



## **Fact Sheet: Glass-Steagall Financial Reform Law and Efforts to Reinstate It**

As the presidential primaries heat up, many candidates are talking about the threats that Wall Street still poses to hardworking families and the need for stronger financial reform. Much of this discussion has focused on a law repealed in 1999 called the Glass-Steagall Act and [the introduction of a bipartisan bill](#) by Senator Elizabeth Warren and others in the Senate to reinstate it. For example, Vermont Senator Bernie Sanders has [talked about](#) the need to reestablish the law; former Governor of Maryland Martin O'Malley has made it a [key part](#) of his campaign; and former Secretary of State Hillary Clinton [has been asked](#) about her views on it, but hasn't taken a clear position yet while [broadly denigrating the idea with unrelated claims](#) (discussed more below). Republican candidates have so far been silent on the issue, although the bill is co-sponsored by Sen. John McCain (R-AZ).

This Fact Sheet discusses the facts related to the Glass-Steagall Act by answering the following questions:

- What is Glass-Steagall?
- What happened to the Glass-Steagall law?
- What happened when Glass-Steagall was repealed?
- What did all this have to do with the financial crash in 2008?
- Who is against the reinstatement of Glass-Steagall-like protections?
- What are the arguments against doing that?

**First, what is Glass-Steagall?** After the Great Crash of 1929 and the Great Depression of the 1930s, several laws were passed to create layers of protections between the gambling on Wall Street and the hardworking American families on Main Street. Importantly, these layers of protections were of different types: structural, regulatory and supervisory.

The Glass-Steagall Act was the key structural legal protection enacted: It prohibited the same bank from engaging in both relatively low-risk traditional commercial banking (using FDIC-insured and Fed-backed savings accounts to make mortgage and business loans) and higher-risk investment banking (running mostly unregulated trading and securities operations). For more than 60 years, the Glass-Steagall Act kept those activities separate and, during that time, the U.S. had the highest rate of economic growth in its history while the financial system avoided catastrophic crashes.

Because Glass-Steagall prohibited banks from engaging in both commercial banking and investment banking at the same time, it prevented high-risk Wall Street gambling from endangering the commercial bank that engaged in socially useful traditional banking. As University of Chicago economist Luigi Zingales explains:

“While Glass-Steagall may not be the most efficient form of regulation, it worked for more than sixty years . . . The beauty of Glass-Steagall, after all, was its simplicity: banks should not gamble with government-insured money. Even a six-year-old can understand that.”

**Second, what happened to the Glass-Steagall law?** It was effectively repealed with the passage of the Gramm-Leach-Bliley Act in 1999, which was part of a larger successful push by Wall Street and its allies to dismantle many of the safeguards put in place to protect the American people following the Great Depression in the 1930s.

