



A Holiday Reader

This summer, we sent out a “Summer Reader” of articles and commentary published in response to the Dallas Fed’s recommendation that banks considered “too big to fail” (TBTF) be downsized and restructured. The debate over this issue has continued and recently intensified. It has developed significantly since we broached the subject on July 23, 2009, in a speech titled, “Two Areas of Present Concern: the Economic Outlook and the Pathology of Too-Big-to-Fail.”

For your Holiday reading pleasure, we have culled a compendium of commentary, both pro and con, from hundreds of articles written since summer. TBTF will remain on the front burner of financial services reform. We will keep you informed regarding the evolution of thought on this important topic.

Happy Holidays to all,
Richard W. Fisher

President & CEO, Federal Reserve Bank of Dallas



Holiday 2012 Reading List

Choosing the Road to Prosperity: Why We Must End Too Big to Fail – Now



This presentation includes links to recommended reading, following the publication of the Dallas Fed's 2012 *Summer Reading List*



Sparking Public Debate About TBTF

In March 2012, the Dallas Fed published its [Annual Report](#) addressing TBTF.

The “end TBTF” message sparked media coverage in:

- | | | |
|------------------------|-------------------------|---------------------------|
| ✓ <i>Forbes</i> | ✓ <i>CNBC</i> | ✓ <i>Wall St. Journal</i> |
| ✓ <i>Rolling Stone</i> | ✓ <i>NPR</i> | ✓ <i>American Banker</i> |
| ✓ <i>PBS Frontline</i> | ✓ <i>New York Times</i> | ✓ <i>The Deal Economy</i> |

A follow-up article went to print two weeks later:

[“How Huge Banks Threaten the Economy”](#)

by **Richard W. Fisher**, Dallas Fed President & CEO,
and **Harvey Rosenblum**, Dallas Fed Executive VP & Director of Research,
April 4, 2012, *Wall Street Journal* Op-Ed

- Filled in some important “next steps” from the Annual Report
- Market-focused breakup of TBTF banks far less radical than quasi-nationalization ('08–09)



