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Was Glass-Steagall's Demise Inevitable and Unimportant?

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Arthur E. Wilmarth, Jr. (September 15, 2018)

The financial crisis of 2007-09 caused the Great Recession, the most severe global economic downturn since the Great Depression. The financial crisis began with the collapse of the subprime mortgage market in the U.S. and spread to financial markets around the world. Similarly, the disastrous financial events of the Great Depression began with the Great Crash on Wall Street in October 1929 and spread throughout the U.S. and Europe during the early 1930s.[1]

Congress responded to the Great Depression by passing the Glass-Steagall Banking Act of 1933. Two of Glass-Steagall's key provisions – Sections 20 and 32 – separated commercial banks from the capital markets. As discussed below, Congress repealed Sections 20 and 32 in 1999, after a prolonged period of erosion during the 1980s and 1990s. The recent financial crisis has revived popular interest in Glass-Steagall, given the similar boom-and-bust cycles that led to the Great Depression and the Great Recession. The Democratic and Republican party platforms in 2016 called for a return to Glass-Steagall's principles, and the issue has resurfaced again during the 2018 midterm election campaign.[2]

The Glass-Steagall Act transformed the U.S. financial industry after it collapsed during the Great Depression. Section 8 established a new system of federal deposit insurance to prevent

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[1] This essay was originally published in Columbia Law School's *The CLS Blue Sky Blog* on September 18, 2018 (available at http://clsbluesky.law.columbia.edu/2018/09/18/was-glass-steagalls-demise-both-inevitable-and-unimportant/). The analysis in this essay is drawn from my forthcoming book on the Glass-Steagall Act. Portions of that analysis appear in two of my articles: "Prelude to Glass-Steagall: Abusive Securities Practices by National City Bank and Chase National Bank During the 'Roaring Twenties'," 90 *Tulane Law Review* 1285 (2016) [hereinafter "Prelude to Glass-Steagall"], available at http://ssrn.com/abstract=2828339, and "The Road to Repeal of the Glass-Steagall Act," 17 *Wake Forest Journal of Business & Intellectual Property Law* 441 (2017) [hereinafter "Road to Repeal"], available at http://ssrn.com/abstract=3026287.

[2] Victoria Finkle, "Is Glass-Steagall posed for a political comeback?", *American Banker* (Sept. 10, 2018), available at https://www.americanbanker.com/opinion/is-glass-steagall-poised-for-a-political-comeback?utm_campaign=bankthink-c-Sep%2010%202018&utm_medium=email&utm_source=newsletter&eid=12a6d4d069cd56cfddaa391c24eb7042.

depositor "runs" on banks. Sections 20 and 32 separated commercial banks from the capital markets. Section 21 reinforced that separation by prohibiting nonbanks from accepting deposits.[3]

A central purpose of Glass-Steagall was to prevent banks from financing speculative securities booms like the one that occurred during the 1920s. During the "Roaring Twenties," large U.S. banks created securities affiliates and operated as "universal banks." Universal banks helped to finance an unsustainable credit bubble during the 1920s by packaging risky domestic and foreign loans into hazardous bonds that were sold to investors across the U.S. and around the world. Universal banks also helped to promote an equally unsustainable bubble in the U.S. stock market by selling speculative stocks to unsophisticated purchasers. Universal banks were at the center of major financial crises that erupted in the U.S. and Europe during the early 1930s.[4]

The Glass-Steagall Act (together with other New Deal legislation) established a decentralized financial system composed of separate and independent sectors. Commercial banks accepted deposits, extended loans, and provided fiduciary services (including wealth management and investment advice) to consumers and businesses. Securities firms attracted longer-term funding commitments from investors and arranged medium-term and longer-term financing for businesses. Insurance companies collected premiums from consumers and businesses and provided medium-term and longer-term coverage for various types of risks. The Bank Holding Company Act of 1956 (BHC Act) reinforced Glass-Steagall's policy of structural separation by (1) preventing commercial or industrial firms from affiliating with banks, and (2)

[3] Wilmarth, "Road to Repeal," *supra* note 1, at 449-50.
[4] *See generally* Wilmarth, "Prelude to Glass-Steagall," *supra* note 1.

prohibiting nonbank subsidiaries of bank holding companies from engaging in activities that were not "closely related to banking."[5]