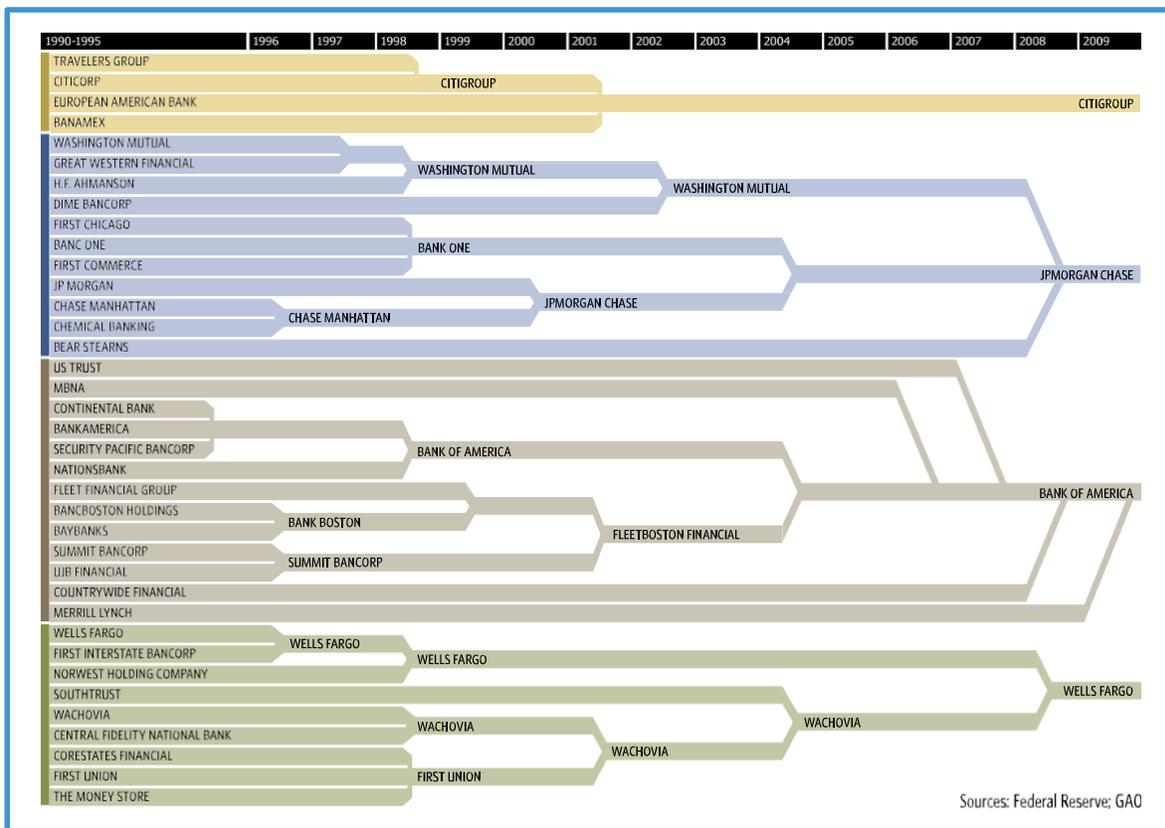
In one of history's great ironies, Citibank spearheaded the effort to repeal the Glass-Steagall Act, even though it was one of the most reckless banks whose behavior helped cause the Great Crash of 1929 and the Great Depression. In fact, Senator Carter Glass (who became the co-author of the Glass-Steagall Act) singled out the CEO of National City Bank (Citibank's predecessor) as one of the men most responsible for the 1929 Crash. ([This terrific article](#) by Andrew Cockburn in Harper's Magazine spells out the details.) And yet, it was Citibank that led the charge to repeal Glass-Steagall in the 1990s, even though it was Citibank's recklessness that led to its enactment in the first place. Once it got Glass-Steagall

repealed, Citibank super-sized itself and went on an irresponsible and illegal spree that was at the center of causing the 2008 financial crisis, requiring numerous bailouts. (As one observer [noted](#), apparently “all you need for a financial crisis are excess optimism and Citibank.”)

This [dangerous deregulatory push](#), fueled by unbridled greed, recklessness and illegal conduct, brought on the 2008 financial crash, which will cost the country [more than \\$20 trillion dollars](#) and has cost tens of millions of middle-class families their jobs, homes and savings.