Sparking Public Debate About TBTF

Dallas Fed [presentation](#), May 1, 2012

39 slides including some *guiding principles for financial system reform*

Change the “do-or-die” decisionmaking paradigm

- Reduce the likelihood of politics driving taxpayer assistance

End banking oligopoly power

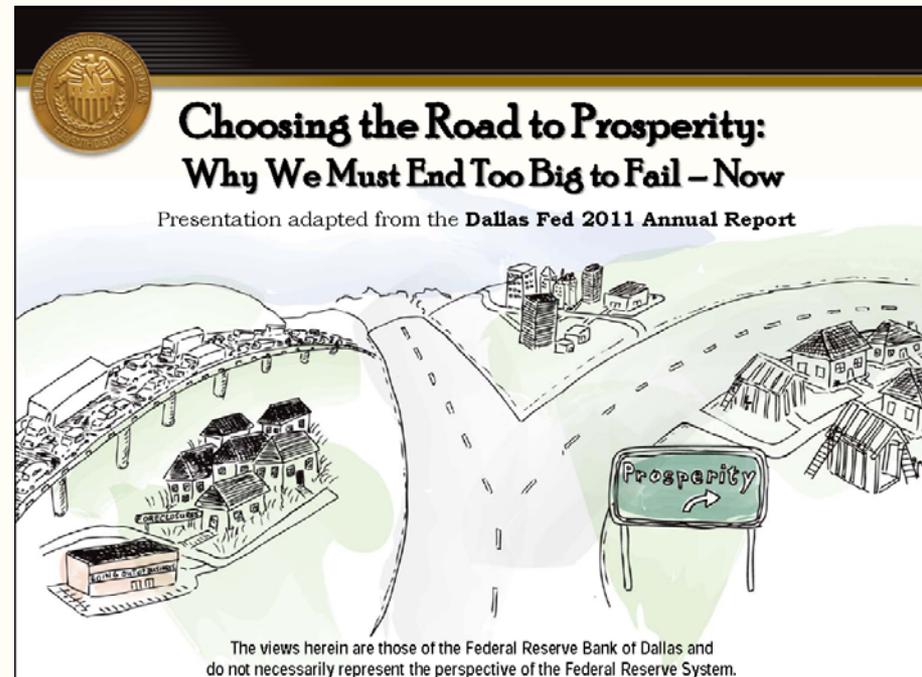
- Reduce concentration & TBTF subsidies

Harness market forces and incentives

- Limit the federal safety net to depository institutions—and NOT their affiliated companies, creditors or counterparties

Punish failure quickly

- Specify, *in advance*, harsh, nonnegotiable consequences for requesting or requiring taxpayer assistance





The TBTF Debate—Summer 2012

Numerous articles by others hit newswires through the summer, prompting a [Dallas Fed Summer Reading List](#) delineating some of the major stories

Major themes advanced to end TBTF included:

- *“Too Big to Govern,” “Too Big to Insure/Hedge,” “Too Big to Manage”*
- Taxpayers should never underwrite the mismanagement or overreach of any firm
- Big banks enjoy “TBTF subsidy” and new, complex regulatory burdens disadvantage community banks—unintended consequences of Dodd–Frank (DFA) overhaul
- Decreased concentration and complacency will benefit competition—a boon for small businesses and U.S. growth
- **Size** and **scale** may be the *problem*, not the *advantages* they are thought to be
- “Right-sizing” megabank institutions will help get back to the basics of good banking judgment and “knowing your customer”



The TBTF Debate—Summer 2012

Some prescriptions for policy included:

- **Regulate and understand** how much risk banks are taking in **total** and require enough **capital** to support that risk
- Dodd–Frank’s “**living wills**” give regulators the power to simplify big banks
- Policy cannot protect the franchises of oligopoly atop the financial sector—need **enhanced disclosure** and **market discipline**, more rigorous regulation and the **credible end to implicit government backing** for this hegemony of megabanks
- Separate the lending culture from the culture of investment, hedging and speculative services (**Glass–Steagall 2.0**)
- **Shareholders** should push for downsizing the big banks: The sum of the parts may be more valuable than the whole
- The efficient and transparent way to wind down failed institutions and protect taxpayers is through **bankruptcy**, not bailouts
- Reintroduce the **SAFE Banking Act**: cap leverage and liabilities of largest banks



The TBTF Debate Continues

Since the summer, more concerns have been voiced about TBTF:

“Too big to manage or regulate are what matter now”

by Philip Augar, British author and former investment banker,
June 28, 2012, *Financial Times* Op-Ed

- Megabanks, as they are currently constructed, are “unmanageable” and have a “warped culture.”
- Recommendations:
 - Banks’ integrated business structure needs to be revisited.
 - The burden of proof must be on the banking industry to regain public trust.
 - The industry has to be serious about cultural change/reforming incentives.

“Banks Risk Distorting Our Democracy: Stiglitz”

by Katy Barnato, June 29, 2012, *CNBC*

- “If we continue on the current course, the financial system will not be serving the rest of our economy, the economy will be weak. Inequality will be greater, and we are paying a very high price for this inequality.”



The TBTF Debate Continues

“Woodrow Wilson knew how to beard behemoths”

by Sebastian Mallaby, senior fellow at the Council on Foreign Relations, July 5, 2012, *Financial Times* Op-Ed

- Firewall between “deposit-taking high street lenders, who ought to be cautious, and risk-hungry investment banks” is a step in the right direction, but such separations would likely melt during a crisis.
- “Political leaders need a modern version of Woodrow Wilson’s dictum [for business but against monopolies]. ... Today’s leaders must be *for finance* but *against banking behemoths*. ... The structure of modern finance—vast institutions that borrow cheaply because taxpayers are on the hook to save them—is an abomination that must stop.

