[188] This "London Whale" loss, discussed in the prologue, demonstrated that senior management could not understand an "egregious" mistake without months of study.[189] To some, these senior bankers are "captured by their quants," referring to the computation mathematicians who devise and executive the complex trading models. Traders may "go rogue" and jeopardize an entire bank.[190]

The major banks organize their business through subsidiaries. These number in the thousands. JPMorgan reports 3,391 separate subsidiaries. Bank of America has 2,019 subsidiaries. The seven largest banks together oversee more than 19,000 subsidiaries.[191] It is simply beyond comprehension that a single CEO of one of these banks would even recognize whether or not the bank controlled all of the 19,000 subsidiaries listed in a book, let alone be able to report on the condition of any single one of the banks.

Stock market valuations affirm that these firms are mismanaged. Stocks at Bank of America and Citigroup trade well below levels they reached before the financial crash. BoA's stock has traded below $15 a share for years. Before the financial crash and acquisition of Merrill Lynch, the stock traded above $50. The stock price of JPMorgan has recovered, but lags that of the average company, as measured by the S&P or Dow. Goldman Sachs and Morgan Stanley also trade below their pre-crash levels. Wells Fargo, which has the least exposure to riskier investment banking, has fared the best.

Bank	**Stock price, May 1, 2007**	**Stock price, February 3, 2016**
Citigroup	$491	$40
Bank of America	$51	$13
JPMorgan	$52	$57
Wells Fargo	$36	$48
Goldman Sachs	$219	$153
Morgan Stanley	$84	$24
Dow Jones	13,136	16,367

Source: Yahoo Finance

Another sign that shareholders hold a dim view of the manageability of mega-banks is the value of the company's stock relative to its book value. Book value refers to the value of a firm's assets, less its liabilities. In a promising firm, investors believe that future operations will generate increasing profits. In accounting terms, this means that investors are willing to pay more for the company than the firm's book value. But at the major banks, the opposite is true. For example, investors in Bank of America believe that the firm would be worth more in parts. The difference between the firm's assets and liabilities is greater than the stock market value of the firm. If the company is liquidated, with the $2.1 trillion in assets sold to pay off the $1.86 trillion in liabilities (deposits, bonds, etc.), this will leave a net of $240 billion.[192] But the stock is only worth about $160 billion. If an acquirer bought all the stock, liquidated all the assets, the net would be more than $80 billion.

Bank of America earns (in after-tax income) 0.23 percent on these $2.1 trillion in assets. Imagine a factory that costs $2.1 trillion that only returns 0.23 percent on that investment each year.[193] Microsoft generates 8.8 percent on its assets,[194] contrasted with BoA's 0.23 percent. Much of this difference between Microsoft and BoA is explained by the bank's massive $1.86 trillion in debt. After servicing that debt, there is little left for shareholders. But if the major banks simply borrowed money from depositors at a rate 1 percentage point lower than they invested in, say, U.S. Treasury bonds, that 1 percent of $2 trillion would yield $20 billion. In fact, that's roughly what JPMorgan — the most skillfully managed bank in the nation, it claims — has earned for the last five years.[195] In other words, these massive firms with enormous technological advantages, with offices that span the globe, with highly skilled personnel, accomplish little better than the risk-averse investor who buys U.S. Treasury notes.

Reform Option

In addition to pressing for legislative and regulatory reform, investors should use their ownership rights to make changes.

Analysts affirm the mega-banks would be worth more in pieces. Goldman Sachs analysts described in detail why this was true for JPMorgan.[196] General Electric, which controlled GE Capital, a major financial firm, announced it would shed this division and the stock soared on the announcement.[197] Investor Carl Icahn believes insurance giant AIG, another financial firm, would be worth more in parts.[198] In 2015 and 2016 this author submitted resolutions to Bank of America, JPMorgan and Citigroup to consider a break up. The initiative built on similar efforts originated by the AFL-CIO.[199]

Public Citizen supports all government measures to break up the mega-banks, as discussed above. We also support shareholder initiatives to break up these banks. We urge shareholders, including those who own mutual funds, to contact their broker or mutual fund to insist they vote the shareholders interest, not those of the mega-banks.

IV. Problem: Too Big to Regulate (TBTR)

In their current state, the largest banks are too big to regulate. The 2008 crash alone attests to this grim reality.

Some of the regulatory challenges are obvious. For example, if a proportionate number of examiners were sent to the largest banks as to small community banks, 70,000 examiners would be required at Citigroup alone, calculated FDIC Vice Chair Tom Hoenig.[200] Instead, Citi is overseen by 20 inspectors from the Federal Reserve and another 70 from the Office of the Comptroller of the Currency.