The system of segmented financial sectors established by Glass-Steagall and the BHC Act prospered from the end of World War II through much of the 1970s. During that period, no major financial crisis occurred. An important reason for that era's financial stability was that problems arising in one sector of the financial markets were much less likely to have a contagious impact on other sectors. Regulators could address financial problems with targeted responses that did not require massive bailouts of the entire financial system. Federal courts at first defended Glass-Steagall, as they struck down several attempts by large banks and federal regulators to open loopholes in the statute from the late 1960s through the early 1980s.[6]

The post-New Deal system of financial regulation experienced a series of economic disruptions and legal challenges after 1970. The economic shocks included the collapse of the Bretton Woods system of fixed exchange rates for international currencies as well as high inflation rates that rose steadily during the 1970s and peaked in 1980. Those events put great pressure on Regulation Q, another aspect of Glass-Steagall's reforms. Regulation Q prohibited banks from paying interest on demand deposits and limited the interest rates that banks could pay on savings accounts and certificates of deposit. Regulation Q was intended to restrain deposit-rate competition among banks and thereby discourage the kind of excessive risk-taking that banks exhibited during the 1920s.[7]

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[5] Wilmarth, "Road to Repeal," *supra* note 1, at 450-52; *see also* Prasad Krishnamurthy, "George Stigler on His Head: The Consequences of Restrictions on Competition in (Bank) Regulation," 35 *Yale Journal on Regulation* 823, 825, 841-43 (2018).

[6] Wilmarth, "Road to Repeal," *supra* note 1, at 452-53; *see also* Krishnamurthy, *supra* note 5, at 825. For examples of court decisions upholding Glass-Steagall, *see, e.g.*, Sec. Indus. Ass'n v. Bd. of Governors of Fed. Reserve Sys., 468 U.S. 137 (1984); Investment Co. Instit. v. Camp, 401 U.S. 617 (1971); Port of N.Y. Auth. v. Baker, Watts & Co., 392 F.2d 497 (D.C. Cir. 1968).

[7] Wilmarth, "Road to Repeal," *supra* note 1, at 450-51, 456-58; *see also* Krishnamurthy, *supra* note 5, at 836-43, 846-47.

Some scholars have argued that the collapse of Bretton Woods and the high inflation rates of the 1970s destroyed the economic foundations of Glass-Steagall. Professor Paul Mahoney has provided a detailed account of that position in a recent article. Professor Mahoney also contends that Glass-Steagall was undermined by the emergence of financial innovations like money market mutual funds ("MMMFs"), short-term commercial paper, short-term securities repurchase agreements ("repos"), securitization, and over-the-counter ("OTC") derivatives. MMMFs, short-term commercial paper, and short-term repos allowed securities firms to offer bank-like products to consumers and businesses. Securitization and OTC derivatives permitted banks to offer financial services that competed directly with securities firms and insurance companies. Professor Mahoney concludes that Glass-Steagall was effectively a dead letter by 1999, when Congress repealed its key provisions in the Gramm-Leach-Bliley Act (GLBA).[8]

I agree with Professor Mahoney that economic disruptions and financial innovations posed serious threats to the viability of Glass-Steagall. However, I do not agree that Glass-Steagall's demise was an inevitable outcome. I contend that industry participants exploited market forces by mounting attacks on Glass-Steagall, and federal agencies and courts helped them to do so.

The Securities and Exchange Commission ("SEC") allowed securities firms and asset managers to create MMMFs in the early 1970s. MMMFs provided the functional equivalent of bank deposits by permitting customers to redeem their investments on demand at a fixed net asset value ("NAV") of $1 per share. The $1 fixed NAV represented a dramatic – and I believe unlawful – departure from basic principles governing mutual funds under the Investment

[8] Paul G. Mahoney, "Deregulation and the Subprime Crisis," 104 *Virginia Law Review* 235 (2018). For other scholars who have presented similar arguments, see Wilmarth, "Road to Repeal, *supra* note 1, at 444 n.7 (citing works by Jerry W. Markham, Peter J. Wallison, and Lawrence J. White).

Company Act of 1940. For mutual funds that are *not* MMMFs, fund managers must redeem a customer's investment based on the (variable) equity value of his or her investment on the date of redemption. The SEC took another radical step by allowing MMMFs to offer check-writing features that turned MMMFs into functional substitutes for bank checking accounts. The Federal Reserve Board ("Fed") could have blocked that step by prohibiting banks from clearing checks for MMMFs. However, the Fed did not do so.