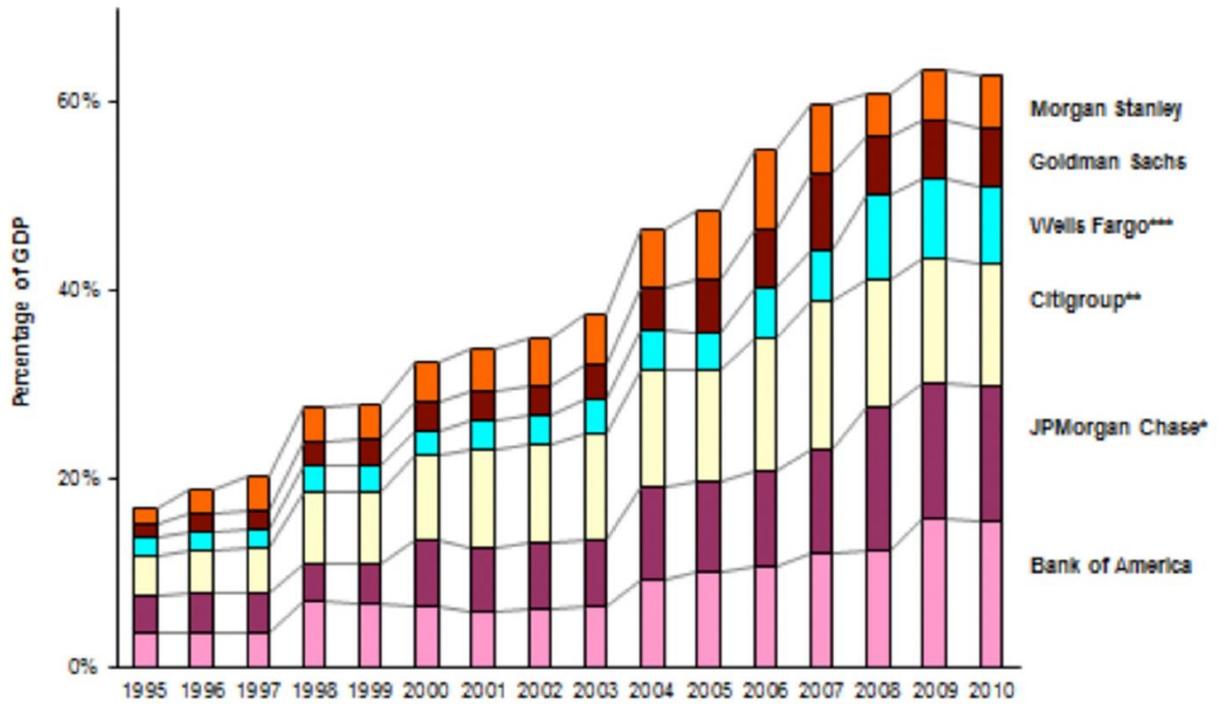
**Third, what happened when Glass-Steagall was repealed?** Large financial institutions were able to acquire other financial institutions and combine lower-risk traditional banking and higher-risk Wall Street trading and securities activities. These mergers are what threatened taxpayers and risked massive bailouts: Large megabanks were created that combined commercial banking and investment banking in one institution. That meant, if the uninsured investment banking activities of a megabank got into trouble and threatened to take down the FDIC-insured part of the bank, then the government would inevitably have to save both parts to save the insured part.

Repealing Glass-Steagall not only took down that critical separation; it also unleashed an acquisition spree that made the biggest banks bigger and bigger as this chart shows:



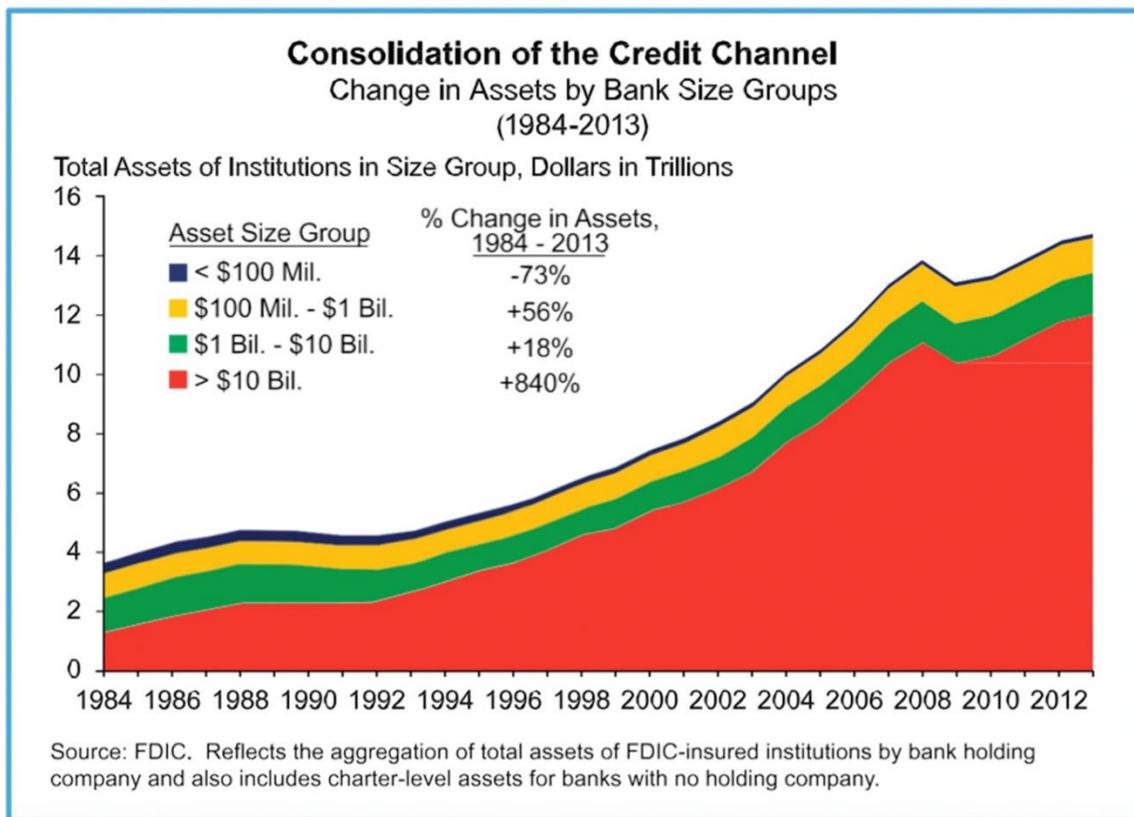
To see a larger version of this chart, [click here](#).

In addition to adding complexity and massive, global management stress from combining so many different banks, these consolidations resulted in many fewer banks of much larger size. In fact, the top 6 banks grew their assets from about 20% of GDP in 1997 to more than 60% of GDP in 2008, as shown on this chart:



Source: Simon Johnson, MIT (@baselinescene)

As those banks grew to colossal proportions, they accounted for an even larger share of the banking assets in this country. Note again what happened after Glass-Steagall was repealed in 1999:



As these banks got larger and larger, they had less equity (called “capital” for banks) to absorb any potential losses they might incur. In fact, some of these banks got leveraged 33 to 1 on borrowed money, meaning that they would be effectively bankrupt if their assets values declined a mere 3%. Making those banks even more fragile, many funded themselves with inordinate amounts of short-term, often overnight, funding, making them highly vulnerable to runs.

**Fourth, what did all this have to do with the financial crash in 2008?** Individually or in combination, by 2008 these banks had become so large, complex and interconnected that if they failed, they would endanger the entire banking and financial system, and ultimately, the entire economy. As a result, because they exposed socially useful traditional banking to losses from high-risk trading and investments, the government and taxpayers ended up on the hook for all of it. That’s what happened in 2008.

Citigroup, a bank holding company that was supposed to be supervised by the Federal Reserve Board of New York, is Exhibit A proving this: it was one of the biggest, most reckless failures of the 2008 crash and [received the biggest bailout of any single institution](#): \$476.2 billion in bailouts from a series of rescue programs. It is also the only Wall Street bank that didn’t repay the money it received from the TARP program – [“the government sold its stake to investors.”](#)

Once Citibank succeeded in getting Glass-Steagall repealed and merged itself with the Travelers Group into a gargantuan bank known as Citigroup, combining commercial lending and securities activities, Citigroup went on a binge of reckless and illegal activities, fueled with massive amounts of FDIC insured deposits. In addition to placing huge proprietary bets, by 2007, Citigroup was the number one worldwide placement agent of high-risk collateralized debt obligations (CDOs), which it sliced and diced into various derivatives that it not only sold, but itself shorted in immense quantities. These were massive, extremely leveraged and very high-risk bets. In a gross miscarriage of justice, only one of

the CDOs that Citigroup put together and shorted resulted in an SEC enforcement action. [As this court filing shows](#), Citigroup engaged in shockingly irresponsible high-risk CDO trading and investments.

