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The Power of the American Banking Sector

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Introduction

J.P. Morgan Chase & Co., one of the ten biggest banks in the world, is headquartered in New York and controls over $2.5 trillion in assets
Fortune

The ten most powerful banks in the United States control over $12 trillion in assets. To get a sense of the immensity of that number, think about it this way: If you counted one number per second, it would take about 372,000 years to reach the number 12 trillion. How do these ten American institutions have so much money and power? What do they do with all this money and power? In this briefing, you will learn about various ways in which the US banking sector has shaped the trajectory of the American society. Based on this knowledge, it is your task, as members of the Senate Committee on Banking, Housing, and Urban Affairs, to craft innovative policy solutions to the underlying issues within the American banking system.

When many Americans put their money into the same ten banking institutions, the result is that the banks can become so large and powerful that they are deemed "too big to fail." The American economy has become so reliant on the core banks controlling the American financial sector that it is a commonly held belief that the economy will collapse without these institutions. Banks, however, have been known to engage in risky behavior that jeopardizes the economy if not properly regulated. The control of large numbers of individuals' and families' assets, combined with the risky behavior that is commonly associated with the banking industry, have the potential to cause problems that could result in financial collapse.

The term "breaking up the banks" is tossed around in political debates and news articles, but it is important to understand the

***Breaking up the banks** – The broad policy proposal that suggests the American public would be better off is banks were smaller either in geographic reach or in banking purpose*

background of this term before making conclusions about the best path forward. **Breaking up the banks** refers to the policy idea of mandating that big banks, the ones often deemed "too big to fail" must divide up assets in order to avoid disaster if they collapse. Primarily, these policy proposals focus on dividing up the purposes of the bank to decrease the impact should it fail. There are many considerations, on both the pro and con sides of the issue, that must be taken into account when thinking about the most appropriate banking policies.

The debate over breaking up the banks is controversial and polarizing. Some people believe that banks should be free to innovate and experiment with investment, and others believe that Congress must implement more restrictions to better ensure they are held responsible to the people who trust their money with them. Financial collapse as a result of risky banking has happened before, as we will discuss in this briefing, and it could happen again. Throughout your research, remember to keep in mind all the important actors in this complex issue: the individual who puts his or her money in the bank, the bank itself and its employees, the US government, and both the domestic and global economies.

EXPLANATION OF THE ISSUE

Historical Development

***Retail banks** – Also known as personal or consumer banking, deal with individual clients*

***Commercial banks** – Deals with business or corporate clients*

***Investment banks** – Primarily concerned with raising capital via investments that are often somewhat riskier compared to those in other forms of banking*

Before going into the history surrounding banking in the United States, it is important to understand three key branches of banking services that will be relevant in this briefing. **Retail banking**, also known as personal or consumer banking, deals mostly with individual clients. Services that are provided to clients of retail banking include issuing loans, mortgages, and setting up savings or checking accounts. **Commercial banking**, also known as business banking or corporate banking, refers to services that are provided to commercial clientele. These services are offered by the bank to businesses. Lastly, **investment banking** is the cohort of services that banks provide to help new firms or businesses raise capital through investments. Investment banking is very complex, but it is important to keep in mind that with an investment comes risk.

Other than banks, many Americans entrust credit unions to hold their money. Fundamentally, credit unions differ from banks because they are non-profit institutions (whereas banks are for-profit). Credit unions are consumer-owned, meaning that each member who puts their money into the union is actually a partial owner of the institution.

Banks have been around in the US since the 18th century. The first banks were mostly facilitated by either the federal government or the

***Stock market** – the system in which the ownership of businesses is controlled by those who invest in publicly-owned companies via buying stocks*

At FDR's first inaugural address in 1933, the incoming US president said, "the only thing we have to fear is fear itself." This quote emphasizes the fact that mass panic has the power to lead to financial crisis.

***Bank runs** – The phenomenon that occurs when a large number of people withdraw their money from the bank, oftentimes caused by large-scale economic panic*

governments of individual states. Private banking, however, became popular after the War of 1812. The Panic of 1819 was one of the first financial crises in the US, occurring after the conclusion of the war. This panic was in part based on rising fears due to the independence of the colonies. With the separation of the US from the rule of Great Britain, the colonies were also left to their own devices economically. This came to a head in the Panic, which resulted in overall economic collapse.

In the mid-1800s, many states deregulated bank charters so as to not require approval by the state legislature. This was called the "free banking" era. At the dawn of the Civil War era, the federal government established the "national banking system," which accidentally, yet advantageously, established a uniform currency for the US. This occurred because the federal government began to allow banks to choose between state charters or national charters; because the banks were for-profit and wanted to expand to reach optimal capacity, most chose the national charter.