In 1979, the Bowery Savings Bank of New York filed a complaint with the Justice Department and the SEC, alleging that MMMFs with check-writing features violated Section 21 of the Glass-Steagall Act. Based on a highly formalistic analysis, the Justice Department ruled that MMMFs were equity investments rather than "deposits," and their check-writing features did not change their fundamental nature. The Justice Department therefore advised the SEC that MMMFs did not violate Section 21's prohibition on the acceptance of deposits by nonbanks. The Justice Department (and the SEC) ignored the fact that MMMFs competed directly with bank deposit accounts and provided the functional equivalent of checking accounts. After receiving this green light from regulators, the MMMF industry quickly grew from $3 billion in 1977 to $235 billion in 1982.[9]

The rapid expansion of MMMFs and the corresponding outflow of deposits from banks provided a convenient rationale for Congress to repeal Regulation Q – a result that federal regulators and many bankers welcomed. MMMFs continued to grow because they enjoyed important cost advantages over banks. MMMFs did not have to pay deposit insurance premiums or maintain capital buffers similar to those required for banks. The total assets held by MMMFs increased to $740 billion in 1995, $1.8 trillion in 2000, and $3.8 trillion in 2007.

[9] Wilmarth, "Road to Repeal," *supra* note 1, at 458-60.

As MMMFs grew, so did the market for commercial paper, a short-term debt instrument (usually with maturities of 90 days or less) issued by nonfinancial corporations and financial firms. MMMFs were the largest investors in commercial paper. The volume of outstanding commercial paper grew from $50 billion in 1975 to $560 billion in 1990, $1.3 trillion in 2000, and $2 trillion in 2007.

MMMFs were also very important cash lenders for repos. Repos are short-term loans (frequently with terms of one to several days) secured by pledges of securities. Like commercial paper, repos expanded in tandem with the growth of MMMFs. The total volume of repos entered into by securities broker-dealers increased from $110 billion in 1981 to $800 billion in 1990, $2.5 trillion in 2002, and $3.5 trillion in 2007. The short-term funding provided by MMMFs, commercial paper, and repos fueled the growth of the "shadow banking system." MMMFs, commercial paper, and repos served as "shadow bank deposits" and allowed securities firms and other nonbank financial companies to compete directly with banks in providing credit to consumers and businesses.[10]

Morgan Ricks has persuasively argued that the rapid growth of "shadow bank deposits" after the mid-1980s represented "an increasing privatization of the broad money supply in the pre-crisis years." MMMFs, commercial paper, and repos functioned as substitutes for bank deposits because they were debt instruments that were effectively payable at par on demand (or with very short notice). In addition, federal regulators and Congress provided favorable treatment for those instruments, including "safe harbors" that exempted them from restrictions imposed on most creditors under the Bankruptcy Code. The favored status of MMMFs,

[10] *Id.* at 460-62.

commercial paper, and repos caused many investors to consider them as being just as "safe" as bank deposits.[11]

Nonbanks and large, bank-centered financial conglomerates relied heavily on "shadow bank deposits" during the credit boom of the 2000s. That reliance exposed major financial institutions to severe liquidity problems in 2007 and 2008, when investors engaged in large-scale "runs" on MMMFs, commercial paper, and repos. To prevent a collapse of the financial system, the Treasury Department, Fed, and Federal Deposit Insurance Corporation provided guarantees, asset purchase programs, and liquidity facilities that functioned as de facto deposit insurance for all three types of "shadow bank deposits."[12]

The market forces that undermined Regulation Q did not compel policymakers to stand by while nonbanks offered deposit substitutes that violated Section 21 of Glass-Steagall. Federal regulators and Congress could have removed or relaxed Regulation Q's restrictions on deposit interest rates – thereby allowing more favorable returns to depositors – while prohibiting nonbanks from offering financial instruments that served as de facto deposits. A realistic, functionally-grounded interpretation of Section 21 would have barred nonbanks from offering MMMFs, short-term commercial paper, and short-term repos. Unfortunately, regulators did not choose to prohibit those instruments and did not require securities firms and other nonbank financial companies to fund their operations in a more stable and transparent manner by issuing longer-term debt securities and entering into term loans with banks.[13]

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[11] *See generally* Morgan Ricks, *The Money Problem: Rethinking Financial Regulation* (2016) (quote at 36); Anna Gelpern & Erik F. Gerding, "Inside Safe Assets," 33 *Yale Journal on Regulation* 363 (2016).
[12] Wilmarth, "Road to Repeal," *supra* note 1, at 462-64; *see also* Zoltan Pozsar et al., *Shadow Banking* (Fed. Res. Bank of N.Y. Working Paper, July 2010), available at http://ssrn.com/abstract=1645337.
[13] Wilmarth, "Road to Repeal," *supra* note 1, at 462; *see also* Krishnamurthy, *supra* note 5, at 846.