These regulators cannot and do not catch all problems before they threaten bank safety. Regulators failed to understand JPMorgan's "London Whale" positions (as the bank managers themselves also failed to understand.) Regulators did not understand for several years that Bank of America overstated its value by billions of dollars.[201] Whistleblowers and the media, not regulators, first caught wind of problems such as manipulation of LIBOR and foreign exchange markets, which were criminal activities that were discovered following the 2008 financial crash.

Dodd-Frank provides new tools and powers for regulators. As noted, Dodd-Frank permits the regulators to break up the largest banks (under Section 165, "Living Wills") if they cannot prove they can fail without causing dangerous systemic tremors.

But these tools and powers assume regulators can and will deploy them. Regulators may suffer from "capture" by the industry. Instead of policing the industry, the police can be controlled by the industry, according to this view. "Regulatory capture is a real threat to our agencies and the banking system we oversee," said Comptroller of the Currency Tom Curry.[202] Former Treasury Secretary Timothy Geithner wrote that the banking regulators are "full of real and perceived sources of capture."[203]

One vector of capture, a factor that leaves regulators especially vulnerable to influence, comes from the so-called revolving door. This is shorthand for the practice of mid-career regulators leaving the government for a better paying job on Wall Street. During the debate over the Dodd-Frank, Public Citizen and the Center for Public Integrity calculated that nearly 1,500 lobbyists pressing Wall Street's case on the bill had previously worked for the federal government.[204] The door spins both ways, as senior bankers may take important posts in the government.[205] Attorney General Holder came from and returned to the law firm of Covington & Burling, a firm that represents large banks. SEC Chair Mary Jo White came from Debovoise & Plimpton, where she personally represented Bank of America. This revolving door can mean that the regulator and those they regulate socialize, attend each others' children's birthday celebrations, share vacations, and even marry. SEC Chair White's husband works for Cravath, Swaine & Moore, which also represents banks along with the accounting firms that audit them. In this case, the SEC chair's decisions may affect her own family income, which is likely largely derived from her husband's private sector employment.

The case of Carmen Segarra dramatized regulatory capture in operation.[206] Carmen Segarra spent seven months, beginning in October 2011, as a senior bank examiner at the New York Federal Reserve Bank. The New York Fed is one of the front-line supervisors of the big Wall Street banks. Segarra took the job after positions at Citigroup, Societe General, and MBNA, and after attending Harvard, Columbia and Cornell. The NY Fed assigned her to help oversee Goldman Sachs. While there, she uncovered serious problems. In a chain of events, when she brought these problems to her supervisors, they fired her.

In 2013, Segarra sued the New York Fed and several of her supervisors.[207] She outlined episodes in which her bosses blocked her efforts to ask tough questions or promote better policies at Goldman Sachs. For example, Goldman worked for El Paso Corp as an advisor as it bid for Kinder Morgan, Inc. Advisors help buyers secure the lowest price and best conditions. But Goldman also owned some $3 billion worth of Kinder, and a Goldman banker held a sizable personal stake in Kinder. Sellers want the highest price when they sell. Segarra questioned Goldman's conflict-of-interest policy. But she says her bosses demanded that she soften her memorandum on the issue. In September 2014, Segarra released audio tapes of the meetings she described. The conversation with her boss proved so compelling as to prompt a congressional hearing.[208] The Fed supervisor who urged her to soften the memo subsequently took a job with a financial firm.[209]

In some cases, bankers who would otherwise forfeit deferred compensation may keep these sums provided they leave for government jobs. JPMorgan and Morgan Stanley also provide special financial rewards to executives who become senior government officials.[210] Recently appointed officials to the Department of the Treasury, the State Department, and other agencies cashed in on rewards when they joined the Obama administration. Current Treasury Secretary Jack Lew received an exit package worth more than $1 million from Citigroup shortly before joining the Obama administration in 2009. His exit package explicitly stated that the retention compensation would be forfeited unless he secured position within government. This type of bonus, received more public attention when Antonio Weiss, a former investment banker at Lazard who was nominated for Treasury Undersecretary for Domestic Finance, acknowledged in financial disclosures that he would be paid $21 million in unvested income and compensation upon exiting Lazard for a full-time job in government. (Weiss withdrew his nomination and accepted a separate position as counselor to Lew.)[211] "Only in the Wonderland of Wall Street logic could one argue that this looks like anything other than a bribe," wrote Sheila Bair, former FDIC Chair.[212]