“Breaking up the banks will win investors’ approval”

by Sebastian Mallaby, July 17, 2012, *Financial Times*

- “Among equity investors, breaking up banking behemoths is increasingly regarded as desirable; by contrast, boosting banks’ capital is anathema.”



The TBTF Debate Continues

“Barclays Bank Bash”

July 5, 2012, *WSJ* Editorial

- Accusations against Barclays regarding attempted defrauding of the LIBOR market has led to a media frenzy regarding the culture of corruption in banking and is yet “another reason why it's essential to return to a system that allows giant financial houses to fail.”
- “In a world of open competition and smaller taxpayer safety nets, market players can make honest judgments about the value they get from giant banks. ... In today's world, regulation essentially locks the incumbent giants in place by giving them implicit and explicit advantages over smaller rivals.”

“The Soviet Banking System—and Ours”

by Judy Shelton, senior fellow at the Atlas Economic Research Foundation,
July 24, 2012, *WSJ* Op-Ed

- Fed has become too big of a player in today’s financial markets, with the greatest impact among the larger institutions that bet on financial derivatives instead of engaging in lending to job-creating entrepreneurs



Sandy Weill Break-Up Bombshell

[“Wall Street Legend Sandy Weill: Break Up the Big Banks”](#)

July 25, 2012, *CNBC*

- Former Citigroup Chairman and CEO Sandy Weill, the man who “invented the financial supermarket,” called for breaking up the biggest banks
- Weill said, “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 Puts Glass-Steagall Back on Washington’s Agenda”](#)

by **Kevin Wack**, July 25, *American Banker*

[“Big-Bank Pioneer Now Sees Breakup”](#)

by **E.S. Browning and David Benoit**, July 26, *WSJ*

[“The Big Banker’s Change of Heart”](#)

July 26, *New York Times* Editorial

[“No Great Divide at Citi”](#)

by **Francesco Guerrera**, July 30, *WSJ*



The TBTF Debate Continues

“For Megabanks, It’s Time to Shape Up or Break Up”

by **Barbara Rehm**, July 25, 2012, *American Banker* Editorial

- “The industry's largest players have to make a better case that the economy, the country, needs them.”

“Too-Big-to-Fail Prevention Is Tested in Post-Crisis Iceland”

by **Omar R. Valdimarsson**, August 3, 2012, *Bloomberg*

- Icelandic lawmakers and bank supervisors are discussing the separation of commercial and investment banking as a way to “prevent the riskier parts of banking being mixed with regular day-to-day banking and shouldered by regular customers or taxpayers.”
- Support from industry leaders as well: Largest investment bank CEO said, “Giving banks too much of a free ride with deposits—money they don’t need to repay if something goes wrong—isn’t such a great idea.”



Criticism Against Rightsizing Big Banks

Around the time of Sandy Weill's confession, a growing list of commentary emerged about *KEEPING THE STATUS QUO*.

The main themes included:

- ❑ Give Dodd–Frank a chance**
 - DFA is aimed at ending TBTF, so let the implementation of the new regs play out to potentially end taxpayer bailouts.
- ❑ Scope and scale of TBTF banks provides value-add to economy**
 - Large multinational corporations *need* global, one-stop-shop banks: If U.S. is capped, companies will replace with large European, Japanese or Chinese banks.
 - Both the U.S. and the global economy benefit from having huge banks.
- ❑ U.S. banking consolidation and TBTF didn't cause the crisis**
 - Consolidation of commercial and investment banking isn't as bad as it is blamed to be; big banks weren't the only destabilizer leading up to the crisis.
- ❑ Don't unscramble the scrambled eggs of past mergers**
 - Wouldn't it be prohibitively disruptive/costly? Won't customers ultimately pay?