Throughout the late 1800s, various "panics" occurred when people tried to over-withdraw from the bank. When too many people withdraw from the bank, the bank isn't able to grant withdrawals any longer, which causes mass panic. People rush to the bank, attempting to remove their money, as they believe the bank to be failing; however this great demand would in turn sometimes actually cause the bank to fail.

Financial panic is essentially what led to the beginning of the Great Depression. In the summer of 1929, a slight recession hit the American economy. However, stock prices still increased, so much so that it became widely believed that the stocks were overly inflated. In October 1929, investors began to get nervous about the amount of money that they had tied to the **stock market**. On Black Tuesday and Black Thursday in October 1929, record numbers of stock market shares were traded due to the overarching panic about the stock market. The stock market crash was largely a result of risky investment on behalf of banks. It was determined after the crash that banks had been too confident in their investments and in spending clients' money on activities from which profit was uncertain.

The crash adversely affected the non-investment side of the banking industry by causing **bank runs**. Bank runs are dangerous for banks because banks do not always necessarily have all the money that they loan out to clients. Banks essentially run on a system of trust, in which the bank trusts the client to pay (or receive) and the client trusts the bank to be able to return on the assets that he or she has invested over a period of time.

In reaction to the disaster of the stock market crash of 1929 and the resulting Great Depression, the US passed what is commonly referred to as the Glass-Steagall Act in 1933. The main provision of this act (which is officially referred to as the United States Banking

Securities – *tradable financial assets that fall under two primary categories: equities (principally stocks) and debts (primarily bonds and CVs)*

Act of 1933 – language was clarified two years later in the US Banking Act of 1935) is that it separated commercial banks from investment banks. The law gave banks a year to determine whether they were an investment bank, which could not own commercial banks, or a commercial bank, which could not deal with **securities**. In order to comply with Glass-Steagall, many banks had to split up. JP Morgan, for example, continued as a commercial bank but had to create Morgan Stanley to deal with investments.

The Glass-Steagall Act also created the Federal Deposit Insurance Corporation (FDIC), which insures up to $250,000 for depositors in member banks. This essentially means that should the bank fail, the FDIC will provide up to $250,000 to the person who deposits their money in a bank. This guarantee is designed to prevent bank runs when panics occur.

After the New Deal banking reforms, the industry remained relatively stable until a period of deregulation in the 1980s. Then, in the mid-1990s, legislation was passed to repeal numerous aspects of the Glass-Steagall Act. The Riegle-Neal Interstate Banking Act of 1994 overturned previous regulation on interstate banking, meaning that banks could expand to cross state lines. This led to the establishment of nation-wide banks, which allowed the institutions to grow to the size and scope that they have reached today. In 1999, Congress passed the Gramm-Leach-Bliley Act, which repealed the provision of the Glass-Steagall Act that banned banks from doing commercial, retail, and investment banking from under the same roof. All of this deregulation also allowed big banks to become bigger via **mergers and consolidation**. In contrast to the early 1980s, when there were around 15,000 banking organizations in the US, there were only around 8,000 by 2008.

Recent Developments in US Banking

Mergers and Consolidation – *When one corporation becomes a part of another corporation or two corporations come together to form a new, larger corporation*

Many young people today do not recall the Great Recession of the late-2000s, but it has had far-reaching effects on our lives. The scale of the Great Recession did not nearly reach that of the Great Depression, but it still resulted in significant economic downturn. GDP decreased 2.8 percent in 2009 and unemployment came close to 10 percent of the US working-age population.

Again, one of the root causes of the Great Recession was that banking institutions assumed too much risk. Because the provisions of the Glass-Steagall Act that prohibited banks from doing both commercial and investment business were repealed in 1999, banks in the mid-2000s were bundling commercial and retail business with risky investment, essentially using the money that they were making from individual clients to invest in uncertain markets. Many banks were investing in the housing market, which was seemingly on the rise in the mid-2000s. However, when the bubble burst, and individuals began defaulting on their housing loans and even foreclosing in large numbers, banks lost a great deal of money on investment, which impacted consumers because retail and commercial business was then under the same roof as investment banking.

Part of the problem with the activity of banks during this time period was that they were approving inappropriate loan rates. **Subprime mortgages** were being approved en masse, and these mortgages were being used to back other investments. Banks initially used good mortgages to back other investments, but then they began to use riskier mortgages to fill bonds. Many attribute the root cause of the financial crash of the late-2000s to lack of government oversight.

Subprime Mortgages – *Mortgages that are given to people who would not qualify for traditional mortgages, usually because of poor credit scores.*

In addition to the banks, credit rating agencies were an important factor in this equation. These groups are supposed to act as intermediaries that provide ratings on bundles of mortgages, which demonstrate the relative risk of these mortgages. However, they were rating mortgages as far safer than they actually were. People disagree over whether they are primarily responsible for the crash, if the banks were, if the government was, if it was homebuyers who were buying homes they couldn't afford, or if blame is shared by any combination of the four.