Moreover, Citigroup also engaged in the fiction of creating entities that were supposedly entirely independent and unrelated. It sponsored several Cayman Island-incorporated structured investment vehicles (SIVs), essentially small banks funded with commercial paper and with no capital requirements. These entities were supposed to be “bankruptcy remote,” meaning that their creditors had no legal recourse to Citigroup and Citigroup was not liable for their debts. However, as is often if not always the case (as Stanford University professor Darrell Duffie pointed out in his book “How Big Banks Fail”), the purchasers of the SIVs’ commercial paper believed that there was an implicit guarantee from Citigroup given that it created the SIVs and sold the paper, which was widely held by money market funds. In late 2007, when the markets began to experience turmoil, Citigroup took more than \$59 billion in assets for which it had zero legal liability back onto its balance sheet, including from seven SIVs it created, to avoid asset fire sales and reputational damage. Citigroup had to then take substantial write downs on these assets, which impaired what little capital it had and began the long term run on and ultimate collapse of the bank.

Confirming the irresponsible recklessness that was at the core of Citigroup, its CEO said 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.” But as everyone knew then, it was only a matter of time before the music stopped. When it did, the liquidity predictably dried up, and Citigroup began its insolvency death spiral. Unlike other businesses that fail and go bankrupt, Citigroup avoided the consequences of its recklessness, poor judgments and illegal behavior only when the government and taxpayers stepped in and provided massive bailouts. (Doesn’t seem like much has changed in the Citigroup CEO suite: in May 2015, when [Citigroup had to pay more than \\$1 billion and plead guilty to a criminal charge](#) for rigging the foreign exchange markets, its current [CEO referred to this as a mere “embarrassment,”](#) i.e., no big deal. Not exactly a comforting tone-at-the-top for a too-big-to-fail bank copping a criminal plea and paying an historically large fine.)

As if all this isn’t enough to prove that Citigroup was an out-of-control recidivist, it [knowingly continued its fraudulent mortgage practices](#), the very activities that inflated the housing bubble and precipitated the financial crash, for four years **after** the 2008 financial crash, into 2012.

Citigroup would not have existed in the form it did and would not likely have been too-big-to-fail, too-complicated-to-manage, too-big-to-jail, engaged in those repeated reckless and illegal activities, posed that incredible danger, and required almost \$500 billion bailouts if Glass-Steagall had been left in place.

That’s why many are proposing to put Glass-Steagall-like protections back into place: to separate traditional socially useful banking from the higher-risk trading and investment activities of banks.

**Fifth, who is against reinstating Glass-Steagall like protections?** Wall Street’s too-big-to-fail banks hate the idea of restoring Glass-Steagall. The most important thing to understand is that Wall Street’s megabanks [want to remain too-big-to-fail because that means they get big bonuses in good times and get taxpayers to bail them out in bad times](#). Also, the bigger the bank, the bigger the compensation they can extract. In addition, they want to keep the subsidy they get from using government backed depositors’ money to fund their higher-risk trading and investment businesses. That’s why they are doing whatever they can to make sure Glass-Steagall-like protections aren’t put back into place.

**Sixth, what are the arguments against Glass-Steagall?** Some say that the repeal of Glass-Steagall had nothing to do with the 2008 crash. They say Bear Stearns, Lehman Brothers and AIG (i.e., the so-called “shadow banking system”) were not subject to Glass-Steagall and, voilà, it is therefore irrelevant. Or, some condescendingly claim that the issue is much more “complicated” than Glass-Steagall, wielding Wall Street’s favorite club to intimidate anyone from looking too closely at what they are really up to. However, those self-serving claims are little more than incomplete, revisionist history that ignores the facts detailed above and so much more.