Criticism Against Rightsizing Big Banks

“Regulate, Don’t Split Up, Huge Banks”

by Steven Rattner, former counselor to Obama administration Treasury secretary, July 31, 2012, *New York Times* Op-Ed

- “We should focus on putting ... new regulations into effect, and devising better ways to deal with financial giants—not distractions like Mr. Weill’s call for reinstating an outmoded concept like Glass–Steagall.”
- We cannot shrink banks “to a size that eliminates the ‘too big to fail’ problem without emasculating one of our most successful industries.”

“Shrinking Banks Will Drag Down the Economy”

by Wayne Abernathy, former assistant secretary of the Treasury and staff director of the Senate Banking Committee, August 27, 2012, *American Banker* Op-Ed

- “A growing banking system and a growing economy feed each other, and decline in either one will be a drag on the other. ... You cannot grow the economy and shrink banks. Let us stop trying. Let us grow both.”



Criticism Against Rightsizing Big Banks

“Don’t Break Up Megabanks, Re-Engineer Them”

by **Allan D. Grody**, August 1, 2012, *American Banker*

- Reverse-engineer TBTF banks slowly over time rather than execute a “hastily prepared living will.”

“Together, forever?”

August 18, 2012, *The Economist*, Finance and Economics

“Banking Reform: Sticking Together”

August 18, 2012, *The Economist*, Leaders

- Better solution than trying to unscramble the egg: “Ring fence” forcing the retail and investment banking arms of universal banks to have their own substantial capital buffers, coupled with the imposition of significant losses on private creditors of a failing institution.



Criticism Against Rightsizing Big Banks

[“JPMorgan’s Jamie Dimon: Here’s Why Banks Should Be So Big”](#)

by **Steve Schaefer**, August 13, 2012, *Forbes*

- Big bank benefits: Scope to serve a large international corporation; scale to provide huge bridge loans for large deals; efficiencies of one-stop-shop (spread fixed costs over a large umbrella of services that ultimately benefits the customers); interconnectedness—an integral part of the global system

[“In Defense of Big Banks”](#)

by **William B. Harrison, Jr.**, former chairman and CEO of JPMorgan Chase, August 22, 2012, *New York Times* Op-Ed

- Consolidation in financial services has been “driven by the market’s needs” and an “evolution toward greater efficiency.”
- Big banks aren’t to blame: Bad lending, risk management, poor regulation and ill-advised consumer behavior all played a role in the crisis
- Too complex to manage can exist for all sizes of firms: In the case of the most complex banks, such diversification can actually be an “antidote to risk.”



Criticism Against Rightsizing Big Banks

“Don’t Make Banks Too Small to Succeed”

by **Phillip Swagel**, former assistant Treasury secretary (George W. Bush administration), September 5, 2012, *Bloomberg Op-Ed*

- Give DFA a chance: Breaking up the biggest banks threatens the benefits of scale and scope while likely pushing business into larger overseas banks or less-regulated shadow banks.

“The Barrier to Breaking Up the Banks”

by **Christine Harper and Hugh Son**, September 6, 2012, *Bloomberg News*

- The status quo gives the big banks advantages of cheap funding in the form of deposits as well as lower borrowing costs because investors believe the government stands behind them.
- Breaking up these banks would deprive securities firms of access to cheap funding in the form of federally insured deposits.



The Tide Turns Again: End TBTF

However, this season of insisting on the *status quo* largely faded as summer ended—the discussion again turned to the dangers of TBTF:

“Are Giant Banks Indispensable? No, Says Big Business”

by Maria Aspan, August 21, 2012, *American Banker*

- “Claiming big multinationals ‘need’ big banks might be a bit of an exaggeration, say treasurers at those large companies.”
- Lack of competition and one-stop-shop bundling of financial services is not necessarily in every company’s best interests.