The 2010 Dodd-Frank Act put additional regulations on banks, but it did not go as far as the 1933 Glass-Steagall Act

After the financial crash, there were several reforms that were put in place to try to avoid future financial crises like the Great Recession. The major piece of legislation that reformed the financial industry is referred to as the 2010 Dodd-Frank Act, after the two primary sponsors of the bill in Congress. Dodd-Frank created the Consumer Financial Protection Bureau, which is tasked with overseeing big businesses (banks, credit card companies, etc.) in the interest of consumers. The legislation also limits the type and amount of **speculative activity** in which a bank or firm can engage.

Politicians and pundits alike are very divided over bank regulation. Recently, Dodd-Frank has been undermined by various Republican efforts. The Economic Growth, Regulatory Relief, and Consumer Protection Act of March 2018 granted exemptions to many American banks from Dodd-Frank regulation.

Scope of the Problem

The banking system in the US is comprised of an incredibly complex infrastructure. There are many facets to the banking industry and financial sector. Below is an explanation of only a few of the considerations that come into play in this discussion. When considering the appropriate policy response to the problems explained in this briefing, be sure to think about more than just the following list of sub-issues within the banking industry.

Occupy Wallstreet protesters in the streets of New York City

Wall Street Journal

Bank Mergers and Interstate Banking

Many banks look to either merge with another bank, acquire another bank, or be acquired in order to broaden the scope of their potential profitability. Mergers and acquisitions are incredibly relevant concerns when considering banking policy.

In the aftermath of the 2008 financial crisis, a number of banks merged in order to avoid total collapse. JP Morgan Chase acquired the failing Bear Stearns; Bank of America acquired Merrill Lynch; Barclays acquired part of Lehman Brothers.

However, after the financial crisis, merging came to a halt for a period of time. Big banks received a bad reputation during the financial crisis, and were blamed both by the public and the federal government for the economic collapse. Occupy Wall Street was a social movement in the early 2010s that was a result of people's frustration with the American banking system, which is headquartered in the financial district of New York City (referred to as Wall Street). The US government under the Obama administration also cracked down on banks with tougher regulation as they increased in size.

Recently, however, banks have begun to attempt to merge again. In February 2019, the biggest bank merger since the financial crisis was announced, between BB&T and Sun Trust Banks. This merger created the sixth largest bank in the US

***Moral Hazard** – The phenomenon of engaging in risky behavior because it does not directly affect the individual taking the risk*

Though having a larger portion of market share via mergers is advantageous for banks, some executives fear tougher regulation and more intense government oversight as a result of mergers. Until recently, this has been successful at deterring banks from large-scale mergers. The Trump administration has taken a softer position on banking regulation, however, which has encouraged banks to again consider merging and acquiring.

***Speculative Activity** – Engaging in financial activity which is high risk and expects significant returns*

Interstate banking, as a result of the 1994 legislation that reversed the ban on multi-state banks, spans the nation. These banks are almost always themselves the result of mergers. An example is BNY Mellon, which is the product of a 2007 merger between Bank of New York and Mellon Financials. Before the Riegle-Neal Act that allowed interstate banking, such a merger would not have been allowed by the US government. Allowing banks to merge increases the risk of economic **moral hazard**, the phenomenon that occurs when a party overestimates its value and engages in risky behavior because it does not impact the people who are making the decisions to engage in the behavior.

Investment versus Commercial Banking

As has been discussed in earlier sections of the briefing, there has been significant concern about the consolidation of banking activity as a result of the 1999 repeal of portions of the Glass-Steagall Act.

The problem with banks doing investment, commercial, and retail business all under the same roof is that it allows the bank to utilize more market power to engage in risky behavior. When individuals or businesses put their money in a bank, they want to know that the bank will safeguard it and increase its value overtime via positive interest rates on savings. Commercial and retail banking are relatively stable and safe engagements. In contrast, investment banking is inherently risky, and in some cases, banks are incentivized by moral hazard to engage in overly risky behavior. If commercial and investment banks are under one roof, this gives the bank the ability to use the stable and safe funds from the commercial branch for the purpose of risky investment banking.

Deutsche Bank is a German Bank which some economists view as a competitor to American banks

AskTraders

Additionally, by allowing the same bank to do both commercial and investment business, the market size of the financial sector decreases. As market size decreases, the number of banks (and subsequently the number of people in charge of the banks) decreases as well, further concentrating the power of the financial sector in fewer hands. This goes along with the previous consideration of bank mergers and interstate banking. As the banks become bigger, the money is increasingly concentrated in only a few institutions. If something happens to these institutions, millions of people's savings may be slashed or diminished.