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The other two financial "innovations" that undermined Glass-Steagall – securitization and over-the-counter (OTC) derivatives – developed along similar story lines that included regulatory arbitrage and regulatory sponsorship. Like MMMFs, securitization and OTC derivatives were not the result of unstoppable market forces. Instead, they were actively encouraged and promoted by federal regulators who wanted to break down Glass-Steagall's wall of separation between the banking industry and the capital markets.

In 1987, the Fed took the first major step by allowing bank holding companies to establish "Section 20 subsidiaries." The Fed permitted those subsidiaries to engage (to a limited extent) in underwriting mortgage-backed securities, asset-backed securities, municipal revenue bonds, and commercial paper. The Fed ruled that Section 20 subsidiaries did not violate Section 20 of the Glass-Steagall Act because they were subject to numerous Fed-imposed restrictions. In view of those restrictions, the Fed determined that Section 20 subsidiaries were not "engaged principally" in underwriting or dealing in bank-ineligible securities and, therefore, did not violate Section 20 of Glass-Steagall.

The Securities Industry Association challenged the Fed's Section 20 order. The Second Circuit Court of Appeals recognized that the Fed's order would help to "dismantle the wall of separation" established by Glass-Steagall. However, the court concluded that it was required to defer to the Fed's interpretation of an "ambiguous" statute under the Supreme Court's 1984 decision in *Chevron*. The Second Circuit stated, "Whether [George] Santayana's notion that those who will not learn from the past are condemned to repeat it fairly characterizes the consequences of the [Fed's] action is not for us to say." The Second Circuit's allusion to Santayana's oft-quoted warning was tragically prescient, but it unfortunately did not alter the court's highly deferential approach. Under Chairman Alan Greenspan's leadership, the Fed steadily removed the restrictions on Section 20 subsidiaries and expanded the scope of its Section 20 loophole between 1987 and 1996.[14]

The Office of the Comptroller of the Currency ("OCC") followed the Fed's example by allowing national banks to securitize residential mortgages and other loans directly (instead of being required to use holding company affiliates). The OCC's efforts were part of that agency's intense competition with Alan Greenspan's Fed for the position of deregulator-in-chief for the banking industry.

In 1987, the OCC issued an order confirming the authority of national banks to securitize residential mortgages. The Securities Industry Association promptly challenged that order. As it had done with the Fed, the Second Circuit deferred to the OCC's view that national banks could securitize loans without violating Glass-Steagall. The Second Circuit concluded that investors in mortgage-backed securities would be adequately protected by the securities laws. The court agreed with the OCC that purchasers of mortgage-backed securities would be "informed investors" with "full disclosure" of all "material facts" about the "underlying loans." The court also concurred with the OCC's opinion that national banks would be "unlikely" to securitize "unsound loans." Those assumptions by the OCC and the Second Circuit proved to be completely wrong. The financial crisis revealed that bank underwriters of mortgage-backed securities *did* have financial incentives to securitize hazardous loans, and did *not* provide investors with full disclosure about the quality and risks of the underlying mortgages.[15]

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[14] Wilmarth, "Road to Repeal," *supra* note 1, at 468-73 (discussing Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984), and Sec. Indus. Ass'n v. Bd. of Governors of Fed. Reserve Sys., 839 F.2d 47, 49 (2d Cir.), *cert. denied*, 486 U.S. 1059)).

[15] Wilmarth, "Road to Repeal," *supra* note 1, at 473-76 (discussing Sec. Indus. Ass' n v. Clarke, 885 F.2d 1034 (2d Cir. 1989)).