“We Need Much Simpler Rules to Rein in the Banks”

by Nicolas Brady, former Treasury secretary (Reagan and George H.W. Bush), August 26, 2012, *Financial Times* Op-Ed

- Similar to the simple solution to “too much debt is not more debt,” we need to reduce the complexity of regulations to fight complexity.
- A straightforward, clear cap on total leverage is a good start.



TBTF Debate Continues

[“Tackling Too Big to Fail: The Most Important Rightsizing in U.S. History”](#)

by **John Prout and Stephan Richter**, September 11, 2012, *The Globalist*

[“Big Banks: Resolving the ‘Too Big to Fail’ Issue”](#)

by **John Prout**, September 12, 2012, *The Globalist*

- Financial over-concentration puts the U.S. at risk: The TBTF banks “must be denied the ability to privatize their profits and socialize their losses.”
 - Safety net should be for the depository institution only.
 - Leverage should be capped.
 - Standardized derivatives (nonbalance sheet) transactions should be cleared.
 - Remove the TBTF subsidy; eliminate oligopoly market and political power.

[“Dear Bankers: Thanks for Wrecking Our Lives ...”](#)

by **Mark Greif**, September 15, 2012, *New York Times Sunday Review*



TBTF Debate Continues

“The Absurdity of Too Big to Fail Banking”

by Scott Shay, founder and chairman of Signature Bank,
September 20, 2012, *American Banker*

- What is good for the big banks is not necessarily good for the economy.
 - American companies will not replace a downsized U.S. bank with a larger European, Japanese, or Chinese bank.
 - Glass–Steagall contributed to the crisis as well as granted permission for “cultural consolidation” of commercial and investment banking.
 - Investment banking activities “are not necessary to run a successful bank.”
 - “Small and medium-sized banks are more effective at making loans to small and medium-sized companies, which are the primary job creators.”
- “If policymakers can get the structure of the banking system right, there will be less of a need for the volumes of devilishly complex regulations.”



TBTF Debate Continues: Hoenig

“Back to Basics: A Better Approach to Basel Capital Rules”

Speech by Thomas Hoenig, director of the FDIC,
September 14, 2012, *American Banker Regulatory Symposium*

- “Abandoning the overly complex and ineffective Basel capital requirements for a straightforward and understandable tangible equity capital ratio would strengthen banks and the financial system.”
- “We would be wise to acknowledge our limits, to simplify the system, to confine the subsidy and to reduce the taxpayers' exposure to an enormous future liability. It is time for international capital rules to be simple, understandable and enforceable.”

“Community Banks Getting on Board with ‘Glass–Steagall 2.0’”

by Joe Adler, October 2, 2012, *American Banker*

“Why ‘Back to Basics’ Is the Right Answer to Basel”

by Thomas Hoenig, October 4, 2012, *American Banker* Op-Ed



TBTF Debate Continues: Hoenig

“Big Bank Execs Just Don't Get It: FDIC's Hoenig”

by **Joe Adler**, September 19, 2012, *American Banker*

- Restricting high-risk trading, derivatives and other broker-dealer practices would help limit the undue expansion of the safety net outside of protecting the payments system and the basic intermediation function of banks.
- The game should not be “fixed in favor of a privileged few”—need to remove incentives that subsidize excessive, leveraged risk-taking.

“A Better Solution Is Needed for Failed Financial Giants”

by **Harvey R. Miller and Maurice Horwitz**, Weil, Gotshal & Manges, bankruptcy attorneys in the Chapter 11 case of Lehman Brothers, October 9, 2012, *New York Times DealBook*

- More than four years after the collapse of Lehman, Congress has failed to adequately resolve how to deal with TBTF; DFA is a “good faith effort” but does not solve the problem: “The danger of another Lehman exists.”



TBTF Debate Continues

“IMF Says Bank Rules Lag on Safety, Too-Big-to-Fail Stays”

by **Cheyenne Hopkins**, September 25, 2012, *Bloomberg News*

- According to an IMF report, financial reform measures are delaying “reboot” to a safer economic system: “Data suggest that financial systems are still overly complex, banking assets are concentrated, with strong domestic interbank linkages, and the too-important-to-fail issues are unresolved.”