It is important to also know that many theorists and economists disagree that there is a problem with US investment and commercial banks being under one roof. These experts argue that US banks are losing market share to the banks of other countries, which are either not regulated as tightly or are state-owned (such as Bank of China, which controls almost $3 trillion). Countries such as Germany and Switzerland allow universal banking, meaning that investment banks can also control commercial banks and their businesses can be intertwined. With increased globalization, some predict that it will be harder and harder for American banks to compete globally with universal banks unless America is lax in its regulation of banks. Moreover, when these banks have a larger pool of capital from which they can draw, they are able to invest more in the businesses driving economic growth in the US.

Additionally, some argue that unilateral dependence on one industry, market, product, or region can be dangerous for banks. Via universal banking, this danger could potentially be mitigated. Universal banking would allow the bank to diversify its portfolio of investments and channels of profit, which ensures stability for the banks and the economy.

The Lack of Attention to Underserved Communities

It may not come as a surprise that while in some areas there are many banks, in other areas there are very few if any. In these areas, banks are also less willing to invest. The communities in which banks

***Banking Deserts** – The absence of banking institutions in some underserved, low-income, or majority minority communities. Results in underbanked or unbanked individuals.*

are absent are those that the banks determine to not be viable for significant profit margins. The term **banking deserts** is used to describe underserved areas that have inadequate banking services. These areas are often low-income and majority minority. Because of a lack of access to mainstream banking services, individuals in banking deserts are forced to either travel long distances to bank, which is inaccessible for many people, or use higher-risk services.

One of the reasons that so many banking deserts exist is that, since the 1990s, banks have become national rather than state-based or local. Prior to the 1990s, most banks served one or a few communities within a single state. Now, banks have near limitless options for where to locate their offices because they can expand through numerous states.

Alternative financial services pose higher risks to more vulnerable individuals than do standard banks. These services include **payday lenders** and check-cashing stores. Such services often charge high fees that standard banks do not, and many accuse them of intentionally engaging in predatory lending. Thus, instead of building wealth, individuals in banking deserts end up using significant portions of income for fees associated with suboptimal financial services. This can further contribute to cycles of poverty by forcing poor people further into debt.

***Payday Lender** – Services which offer immediate and short-term loans (often in cash) with very high interest rates. They are often the only option for people with bad credit or people in banking deserts.*

The Revolving Door Between Washington and Wall Street

The so-called "revolving door" between Washington and Wall Street refers to the strong ties between policymakers and the financial sector and the ease with which regulators and bankers can move to the opposite industry. As will be discussed more in a few pages, many politicians have, or are accused of having, deep ties to Wall Street. This extends to both the Democratic party and the Republican party.

The main problem with the revolving door between Washington and Wall Street is that it can lead to issues of conflicting interests. When someone who has worked in the banking industry transfers over to a regulatory position, that person could still foster sentiments that promote the industry over the interests of the public. Ethical scandals and concerns about independence of regulators have resulted. Additionally, some legislators hope to find jobs in the financial sector after leaving public office and are therefore not inclined to regulate the industry because they hope to make money there in the future.

However, many argue this problem is more political messaging than substance. They argue that regulators need to understand how the industry works, and the headline-grabbing cases of abuse are rare and prove that the existing federal safeguards and regulations are working (after all, it would be folly to expect all people to play by the rules under any system).

Congressional Action

As has been outlined, there have been numerous significant pieces of legislation that have contributed to the structure of today's banking system.

The Glass-Steagall Act of 1933 set up tough regulation on banking, prohibiting investment banks from also being commercial banks.

The Riegle-Neal Interstate Banking Act of 1994 overturned previous regulation on interstate banking, meaning that banks could expand to cross state lines.

The Gramm-Leach-Bliley Act of 1999 repealed the provision of the Glass-Steagall Act that banned banks from doing commercial, retail, and investment banking from under the same roof.

The 2010 Dodd-Frank Act created the Consumer Financial Protection Bureau, which is tasked with going after big businesses (banks, credit card companies, etc.) in the interest of consumers. Dodd-Frank also limits the type and amount of speculative activity in which a bank or firm can engage. Dodd-Frank was passed instead of reinstating the provisions of Glass-Steagall that would ban joint investment and commercial banks.

Rep. Ocasio-Cortez and Senator Sanders discuss banking regulations

NowThis

In May 2018, President Trump signed the Economic Growth, Regulatory Relief, and Consumer Protection Act. This law raises the size threshold for banks that must be most carefully overseen by the federal government to $250 billion in assets. Previously, the threshold was $100 billion. One argument for this law was that the previous threshold applied the strict regulations to credit unions, which didn't make sense because they operate very differently from the big Wall Street banks. This legislation passed with bipartisan support, as many moderate Democrats signed on, arguing that flexibility for credit unions and small banks would help counter banking deserts.