By 1999, when Congress repealed Sections 20 and 32 of Glass-Steagall, banks had already underwritten $900 billion of mortgage-backed securities and other asset-backed securities. Following Glass-Steagall's repeal, the volume of outstanding mortgage-backed securities and other asset-backed securities underwritten by banks increased to $5 trillion by 2007. Securitization of nonprime mortgages and other high-risk loans fueled the toxic credit boom that led to the financial crisis of 2007-09. Securitization by banks could not have occurred prior to 1999 without a prolonged campaign of successful litigation that was financed by major banks and supported by friendly regulators.[16]

OTC derivatives were the third major "innovation" that broke down Glass-Steagall's barriers. OTC derivatives enabled banks to offer synthetic securities and synthetic insurance products to their customers, in much the same way that "shadow bank deposits" allowed securities firms and other nonbanks to offer bank-like products to their clients. As Saule Omarova has documented, the OCC followed a prolonged, step-by-step process that allowed national banks to offer a wide range of OTC derivatives.

National banks first offered interest rate swaps and currency rate swaps, which grew out of their traditional activities of discounting debt obligations and exchanging foreign currencies. The OCC drew analogies from those swaps and developed a steadily expanding concept of "the business of banking," which rationalized orders permitting national banks to deal in equity swaps and commodity swaps. The OCC subsequently authorized national banks to offer credit default swaps (CDS), which provided the equivalent of insurance against defaults on loans and debt securities.

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[16] *Id.* at 476-77.

The OCC and the Fed ruled that banks could reduce their capital requirements by obtaining CDS protection for their loans from AIG and other insurance companies. CDS from insurance companies also enabled banks to create collateralized debt obligations (CDOs). CDOs were second-level securitizations based on pools of unsold mortgage-backed securities. CDS from insurance companies supported decisions by credit ratings agencies to issue "AAA" ratings for CDOs. The nonprime mortgage boom could not have reached its massive size without the crucial roles played by CDOs and CDS. Without CDOs, many lower-rated mortgage-backed securities would have remained unsold, and funding for nonprime mortgages would have dried up. Without CDS, banks could not have obtained the "AAA" credit ratings they needed to sell CDOs to investors.

By 2007, there were $58 trillion of outstanding CDS, and some estimates indicate that a third of those CDS represented bets on the performance of nonprime mortgages, mortgage-backed securities, and CDOs. AIG and the other insurance companies that issued CDS were not required to hold any reserves for those CDS because state insurance commissioners had no authority to regulate CDS. The vast pyramid of bets created by CDS and CDOs magnified the losses that occurred when borrowers defaulted on their nonprime mortgages.[17]

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I agree with Professor Mahoney that Glass-Steagall's wall of separation eroded significantly prior to its repeal in 1999. As shown above, federal agencies and federal courts opened a number of loopholes in the legal barriers that separated banks from the securities and insurance sectors during the 1980s and 1990s. However, those loopholes were subject to many

[17] For discussions of CDS and other OTC derivatives, *see id.* at 477-91; Saule T. Omarova, "The Quiet Metamorphosis: How Derivatives Changed the 'Business of Banking'," 63 *University of Miami Law Review* 1041 (2009).

restrictions and did not allow banks to establish full-scale affiliations with securities firms and insurance companies. Leaders of the largest banks needed two major pieces of legislation to achieve their goal of creating full-service universal banks.

First, the big-bank lobby needed to repeal Sections 20 and 32 of the Glass-Steagall Act and modify Section 4 of the BHC Act. Those three provisions prevented banks from creating unrestricted affiliations with securities firms and insurance companies. Large banks and their trade associations pursued a 20-year campaign to accomplish that objective. Their campaign gained significant momentum in 1997 and 1998, when securities broker-dealers and insurance underwriters finally joined big banks in pushing Congress to authorize financial holding companies that could own all three types of financial institutions. However, community banks and insurance agents continued to defend Glass-Steagall.

To overcome the remaining pockets of resistance, Alan Greenspan's Fed issued a 1998 order allowing Travelers, a big securities and insurance conglomerate, to acquire Citicorp, the largest U.S. bank. President Bill Clinton and Treasury Secretary Robert Rubin publicly endorsed the creation of "Citigroup" – the first U.S. universal bank since 1933. The Fed approved the acquisition by relying on a temporary exemption in the BHC Act, which allowed newly-formed bank holding companies to divest nonconforming activities within 2-5 years. As one banking lawyer noted, that temporary exemption was "intended to provide an orderly mechanism for disposing of impermissible activities, not warehousing them in hopes that the law would change so you could keep them."[18]