Reform Options

Public Citizen believes the revolving door must not spin so easily. Public Citizen worked with U.S. Sen. Tammy Baldwin (D-Wis.), and U.S. Rep. Elijah Cummings (D-Md.) to introduce legislation to address these problems. The Financial Services Conflict of Interest Act bans the banker bonuses and institutes a cooling-off period that prevents bank regulators from taking Wall Street jobs for two years after leaving government.[213] The legislation enjoys the endorsement of both Democratic presidential candidates.[214]

Public Citizen endorses legislation to end the revolving door that compromises regulatory independence and zeal. We urge our members and support-

ers to contact their member of Congress to endorse this legislation.[215]

Public Citizen also supports the President's Executive Order 13490. This restricts presidential appointees entering government from industry.

Conclusion

America's largest banks are too big – too big to fail, too big to jail, too big to manage, too big to regulate.

Why do these problems persist? Generally, problems persist because the remedies are stymied and the economic immune system is itself impaired. Shareholders might approve a break-up, but many shares are voted by the mega-banks themselves. JPMorgan controls mutual funds for its customers, and some of these funds hold shares in JPMorgan, and Bank of America and Citigroup. Washington's law enforcers should prosecute bankers and regulators should enforce penalties. But some of these law enforcers are conflicted. Regulators should be aggressive, but many are "captured" by industry, sliding through the revolving door to higher paying private sector jobs with the very banks they regulate. Lawmakers should pass legislation to break up these banks. But many receive generous campaign contributions from these mega-banks. Finally, financial reform issues can be complex and inherently unfriendly for kitchen table conversation. Whether the nation should go to war, or legalize certain drugs, or change immigration policy naturally and should enjoy widespread debate; but so, too, should Wall Street reform.

Congress responded to the 2008 crash with the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. But this does not complete the needed reform. We believe there remains the political will. Congress waited four years after the 1929 crash to approve a new banking law. Republicans controlled both the White House and Congress in the first years after the Great Crash and didn't support Wall Street reform. Democrats took control in 1933. Congress approved another reform bill, namely the Securities Exchange Act in 1934. In other words, the 2008 crash may yet be translated into the political will to deliver more reform than what was approved two years after the 2008 crash.

Let this Public Citizen compellation of reform ideas serve as the blueprint for a Congress and a President prepared to complete the job and make good on the pledge that never again will America be held hostage to a bank that's too big to fail, too big to jail, too big to manage, and too big to regulate. Too big ... must not be.

Summary of Public Citizen's Blueprint for Wall Street Reform

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act represents real progress in improving banking, but further reform is necessary. The following is a summary of the policy options that provide a blueprint for additional Wall Street Reform:

- *Capital levels at 20 percent.*
- *A vigorously enforced Volcker Rule. This should include better public reporting of compliance.*
- *A reinstatement of a strengthened version of Glass-Steagall that includes a limitation on bank derivatives activities and a clear separation between banking and commerce.*
- *A break up of systemically important financial institutions.*
- *Principles in the Yates memo and looks forward to concrete results that verify its use, namely, that with any identified bank misconduct, individuals are held to account, including any applicable jail sentences.*
- *Regulators to ensure that senior bank pay is deferred for use in penalties for any bank misconduct carried out during the supervisor's tenure.*
- *Regulatory agencies should enforce, not waive, banks from the mandatory penalties. A bill introduced by U.S. Rep. Maxine Waters (D-Calif.) would require all five SEC commissions to agree to a waiver, a measure that effectively gives each commissioner a veto.*
- *An end of deductions for any restitution or compensation associated with penalties.*
- *An end to deferred prosecution agreements except in cases where the government finds a full prosecution would lead to systemic repercussions, in which case, the agreement must require a bank break-up.*

- *All government measures to break up the mega-banks, as discussed above. We also support shareholder initiatives to break up these banks. We urge shareholders, including those who own mutual funds, to contact their broker or mutual fund to insist they vote the shareholders interest, not those of the mega-banks.*
- *Legislation to end the revolving door that compromises regulatory independence and zeal. We urge our members and supporters to contact their member of Congress to endorse this legislation.*
- *The President's Executive Order 13490. This restricts presidential appointees entering government from industry.*