Senator Bernie Sanders and Congresswoman Alexandria Ocasio-Cortez proposed the Loan Shark Prevention Act in May 2019. If enacted, this bill would target and reduce predatory activity from banks by introducing a 15 percent interest rate cap.

Other Policy Action

Because most banks are now national, due to the 1994 law that allows banks to become interstate, they are almost entirely overseen by the federal government.

However, other countries have different systems for banking. For example, there are few Canadian banks but many branches of each bank. The system weighs stability over experimentation, which contrasts the US system.

In Europe, the Banking Union was formed after the Great Recession to supervise and support banks in Europe. All countries in the EU abide by the regulation of the Union.

Banks in India are divided based on purposes. Each banking group has its own market—for commercial services, investment services, and other types of financial services. This system is somewhat like the US in that the American banking system is also divided based on purpose. However, in India, much of the banking industry is state-owned.

The banking sector in Latin America has gone through much turmoil due to foreign investments and myriad political turnovers in the region. However, experts say that the system is becoming increasingly globally competitive.

IDEOLOGICAL VIEWPOINTS

Conservative View

Laissez-faire Economics *– The model that argues that the economy is best left alone without government or external interference. Translates from French directly to "let do."*

The traditional, economically-conservative perspective on banking policy adopts **the laissez-faire economic model** and applies it to issues of regulatory oversight. The laissez-faire economic model theorizes that the "invisible hand" of the economy is apt to self-adjust and self-regulate based on events that occur. According to many conservative theorists, the economy is best left as untouched as possible.

With regard to banking policy, the conservative approach is to allow banks to regulate themselves with minimal government infringement. This means that banks would be allowed to merge with others, lend to whomever they want, and become investing and commercial conglomerates.

Many conservatives adopt the philosophy that American banks should do whatever they deem necessary (within humanitarian constraints, of course) to compete in an increasingly global economy. Conservatives would argue that countries such as Germany have been successful in creating large bank conglomerates. Conservatives also often dismiss added regulation, citing the fact that bankers likely know banking better than government officials do.

Recently, the Republican Trump administration has acted to roll back some of the Dodd-Frank regulations on banks. Trump has consistently taken an anti-regulatory perspective. As discussed earlier, part of their argument for this action is that these regulations are so onerous as to crowd-out smaller banks and credit unions, which would otherwise create a more diversified (and, thus, stable) banking system and would better counter the problem of banking deserts.

Liberal View

In contrast to the conservative approach, the liberal view on banking policy emphasizes increased government oversight and more limitations to the size and scope of banks. The liberal approach is more hands-on, believing that if the government does not take on a regulatory role, banks will do whatever they believe to be in their best economic interest—which is not always in the best interest of the public.

Liberals largely believe in promoting stability for the consumer rather than profitability for the bank. The Democratic party is somewhat split on how closely it is tied to the banking industry. In the 2016 election, Democratic nominee for president Hillary Clinton was ridiculed for her ties to Wall Street and for accepting money from banks. Clinton did advocate for banking reform, but she was not excessively progressive on the issue.

Democrats such as Senator Bernie Sanders, Senator Elizabeth Warren, and Congresswoman Alexandria Ocasio-Cortez have taken more extreme positions on the banking industry. Sanders is famous for taking a near zero-tolerance policy of big banks. During his campaign for president, Sanders said, "It is not acceptable that the 6 largest financial institutions in this country have assets of almost 10 trillion dollars, and issue half of the mortgages and two-thirds of the credit cards. That is too much wealth and power in the hands of a few."

Libertarian View

The libertarian view on the banking industry is similar to the conservative view in that it argues that the industry would be better off with less government intervention. In particular, however, it argues that the government caused the 2008 Great Recession. It points to the history of the US Federal Government bailing out the banks whenever they go under. Libertarians would argue that these bailouts – including the extensive TARP bailouts after 2008 – incentivize banks to engage in risky behavior that they wouldn't otherwise, because they know there would be no real consequence for their bad behavior. They reject the idea that banks can be "too big to fail," arguing that the free market only works when companies are allowed to fail. If the bankers at these banks instead knew that if they goofed up, they would pay the price for it, they never would have engaged in that behavior – but instead, the government bailed them out with taxpayer dollars. Their belief is that the government should refuse to bail out the banks and let the free market work like it is supposed to in the future, rather than waste precious time and resources on regulation that they don't believe is very effective.