The creation of Citigroup confronted Congress with a Hobson's choice – either repeal the anti-affiliation provisions of Glass-Steagall and the BHC Act or force Citigroup (a $1 trillion

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[18] Wilmarth, "Road to Repeal," *supra* note 1, at 512-14 (quoting Barbara A. Rehm, "Megamerger Plan Hinges on Congress," *American Banker* (April 7, 1998), at 1 (quoting an unnamed banking lawyer)).

financial conglomerate) to break up within five years. The Citigroup deal put a gun to the head of Congress, and it did so with the blessing of the President and the two most important financial agency leaders. As Jeff Madrick observed, Citigroup's creation was "a stark example of the ease with which the powerful on Wall Street got the ear of key policymakers, and how easily the Fed, through its rulings, could bypass the intentions of Congress."[19]

Citigroup spearheaded the final assault on Glass-Steagall, a campaign fueled by $300 million of political contributions and lobbying expenditures. Advocates for repeal called on Congress to clear away the "costly" and "unstable" loopholes created by federal agency and court rulings, and to provide a definitive legal framework for unrestricted affiliations among banks, securities firms, and insurance companies. In November 1999, Congress passed GLBA, which repealed Sections 20 and 32 of Glass-Steagall and modified Section 4 of the BHC Act. Senator Phil Gramm declared, "We are here to repeal Glass-Steagall because we have learned that government is not the answer." As President Clinton signed GLBA into law, he stated that "we have done right by the American people."[20]

The financial lobby's second major legislative goal was to insulate OTC derivatives from substantive regulation by the SEC and the Commodity Futures Trading Commission ("CFTC"). During the 1990s, the ability of banks and securities firms to offer OTC derivatives depended on a tenuous exemption approved by the CFTC in 1993. CFTC chairman Brooksley Born tried to reconsider that exemption in 1998, but she was blocked by the derivatives lobby and the

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[19] *Id.* at 514-15 (quoting Jeff Madrick, *The Age of Greed: The Triumph of Finance and the Decline of America, 1970 to the Present* 313 (2011)).
[20] *Id.* at 515-18 (quoting statements by congressional supporters of GLBA, as well as Sen. Gramm and President Clinton)

vigorous opposition of Fed chairman Greenspan, Treasury Secretary Rubin, and SEC chairman Arthur Levitt.[21]

The Treasury, Fed, and SEC continued to push for a sweeping deregulation of OTC derivatives despite the near-collapse of Long-Term Capital Management ("LTCM") in 1998. LTCM was a big hedge fund with massive derivatives exposures that suffered devastating losses after Russia's debt default in August 1998. The Fed prevented a potentially serious disruption of the financial markets by persuading a group of large banks and securities firms to rescue LTCM. The LTCM debacle vividly illustrated the dangers of unrestrained speculation in derivatives.[22]

Unfortunately, the LTCM crisis proved to be the canary in the coal mine, or the tree falling in the forest, that advocates of "financial modernization" were determined neither to see nor hear. In November 1999, the President's Working Group on Capital Markets – including Rubin, Greenspan, and Levitt – recommended legislation that would broadly exempt OTC derivatives from federal and state regulation. The Working Group argued that comprehensive deregulation was needed to remove "legal uncertainty" and "provide a permanent clarification of the legal status" of OTC derivatives.[23]

Armed with the Working Group's recommendation, the derivatives lobby and its political supporters persuaded Congress to enact the Commodity Futures Modernization Act ("CFMA") in December 2000. The only major question was how far-reaching the deregulation of OTC derivatives would be. Senator Gramm led the successful effort to exempt OTC derivatives from all types of substantive regulation under federal and state laws as long as the counterparties to those instruments were financial institutions, corporations, institutional investors, or wealthy

[21] *Id.* at 524-29, 534.
[22] *Id.* at 530-33.
[23] *Id.* at 533-39 (quoting the Working Group's report issued in November 1999).

individuals. Gramm declared that CFMA "completes the work of [GLBA]" and "protects financial institutions from over-regulation." He left the Senate in 2002 and became vice chairman and a registered lobbyist for UBS, a giant Swiss universal bank. UBS suffered more than $50 billion of losses during the financial crisis and was forced to accept a large bailout from the Swiss government in the fall of 2008.[24]

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As the foregoing summary indicates, GLBA and CFMA were highly consequential laws. They enabled banking organizations to become much larger and more complex and engage in a far broader range of activities. They transformed the U.S. financial system from a decentralized system of independent financial sectors into a highly consolidated industry dominated by a small group of giant financial conglomerates.