Appendix I

What Leaders Say About Glass-Steagall

Name and Link to Quote	Title	Quote
Brooksley Born	Former Chairman of the Commodity Futures trading Commission	"Banks must be 'tasked with the job of deciding how best to split themselves up' under the supervision of regulators. … There should be rules imposed, perhaps something like Glass-Steagall."[216]
Maria Cantwell	U.S. Senator (D-Wash.)	"So much U.S. taxpayer-backed money is going into speculation in dark markets that it has diverted lending capital from our community banks and small businesses that depend on loans to expand and create jobs. This is stifling America and it is why there is bipartisan support for restoring the important safeguards that protected Americans for decades after the Great Depression. It's time to go back to separating commercial banking from Wall Street investment banking."[217]
Ben Carson	Republican Presidential Candidate	"The Glass-Steagall Act was a very appropriate reaction to the inappropriate use of people's personal funds by investment bankers after the Great Depression. It basically represented a minimal level of government oversight to protect the hard earned money of American citizens."[218]
Newt Gingrich	Former Speaker of the House (R-Ga.)	"I think, in retrospect, repealing the Glass-Steagall Act was probably a mistake. We should probably reestablish dividing up the big banks into a banking function and an investment function and separating them out again."[219]
Tom Harkin	Former U.S. Senator (D-Iowa)	Sponsored "Return to Prudent Banking Act," which generally restores Glass Steagall.[220]

Leaders (continued)

Thomas Hoenig	Vice Chair of the FDIC	"I have a proposal to strengthen the U.S. financial system by simplifying its structure and making its institutions more accountable for their mistakes. Put simply, my proposal would help prevent another 2008-style crisis by prohibiting banking organizations from conducting broker-dealer or other trading"[221] activities and by reforming money-market funds and the market for short-term collateralized loans (repurchase agreements, or repos). In other words, Glass-Steagall for today."
Steny Hoyer	U.S. Representative (D-Md.)	"As someone who voted to repeal Glass-Steagall, maybe that was a mistake."[222]
Jon Huntsman	Republican Former Governor of Utah	"I want to return to the spirit of Glass-Steagall.... You've got to look at, fundamentally look at, downsizing some of our banks, looking at some sort of a cap requirement on the size of things. When you have financial institutions of which there are six and any one of them collapsing could cause such dire reverberations in the global economy that it could be catastrophic, it becomes too big to fail. ... Not Glass-Steagall from the 1930s but something in the spirit of Glass-Steagall, something that would ultimately right-size banks."[223]
Simon Johnson	MIT Economist	"The biggest U.S. banks have become too big to manage, too big to regulate, and too big to jail. At a stroke, the proposed law would force global megabanks such as JPMorgan Chase and Bank of America to become smaller and much simpler — divorcing high risk activities from plain-vanilla traditional banking. Their failures would no longer threaten to bring down the economy."[224]
Marcie Kaptur	U.S. Representative (D-Ohio)	"After Wall Street's 2008 economic collapse led to the Great Recession, it has become evident that to move forward, we must return to the past to ensure a safe, viable financial system for a 21st-century American economy. We must reinstate the Glass-Steagall Act of 1933."[225]
Dennis Kelleher	President and Chief Executive of Better Markets Inc.	"If Glass-Steagall hadn't been repealed, there's little doubt it would have lessened the depth and breadth of the 2008 financial crisis, which has cost our country trillions of dollars and caused tens of millions of people to lose their jobs, homes, savings and much more."[226]

Leaders (continued)

Angus King	U.S. Senator (I-ME)	"In order to address our nation's problems, Congress must be willing to look beyond party ideology and reach agreements that reflect the best interests of the American people. The 21st Century Glass-Steagall Act is just that. Our bill represents bipartisan, common-sense solution that, if passed, would help prevent another financial meltdown, like the one we saw five years ago, without placing unnecessary burdens on small banks."[227]
John McCain	U.S. Senator (R-Ariz.) and Republican Former Presidential candidate. Co-sponsored bill to reinstate Glass-Steagall.	"Since core provisions of the Glass-Steagall Act were repealed in 1999, shattering the wall dividing commercial banks and investment banks, a culture of dangerous greed and excessive risk-taking has taken root in the banking world ... Big Wall Street institutions should be free to engage in transactions with significant risk, but not with federally insured deposits."[228]
Martin O'Malley	Democratic Former Governor of Maryland and Presidential Candidate	"We made a commitment to the American people that we'd follow through on Wall Street reform, and we have not done that yet ... Any Democrat running for president who expects to succeed in the general election I believe will need to make basic commitments ... to pass a modern version of Glass-Steagall."[229]
Saule Omarova	Banking and Financial Law Scholar	"Well, personally, I think that the proposed bill on the 21st century Glass-Steagall Act is a move potentially in the right direction."[230]
Richard Parsons	Former Chairman of Citigroup	"To some extent what we saw in the 2007, 2008 crash was the result of the throwing off of Glass-Steagall. ... Have we gotten our arms around it yet? I don't think so because the financial-services sector moves so fast."[231]
Rick Perry	Republican Former Governor of Texas	"We could once again require banks to separate their traditional commercial lending and investment banking and related practices."[232]
Nomi Prins	Financial Journalist, and Author	"What we need is a resurrection of the Glass-Steagall Act. We need to realize it wasn't just a law, it was a policy of stability."[233]