AREAS OF DEBATE

The banking system in the US is incredibly complex. In order to propose the best policy solutions to the issues discussed, it is necessary to take all of the actors involved in banking into consideration. How will the proposed policy impact the people who place their life savings into banks? How will it impact the banks and their employees? What role will the government take in the proposed policy? Finally, how will the overarching domestic and global economies be affected? Will more or fewer people want to invest in American banks and American businesses?

The following list of potential policy solutions is not nearly complete. As delegates of the Senate Committee on Banking, Housing, and Urban Affairs, it is your job to explore out-of-the-box solutions to problems that policymakers and pundits alike have considered for years on end. Through innovations in policy, it is possible that both banks and individuals putting their money in them can be better off.

Not included in the following list of ideas is to create legislation to limit bank mergers if the banks have a certain threshold of assets.

Stricter Regulations on Banking and Lending

In line with the discussion of subprime mortgages in the section on the causes and manifestations of the Great Recession, banks have been known to engage in predatory lending. As we discussed before, subprime mortgages are given to people who would not qualify for traditional mortgages. Similarly, predatory lending is when banks give loans (or mortgages) to people who they suspect will not be able to pay back the bank based on poor lines of credit or histories of defaulting on loans. It can also be when the bank deceives the client about what they have to pay, making it seem as though the investment is more affordable and feasible than it is. There are regulations that prohibit predatory lending, but it still occurs today.

Some would argue that deregulating the banking sector would result in American banks becoming more globally competitive

One possible solution to the problems within the American banking system is to crack down on predatory lending practices. These practices adversely target lower-income individuals. A main cause for the 2008 housing market crash was that banks were making it seem as though people could afford to pay high mortgages that they really could not afford. By taking additional action to regulate predatory banking practices, future economic crises could be avoided.

Those who believe that regulation is overly burdensome would argue that additional legislation on predatory banking practices is unnecessary because it would hurt the banks' profitability capabilities.

Political Perspectives on this Solution

Liberals would likely be more in favor of this type of solution than conservatives. In general, liberals are more prone to favor additional regulation than conservatives are.

Banking associations would not be in favor of additional regulation on predatory practices. They would argue that this type of legislation would put American banks at a disadvantage in the global economy.

Deregulate Banks and Allow Universal Banking

This policy proposal would allow American banks to engage in universal banking and lessen the extent of banking supervision from the federal government. This solution would be meant to solve the issue that American banks are facing challenges in competing in the global economy because of the excessive burdens associated with federal regulations.

Arguments in favor of this type of solution would assert that the invisible hand of the economy is more apt to control banks than the US government. Proponents of deregulation would posit that banks do not need the supervision of the government in order to best serve the American population. Additionally, proponents would argue that allowing universal banking would allow banks to experiment and innovate with additional funds, which could lead to innovations in the American economy or the global banking industry.

However, opponents of this type of legislation would argue that deregulation could lead to another financial crisis, as happened the late 1920s and in the late 2000s. These people would assert that the banking industry, if not properly regulated, would work in the best interests of only themselves, not of the public. This could include engaging in practices that are not appropriate. Additionally, opponents would take issue with universal banking because of how risky it can be. They would say that universal banking is inappropriate because it uses funds from individuals or businesses as vehicles for risky judgements about investments.

Political Perspectives on this Solution

Deregulation is an inherently conservative/libertarian policy proposal. President Trump recently took action to deregulate parts of the banking industry, as was received in the Congressional Action section. However, as was noted in that section, some Democrats supported that specific deregulation as well. Conservative policymakers are in favor of deregulation because it gives more power to the private sector and less power to the government. Banking associations would also be in favor of this type of action. The fewer regulations they have to undergo, the more profit they are able to turn – and the more communities and growing businesses they are able to serve, they argue.

Liberals would take issue with deregulation because it allows banks to do whatever they please with minimal supervision, which they argue endangers the economy and the people placing their money in these institutions. Liberals generally favor more involvement in the private sector, rather than less.

Stop the Revolving Door Between Washington D.C. & Wall St.

Public confidence in the governmental institutions that govern the financial sector has eroded as increasing numbers of multimillionaire banking executives have been appointed top positions in the institutions that regulate and oversee the banking industry. Public opinion about government institutions is incredibly important, as it informs how strong individuals believe governmental authority to be.

Public opinion about government institutions is incredibly important, as it informs how strong individuals believe governmental authority to be

A policy proposal to stop the revolving door between Washington and Wall Street would essentially create a barrier between those who enter private sector banking and those who enter public sector regulating. This type of policy could resemble a waiting period of a number of years for any individual to transfer sectors or a complete ban.

Proponents of such a policy to stop the revolving door would say that a waiting period or ban would get rid of people within each sector who have ulterior motives for being in those sectors. It would effectively limit the conflicts of interest that are posed by having people slid from profiting and regulating and vice versa.