I disagree with Professor Mahoney and other scholars who contend that GLBA and CFMA did not play important roles in promoting the toxic credit boom that led to the financial crisis of 2007-09. Those scholars argue that GLBA and CFMA merely ratified what federal regulators and courts had already done, prior to 1999, by permitting nonbank financial institutions to offer "shadow bank deposits," by allowing banking organizations to engage in securitization, and by enabling both types of institutions to offer OTC derivatives.

I agree that regulators and courts opened loopholes that seriously weakened the structural barriers established by the Glass-Steagall and BHC Acts. However, those loopholes rested on highly contestable legal interpretations and could have been reversed by either regulators or the courts. Supporters of GLBA and CFMA argued that both statutes were urgently needed to remove burdensome restrictions and provide "legal certainty" for a deregulated regime of

[24] *Id.* at 539-41 (quoting Sen. Gramm); Eric Lipton & Stephen Labaton, "A Deregulator Looks Back, Unswayed," *New York Times* (Nov. 17, 2008), A1.

universal banking. The big-bank lobby secured passage of GLBA and CFMA after prolonged campaigns that cost hundreds of millions of dollars. Those campaigns would not have occurred unless big banks and their trade associations viewed both statutes as highly important.

One very tangible way to confirm the significance of GLBA and CFMA is to see how quickly the U.S. financial industry changed after they were enacted. GLBA's first major dividend was to validate Citigroup's universal banking structure – a result that allowed Citigroup to remain intact. During 2000, Credit Suisse and UBS capitalized on GLBA by acquiring two large U.S. securities firms (Donaldson, Lufkin & Jenrette and Paine Webber). Another immediate benefit was that GLBA permitted large bank holding companies to convert their limited Section 20 subsidiaries into full-service securities broker-dealers. As one federal regulator noted in 2000, "Loopholes cost money. . . . A top bank told me [GLBA] was a major boost to their bottom line."[25] GLBA enabled banking organizations to triple their share of the U.S. corporate debt underwriting market from 25% in 1998 to 75% in 2003. The number of banking organizations that ranked among the top-five underwriters of U.S. corporate debt rose from zero in 1996 to four in 2003.[26]

A second indication of GLBA's and CFMA's significance is the explosive growth that occurred in the shadow banking, securitization, and derivatives markets between 2000 and the outbreak of the financial crisis in 2007. The volume of outstanding MMMFs increased from $1.8 to $3.8 trillion, while commercial paper grew from $1.3 trillion to $2 trillion, and repos at broker-dealers rose from $2.5 trillion to $3.5 trillion. Mortgage-backed securities and other asset-backed securities (including CDOs) expanded from $1.6 trillion to $5 trillion, while OTC

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[25] *Id.* at 543 (quoting Barbara Rehm, "No Merger Wave, But Money Saved," *American Banker* (Nov. 7, 2000) (quoting an unnamed federal regulator)).
[26] Randall S. Kroszner & Philip E. Strahan, "Regulation and Deregulation in the US Banking Industry," in Nancy L. Rose, ed., *Economic Regulation and Its Reform: What Have We Learned?* 485, 499-500 (2014).

derivatives mushroomed from $95 trillion to $673 trillion. It is very unlikely that such dramatic growth would have occurred in all of those markets without the comprehensive deregulation authorized by GLBA and CFMA.

Glass-Steagall's demise was *not* inevitable, and its disappearance had highly important and devastating consequences. The same financial "innovations" that helped to erode Glass-Steagall – shadow banking deposits, securitization, and OTC derivatives – ultimately fueled the toxic credit boom and created the unstable financial conditions that led to the crisis of 2007-09. Had Glass-Steagall remained intact, I believe the financial crisis might not have happened, and it certainly would have had a much less severe impact if it did occur. I therefore agree with Professor Kathryn Judge's suggestion that we need to consider *both* "market forces" *and* "legal changes" as we evaluate whether it was a wise policy decision to repeal Glass-Steagall (or to allow it to be undermined by federal agency rulings and court decisions).[27]

[27] Kathryn Judge, "Regulation and Deregulation: The Baseline Challenge," 104 *Virginia Law Review Online* 101 (2018).