For example, the so-called shadow banking system, which includes the investment banks Goldman Sachs, Morgan Stanley, Bear Stearns, Lehman Brothers and Merrill Lynch, was funded – directly or indirectly – by FDIC-insured and Fed-

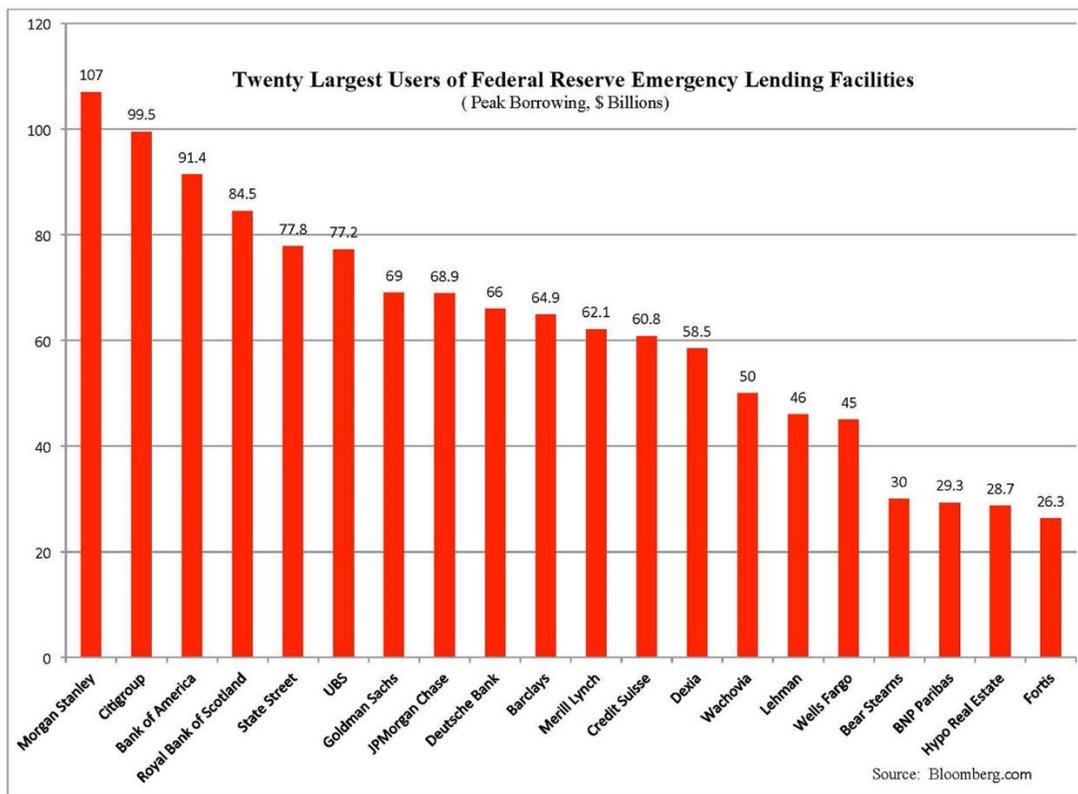
backed bank holding companies like JPMorgan Chase, Bank of America, and Citigroup. These banks funded the shadow banking system directly through lines of credit as well as repurchase agreements (so-called “repos”) and in lots of other ways.

Moreover, JPMorgan’s acquisition of Bear Stearns only happened because it’s CEO, Jamie Dimon, insisted that U.S. taxpayers assume 100% of the risk of \$30 billion of Bear Stearns’ most toxic derivatives. The U.S. government assumed this multi-billion dollar risk because Bear Stearns was the counterparty to and interconnected with the gigantic too-big-to-fail bank holding companies made possible by Glass-Steagall’s repeal. The same is true for Lehman Brothers, which precipitated the financial crisis because of that very same interconnectedness. AIG is probably the clearest example of this nexus between too-big-to-fail banks and the shadow banking system: Its bankruptcy was prevented by the U.S. government bailout because its counterparties were global too-big-to-fail banks.