Opponents of such a policy would say that this proposal would be a limitation on the rights of private citizens to do as they please. Once a person no longer works for the government, they return to being a private citizen and, some would argue, should have no limitations on their behavior simply because of a previous job. They would further argue, as was mentioned earlier, that the existing regulations suffice, and this issue is not actually a problem, but rather political messaging.

Political Perspectives on this Solution

This policy proposal leans to the liberal side. Bankers would not be in favor of this proposal as it limits their autonomy. Conservatives would also likely not be in favor of this proposal because it causes increased government interference in the lives of individuals.

Mandate Banks to Focus More on Underbanked Communities

This policy solution could take many forms, but its overall goal would to be focus more attention on "underbanked and unbanked" American communities.

One such policy solution would be that banks would begin piloting systems of agency banking. Agency banking is a system that was started in Kenya that allows unbanked individuals to work directly with a branchless agent. The agent is located in some commercial business or frequented location. If American banks implemented agency banking, individuals might be able to bank at a supermarket or gas station. A program by Capital One bank—which has set up multiple joint coffee shops and banks—is similar to agent banking (albeit their locations do not primarily target lower-income or underbanked populations).

Another policy solution that would encourage more attention to be given to underbanked communities would be to require banks to have "pop up" community outreach centers or digital banking opportunities in underbanked regions. Such policies would also have to be accompanied by an underlying infrastructure of banking and personnel support.

Political Perspectives on this Solution

These policies have somewhat of a liberal bent to them, but many people would universally agree that all individuals should have access to banking support. When people put money into banks, the entire economy is better off, not just the individual doing so. However, in particular, focusing more attention on underbanked communities in the area could help close the wealth and asset gap between races. In part because communities of color and rural communities are often underbanked or unbanked, individuals in these communities often do not accumulate as much wealth throughout their lives as their white peers.

Payday loan locations often pop up in underbanked communities
Cash4You

Interest groups that represent people of color, rural communities, and lower-income individuals would likely be very supportive of policies that would mandate that banks become more attentive to underserved communities. However, as mentioned earlier, the exact policy to combat this problem remains unclear – for example, many in Congress support deregulation to encourage credit unions and smaller banks to step into these communities, rather than having the same big banks from Wall Street do so.

Require Banks to Have Representative Executive Boards

As discussed, ten American banks have a massive amount of both economic and political power. This immense amount of power and capital in very few hands is magnified by the fact that the executive boards of banks have historically been unrepresentative of the American population. Even today, most people entering Wall Street are white and male, despite the US population becoming increasingly diverse.

The net worth of Gary Cohn, who was the former CEO of Goldman Sachs, is in the hundreds of millions. Trump appointed Cohn the Director of the National Economic Council in 2017, a post which Cohn resigned from in 2018.

Vanity Fair

This policy solution mandates that executive boards of banks are representative, which could either focus specifically on the diversity and interests of the workers of the company or include the general diversity of the US population. For example, a policy proposal by 2020 presidential candidate Massachusetts Senator Elizabeth Warren mandates that large companies' workers must be allowed to elect 40% of the executive boards that control the firm. In the banking world, this would allow rank-and-file workers for banks to elect someone to represent them in the executive board room.

This policy proposal would be positive for workers because it would essentially give them a seat at the decision-making table. If company workers are represented in the boardroom, decisions that are made are more likely to consider the perspectives of the regular workers for the bank and not just the CEOs at the very top.

A drawback of this policy proposal is that it would likely not be financially profitable for the bank. Representatives of workers or of the diversity of the American population may bring in various considerations that are not in the best economic interest of the bank. Because banks influence the entire economy and are responsible for millions of Americans' savings, the repercussions of such a proposal could thus be incredibly severe.

Political Perspectives on this Solution

As is evidenced by the fact that a similar proposal is on the platform of Democratic presidential candidate Elizabeth Warren, this policy proposal has a liberal bent to it.

Unions and workers would likely be very much in favor of this type of policy change, as it would give them more power in the company. Conservatives might worry that such a policy places an undue burden on companies and that it would not be the role of government to dictate who companies must hire.

BUDGETARY CONSIDERATIONS

As has been discussed, the banking industry is incredibly profitable. It should be noted that almost all economists agree profit is not necessarily a bad thing, and in most cases is a decidedly good thing – it allows companies to innovate, expand to new customers, invest in people and the economy, and reward savers – in short, it is the backbone of a growing American economy. When thinking about any given policy, it is important to take into consideration what the policy's political and economic ramifications will be. The banking industry employs millions of people in the US, and any hit that it takes due to increased regulation will likely result in some people in the industry losing their jobs. Additionally, these regulations have the potential to drive banks out of important markets or force additional consolidation in the industry, which some argue creates more dangers.