Leaders (continued)

John S. Reed	Former Chairman of Citigroup	"As another older banker and one who has experienced both the pre- and post-Glass-Steagall world, I would agree with Paul A. Volcker (and also Mervyn King, governor of the Bank of England) that some kind of separation between institutions that deal primarily in the capital markets and those involved in more traditional deposit-taking and working-capital finance makes sense. This, in conjunction with more demanding capital requirements, would go a long way toward building a more robust financial sector."[234]
Paul Ryan	U.S. Representative (R-Wis.), Chairman of the House Committee on Ways And Means and Former Vice Presidential Candidate	CALLER: Hasn't there been a separation with the removal of Glass-Steagall and the uptick rule to let Wall Street go wild? When is someone going to put that back in place? We need to put that back in place to help stabilize things. RYAN: Yeah, I agree with that. [...] Mixing banking and commerce, meaning allowing banks to go do non-banking activities, by leveraging their deposits. [...] The way I look at this, there's a lot of merit to what you just said. [...] If banks want to make hedge fund-like returns, then they should go be a hedge fund. But if you want to be a bank, then be a bank. Don't try to be a hedge fund and take undue risks with your depositors' money."[235]
Bernie Sanders	U.S. Senator (I-VT) and Presidential Candidate	"Today, not only must we reinstate this important law, but if we are truly serious about ending too big to fail, we have got to break up the largest financial institutions in this country."[236]
Richard L. Trumka	President, AFL-CIO	"The Volcker rule provision in the Dodd-Frank Act that will restrict speculative trading by banks is a good start. Bank regulators must resist the ongoing demands from Jamie Dimon and other Wall Street CEOs to water down this rule. But Congress should go a step further, and pass a new Glass-Steagall Act to separate high-risk investment banking from more traditional banking activities."[237]
Elizabeth Warren	U.S. Senator (D-Mass.). Co-Sponsored bill to reinstate Glass-Steagall.	"JPMorgan's recent losses show that there are still serious risks in our banking system, and if we don't act, then the next trade that goes bad could threaten our whole economy." "A new Glass-Steagall would separate high-risk investment banks from more traditional banking. It would allow Wall Street to take risks, but not by dipping into the life savings and retirement accounts of regular people."[238]

Leaders (continued)

Sanford I. Weill	Former Citigroup Chairman & CEO	"I'm suggesting that they [banks] be broken up so that the taxpayer will never be at risk, the depositors won't be at risk, the leverage of the banks will be something reasonable, and the investment banks can do trading, they're not subject to a Volker rule, they can make some mistakes, but they'll have everything that clears with each other every single night so they can be mark-to-market."[239]
George Will	Conservative Columnist	"By breaking up the biggest banks, conservatives will not be putting asunder what the free market has joined together."[240] Government nurtured these behemoths by weaving an improvident safety net and by practicing crony capitalism."

Appendix II

Shareholder Resolutions to Break up the Mega-Banks

Shareholder resolution at JPMorgan, spring 2016

Resolved, that stockholders of JPMorgan Chase & Co. urge that:

1. The Board of Directors should appoint a committee (the 'Stockholder Value Committee') composed exclusively of independent directors to address whether the divestiture of all non-core banking business segments would enhance shareholder value.
2. The Stockholder Value Committee should publicly report on its analysis to stockholders no later than 300 days after the 2016 Annual Meeting of Stockholders, although confidential information may be withheld.
3. In carrying out its evaluation, the Stockholder Value Committee should avail itself at reasonable cost of such independent legal, investment banking and other third party advisers as the Stockholder Value Committee determines is necessary or appropriate in its sole discretion.

For purposes of this proposal, “non-core banking operations” mean operations that are conducted by affiliates other than the affiliate the corporation identifies as JPMorgan Chase Bank, N.A., which holds the FDIC Certificate No 628.