The financial crisis made clear the dangerous interconnectedness that existed between the too-big-to-fail banks made possible by the repeal of the Glass-Steagall Act and the investment banks that populated the shadow banking system. Remember the week of September 15, 2008, in which Lehman’s failure nearly brought down the financial system: Lehman failed on Monday, AIG was bailed out on Tuesday, the Reserve Fund broke the buck on Wednesday, the equity markets continued to crash and the wholesale funding markets dried up on Thursday (which caused the Treasury to guarantee the \$3.7 trillion money market industry), and by Friday Morgan Stanley didn’t believe it would be able to open the following Monday, which meant that Goldman Sachs was “[toast](#).”

It is undeniable that all these events were inextricably interconnected with the too-big-to-fail bank holding companies, which were directly threatened with failure due to their own irresponsible conduct and the cascading crash of the financial system. The truth is that the repeal of Glass-Steagall created the too-big-to-fail banks, which all had to be bailed out by the U.S. government and taxpayers, as proved by the following chart (which actually significantly understates the scope and breadth of the bailouts each received):

# Banks Needing Bailouts



Some have rebutted other arguments against reinstating Glass-Steagall, but they are not arguments that anyone is making. For example, Secretary Clinton [said](#) “I think this is a much more complicated issue than pointing to any one piece of legislation and saying if we just pass that everything would be fine.” She also [said](#) that she is “not interested in just saying there is one answer to the too-big-to-fail problem.” The problem with this nonresponse is that no one is saying any of those things. Everyone agrees preventing financial crashes is a “complicated issue,” but no one is “pointing to [Glass-Steagall] and saying, if we just pass [that one bill], everything will be fine.” And, no one is “just saying there is one answer to the too-big-to-fail problem.” Everyone knows that there are no magic bullets, single solutions or simple answers to the massive threat posed by the too-big-to-fail firms and activities. Indeed, everyone recognizes that even the description of the problem (“too-big-to-fail”) is inaccurate because size is just one of the many issues that need to be addressed (along with complexity, interconnectedness, funding, resolution, cross-border, etc.).

That’s why every candidate must have a specific, detailed, concrete, comprehensive plan that has different types of protections (structural, regulatory, supervisory, etc.) that will effectively rein in Wall Street’s riskiest activities and protect Main Street families once again, not just today, but throughout the business cycle and, indeed, for decades. That’s what political leaders did after the Great Crash of 1929 and the Great Depression of the 1930s and that’s what political leaders of today must do.

**Conclusion.** The point of restoring the structural barrier between taxpayer-supported commercial, socially-useful lending and Wall Street’s high-risk securities and investment gambling (i.e., a Glass-Steagall like law) isn’t to prevent the last crisis or to be so foolish to think the next crisis can be predicted with clarity. As far-sighted policy makers saw after the Great Crash of 1929, what a safe, sound, durable, non-threatening, socially-useful financial system needs are multiple layers of protection of different types between Wall Street and Main Street. Restoring the separation between commercial and

investment banking is one of the most sensible layers of protection because it takes away the taxpayer subsidy of insured deposits while at the same time forcing the biggest banks to absorb their own costs and, therefore, become less dangerous to taxpayers and the economy. Plus, as noted above, creating a barrier between commercial banking and investing banking is clear and simple: “even a six-year-old can understand” it.

Reinstating Glass-Steagall is not the only solution and it won’t solve too-big-to-fail by itself. It can, however, be an important part of an overall plan to reduce the risk on Wall Street while increasing the protections for Main Street.

Voters in both parties support Wall Street reform because they know that we cannot afford a repeat of the 2008 financial crash, which caused an economic calamity from coast to coast and [diverted trillions of dollars](#) from many important issues like education, health care, poverty, job training, infrastructure, research and development, and so much more. Voters deserve to know how each candidate plans to prevent high-risk Wall Street gambling from endangering Main Street families and priorities, including whether they support reinstating a Glass-Steagall-like law or advocating for other specific, concrete proposals that will provide layers of protection for America’s hardworking families and take them off the hook for future bailouts.

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Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements and more. To learn more, visit [www.bettermarkets.com](http://www.bettermarkets.com).