That being said, the banking industry is also incredibly profitable. Some bank CEOs are paid in the tens of millions of dollars each year—for example, Bank of America Chairman and CEO Kenneth Lewis was paid $24 million in 2007. Gary Cohn, the former CEO of Goldman Sachs, was paid $72 million the same year. Since then, bank executive salaries have gone somewhat down, largely due to the financial crisis, but they still remain incredibly high. Thus, it could be argued that the banking sector could afford, no pun intended, to pay more to the government so as to ensure that consumers are protected.

CONCLUSION

As you have learned throughout this briefing, the American banking sector wields an incredible amount of power. It has shaped the course of world history and the underlying issues within the industry continue to pose problems for millions of families across the US. Even when we aren't aware of it, the banking industry has immense power in all of our lives.

As members of the Senate Committee on Banking, Housing, and Urban Affairs, it is your task to come up with innovative solutions to the issues in the banking industry. One of the primary issues is that there is an immense concentration of wealth and power in the financial sector. Another problem is that banks don't serve more vulnerable parts of the American population. A third problem is that regulators could have conflicts of interest if they have previously been employed by the banking industry. Depending on your ideological and practical viewpoints, you will have different perspectives about what problems are real, who is responsible for what (including consumers, the government, rating agencies, and credit unions and local banks), and what actions the government must take. The list of underlying issues in the banking sector goes on.

Financial stability affects everyone, and banking plays a huge role in that. Even as young people, we are taught to save our money in a piggy bank for some day when we might need it. But what happens when the banks that we entrust to save our money act recklessly with it? And what happens when some people don't have the opportunity to save their money in the piggy bank because they can't easily access it? The result is often that some people lose out immensely and are stuck struggling to make ends meet. When the financial system doesn't work, there are real costs for Americans.

As you begin to do external research, remember to keep all the actors involved in the banking industry in mind as you brainstorm different policies. Each policy you propose will have immense impacts — likely some positive and some negative — on various sectors of the economy. Remember that many solutions are not mutually exclusive, and you can and should think about how they can be put together to best serve the American people. Moreover, do not feel constrained to the potential strategies outlined in this briefing – in fact, you will do best in committee if you come with your own ideas and strategies as well, based off of your additional research.

Best of luck, delegates. The financial future of millions of Americans is depending on you.

GUIDE TO FURTHER RESEARCH

There are many places to look for further information about the banking industry. Feel free to reference the works cited list at the end of this briefing to begin your research. I would suggest that you first complete all the research necessary to understand the banking sector as a whole, and that only after that, you move on to doing research about the specific senator that you are representing. Become familiar with your senator's perspectives on banking, finance, the 2008 recession, and regulation. Does the senator you are representing favor increased regulation or decreased regulation? Is the senator more concerned with protecting consumers or allowing the financial sector to innovate and experiment? Does the senator accept money from the banking industry, or does he/she believe in comprehensive campaign finance reform? How does your senator feel about antitrust policy? These are only some of the questions you should be able to answer as you prepare to represent your assigned senator at Harvard Model Congress Boston 2020.

GLOSSARY

Banking deserts – The absence of banking institutions in some underserved, low-income, or majority-minority communities. Results in underbanked or unbanked individuals.

Bank runs – The phenomenon that occurs when a large number of people withdraw their money from the bank, oftentimes caused by large-scale economic panic

Breaking up the banks – The broad policy proposal that suggests the American public would be better off is banks were smaller either in geographic reach or in banking purpose

Commercial banks – Deals with business or corporate clients

Investment banks – Primarily concerned with raising capital via investments that are often somewhat riskier compared to those in other forms of banking

Laissez-faire economics – The model that posits that the economy is best left alone without government or external interference. Translates from French directly to "let do."

Mergers and consolidation – When one corporation becomes a part of another corporation or two corporations come together to form a new, larger corporation

Moral hazard – The phenomenon of engaging in risky behavior because it does not directly affect the individual taking the risk.

Payday Lenders – Services which offer immediate and short-term loans (often in cash) with very high interest rates. They are often the only option for people with bad credit or people in banking deserts.

Retail banks – Also known as personal or consumer banking, deal with individual clients

Securities – Tradable financial assets that fall under two primary categories: equities (principally stocks) and debts (primarily bonds and CVs)

Speculative activity– Engaging in financial activity which is high risk and expecting significant returns

Stock market – The system in which the ownership of businesses is controlled by those who invest in publicly-owned companies via buying stocks

Subprime mortgages – Mortgages that are given to people who would not qualify for traditional mortgages, usually because of poor credit scores

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