“We Should Go further Unbundling Banks”

by **Andrew Haldane**, Bank of England executive director,
October 2, 2012, *Financial Times* Op-Ed

- Proposed structural reforms may still not quite go far enough.
- The biggest banks appear to be “too complex to price.”

“U.K.’s Haldane: Throwing a Frisbee, Saving the Financial System”

by **Barbara Rehm**, October 5, 2012, *American Banker*



TBTF Debate Continues

[“Another Crisis is Coming, Barofsky Says,”](#)

by **Paul Vigna**, October 10, 2012, *WSJ*

- Barofsky, former TARP inspector general: “We have to break the political-economic logjam at the top. ... Will it happen before or after the next crisis?”

[“Too big to maintain?”](#)

by **George F. Will**, October 12, 2012, *Washington Post* Op-Ed

- Endorsing the work and fight of Richard Fisher and Harvey Rosenblum, Will laments, “TBTF is a double moral disaster: It creates moral hazard by encouraging risky behavior, and it delegitimizes capitalism by validating public cynicism about its risk-reward ratios.”

[“Decoding New Rules for Banks”](#)

by **David Wessel**, October 17, 2012, *WSJ*

- Are the biggest banks growing larger because it makes business sense in a globalized world or because they are assumed to be TBTF?



TBTF Debate: Federal Reserve

Besides Pres. Fisher, other Fed officials have spoken out about TBTF:

“Fed Governor: Put Cap on Big Financial Firms”

by Victoria McGrane and Alan Zibel, October 11, 2012, *WSJ*

- Fed Board Governor Daniel Tarullo called on Congress to consider capping the size of U.S. financial conglomerates by limiting nondeposit liabilities—usually short-term borrowings—to a fixed percentage of U.S. GDP.

“Fed’s Bullard—Banks Should Be Smaller to Manage Failure”

by Alister Bull, October 11, 2012, *Reuters*

- St. Louis Fed President James Bullard backs calls to limit banks’ size.

“NY Fed’s Dudley: ‘Blunter approach may yet prove necessary’ for too-big-to-fail banks” **by Pedro da Costa**, November 19, 2012, *Reuters*

“Fed’s Kocherlakota: Need to Find Too-Big-to-Fail Measurements”

by Michael S. Derby, November 30, 2012, *WSJ*



TBTF Debate Continues: S. Johnson

“Big Banks Are Hazardous to U.S. Financial Health”

by Simon Johnson, MIT Sloan professor, Peterson Institute senior fellow, September 2, 2012, *Bloomberg* Op-Ed

- Defenders of large banks have pushed back since the summer, but there are incentives for “management to talk up the social value of their bank becoming even larger”: Implicit subsidies increase with systemic importance.
- “Global megabanks have become a huge, nontransparent and dangerous government-subsidy program. ... The U.S. should make its largest banks small and simple enough to fail without government or central-bank intervention.”

“Fed Should Push to Cut Biggest Banks Down to Size”

by Simon Johnson, October 14, 2012, *Bloomberg* Op-Ed

- “Capping bank size is the modern equivalent of trust busting and attracts support from across the political spectrum.”

Related, also by Simon Johnson:

“Tarullo Telegraphs Fed’s Plans to Cap Bank Size,” December 9, *Bloomberg*



TBTF Debate Continues: S. Johnson

[“Breaking Up Big Banks Is a Severely Conservative Project”](#)

by **Simon Johnson**, October 28, 2012, *Bloomberg* Op-Ed

- Richard Fisher and Harvey Rosenblum have expressed three important ideas:
 - TBTF banks are too complex for effective market and regulatory discipline.
 - Restructuring TBTF banks is less radical than quasi-nationalization (i.e., 08–09).
 - TBTF policies inhibit proper functioning of monetary policy and impede economic recovery.
- “If you want monetary policy to become effective again, you need the largest banks to be broken up. Equity capital also must increase, relative to debt, throughout the financial system.”