Supporting Statement

The financial crisis that began in 2008 underscored potentially significant weaknesses in the practices of large, inter-connected financial institutions such as JPMorgan. As the financial crisis unfolded in 2008, JPMorgan stock fell from $49.63 on Oct 1, 2008, to $15.93, on March 6, 2009.

The crisis revealed that some banks were “too big to fail,” which was a moral hazard that invited such institutions to take extraordinary risks with an understanding that they’d be rescued by taxpayers in the event of failure. This risk-taking proved especially lethal with the ability of banks to use abundant, low-cost, federally insured deposits for derivatives speculation. Such activity was previously proscribed by rule and law generally described as “Glass Steagall.” The crisis prompted questions about how to regulate “too big to fail” institutions such as JPMorgan and about whether it made sense to allow financial institutions to engage in both traditional banking and investment banking activities, which had previously been barred by the Glass-Steagall Act.

Congress sought to address these concerns with the Dodd-Frank Act in 2010.

We are concerned that current law may not do enough to avert another financial crisis and damage JPMorgan value. Our concern too is that a mega-bank such as JPMorgan may not simply be “too big to fail,” but also “too big to manage” effectively so as to contain risks that can spread across JPMorgan’s business segments. JPMorgan’s London Whale episode led to losses of more than $6 billion, and send the stock price down more than 20 percent.

Further, shareholders have paid more than $20 billion in fines because bank managers failed to prevent misconduct related to Bernie Madoff’s Ponzi scheme, mortgage securities sales, energy market manipulation, military lending, foreclosures, municipal securities, collateralized debt obligations, mortgage servicing, foreign exchange rigging, and more.

An analysis by Goldman Sachs shows that JPMorgan would be worth more if broken up owing to tighter regulations required for the largest banks.

We therefore recommend that the JPMorgan act to explore options to split the firm into two or more companies, with one performing basic business and consumer lending with FDIC-guaranteed deposit liabilities, and the other businesses focused on investment banking such as underwriting, trading and market-making.

We believe that such a separation will reduce the risk of another financial meltdown that harms depositors, shareholders and taxpayers alike; in addition, given the differing levels of risk in JPMorgan’s primary business segments, divestiture will give investors more choice and control about investment risks.

Shareholder resolution at Bank of America, spring 2015[241]

Resolved, that stockholders of Bank of America Corporation urge that:

1. The Board of Directors should promptly appoint a committee (the 'Stockholder Value Committee') composed exclusively of independent directors to develop a plan for divesting all non-core banking business segments.
2. The Stockholder Value Committee should publicly report on its analysis to stockholders no later than 300 days after the 2015 Annual Meeting of Stockholders, although confidential information may be withheld.
3. In carrying out its evaluation, the Stockholder Value Committee should avail itself at reasonable cost of such independent legal, investment banking and other third party advisers as the Stockholder Value Committee determines is necessary or appropriate in its sole discretion.

For purposes of this proposal, "non-core banking operations" means operations that are conducted by affiliates other than the affiliate the corporation identifies as Bank of America, N.A., which holds the FDIC Certificate No 3510.

Supporting Statement

The financial crisis that began in 2008 underscored potentially significant weaknesses in the practices of large, inter-connected financial institutions such as Bank of America, which for a time saw its stock price cascade from $39.74 on Feb. 1, 2008, to $3.95 on Feb. 1, 2009. The crisis prompted questions about how to regulate "too big to fail" institutions such as Bank of America and about whether it made sense to allow financial institutions to engage in both traditional banking and investment banking activities, which had previously been barred by the Glass-Steagall Act. Of particular concern was the fact that derivatives trading activities could be funded by FDIC-insured deposits, which would then be placed at risk if there were significant losses.

Congress sought to address these concerns with the Dodd-Frank Act in 2010, which reformed regulation of financial institutions.

We are concerned that current law may not do enough to avert another financial crisis. Our concern too is that a mega-bank such as Bank of America may not simply be "too big to fail," but also "too big to manage" effectively so as to contain risks that can spread across BoA's business segments. We therefore recommend that the board act to explore options to split the firm into two or more companies, with one performing basic business and consumer lending with FDIC-guaranteed deposit liabilities, and the other businesses focused on investment banking such as underwriting, trading and market-making.

We believe that such a separation will reduce the risk of another financial meltdown that harms depositors, shareholders and taxpayers alike; in addition, given the differing levels of risk in BoA's primary business segments, divestiture will give investors more choice and control about investment risks.

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