[“‘Too Big to Fail’ Remains Very Real”](#)

by **Simon Johnson**, November 1, 2012, *New York Times* Op-Ed

- In a recent speech, “[On Being the Right Size](#),” **Andrew Haldane** from the Bank of England suggests that the elimination of TBTF subsidies is paramount.



TBTF Debate Continues

[“2 Senators Call for Greater Bank Capital Requirements”](#)

by **William Alden**, October 17, 2012, *New York Times DealBook*

- “We write today to urge your agencies to simplify and enhance the capital rules that will apply to U.S. banks,” reads the letter from **Democratic Senator Sherrod Brown** of Ohio and **Republican Senator David Vitter** of Louisiana arguing for simpler rules on stronger bank capital reserves.
- “I think both conservatives and progressives believe the government shouldn’t be subsidizing Wall Street banks.”

[“The Right Way to Break Up the Banks”](#)

by **Brad Miller**, U.S. Representative from North Carolina (D),
October 21, 2012, *Bloomberg Op-Ed*

- Legislation introduced by Senator Brown and Representative Miller proposes a cap on bank size—a complement to the diligence of shareholders and supervisors that is needed to end TBTF.



TBTF Debate Continues

“The Biggest Kiss”

by **C. Boyden Gray**, former White House counsel to George H.W. Bush, and **Adam J. White**, October 29, 2012, *Weekly Standard*

- “Dodd–Frank subsidizes large, influential Wall Street financial institutions, while imposing disproportionately heavy burdens on Main Street banks and the communities they serve. Even if we take ... supporters at face value when they protest that they actually intended to rein in Wall Street banks, the laws they passed accomplish the opposite result. Intentional or not, a kiss is still a kiss.”

“Thanks to Dodd–Frank, Community Banks Are Too Small to Survive”

by **Louise Bennetts**, November 9, 2012, *American Banker*

“Economist Kaufman Calls for Breakup of Banks”

by **Sam Forgione**, November 26, 2012, *Reuters*

- Former Salomon Brothers vice chairman, Dr. Henry Kaufman, said that big banks have become too complex to manage efficiently and government reforms have been counterproductive.



TBTF Debate Continues

[“Dallas Fed Economist Is on a Quest to Downsize the Big Five”](#)

by **Cheryl Hall**, November 27, 2012, *Dallas Morning News*

- An interview with Harvey Rosenblum regarding the calls from the Dallas Fed to restructure the behemoth banks:
 - Market forces to determine smaller, viable, profitable and unthreatening size.
 - Limit safety net to deposits: “It’s called deposit insurance for a reason.”
 - TBTF encompasses *too complex for external discipline, too powerful to indict*.

[“Too Big to Indict”](#)

December 11, 2012, *New York Times* Editorial

[“Fed: Some Banks Are Too Big to Deal”](#)

by **Victoria McGrane and Dan Fitzpatrick**, December 11, 2012, *WSJ*



AIG Focuses TBTF Debate

“AIG: An improbable profit”

by **Henny Sender**, October 22, 2012, *Financial Times*

- Monetary policy is held hostage by need to support TBTF institutions.
- “The recovery in asset prices that made it possible for the Fed to wind down the AIG portfolio was the inevitable result of the Fed’s own quantitative easing policies. ... We [the Fed and Treasury] bought at the bottom of the market because *we made it the bottom of the market.* ...”

“Time to Learn From AIG’s Bailout”

by **Francesco Guerrera**, December 17, 2012, *WSJ*

- “When financial historians ask what was learned from the AIG saga, the truthful answer should be: Don't do it again.”
- “We massively downsized AIG and made it an easier, simpler, more easily manageable company” ... *just like proponents of ending TBTF advocate.*