



A Summer Reading List

In March, the Dallas Fed issued our annual report featuring an essay on banks considered too big to fail (TBTF), followed by a *Wall Street Journal* op-ed article I co-wrote with the essay's principal author, Harvey Rosenblum. We concluded that the "least worst" option for dealing with TBTF was to break up these behemoth financial institutions. We acknowledged that the financial entities that emerged needed to be smaller, less opaque and less complex. Equally important, they had to be viable, profitable companies that served customers' needs.

At the time, we refrained from making specific recommendations as to how, preferring to see what might emerge from the marketplace of ideas. Plenty of market-focused recommendations have emerged from prominent observers. In the spirit of traditional summer reading lists, we attach for your reading pleasure a list of articles and authors you may wish to peruse as you lie on the beach, retreat to mountains and streams, or choose instead to take a "staycation."

With all best wishes for the summer,
Richard W. Fisher

President & CEO, Federal Reserve Bank of Dallas



Summer 2012 Reading List

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



This presentation includes links to recommended reading that followed the Dallas Fed 2011 Annual Report and subsequent Fisher/Rosenblum *Wall Street Journal* OpEd



The Public Debate Surrounding TBTF

Press coverage following the [Annual Report](#):

- ✓ *Forbes*
- ✓ *Rolling Stone*
- ✓ *PBS Frontline*
- ✓ **CNBC**
- ✓ **NPR**
- ✓ *New York Times*
- ✓ *Wall St. Journal*
- ✓ *American Banker*
- ✓ *The Deal Economy*

Two weeks after the Annual Report was published ...

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

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

- Filled in some important “next steps” and “how to” from the Annual Report
- *Kicked off public debate about the market-focused break-up of TBTF banks*



The Public Debate Surrounding TBTF

“Sordid footnote offers lesson for megabanks”

by Tom Braithwaite,

April 16, 2012, *Financial Times Inside Business*

- “Subsidiarization”—organizing global banks into separate national operations—is the “watchword of modern banking,” and Goldman, HSBC and Citi have recently sold stakes in international markets.
- Many officials think more “national organization” is inevitable, and “much of this change might be desirable.”
 - *But* will this actually bring benefits of liquidity and customer experience?

“JPMorgan loss fuels calls for simplification”

by Tom Braithwaite,

May 14, 2012, *Financial Times Inside Business*

- JP Morgan’s trading debacle fuels calls for big bank simplification; Dodd–Frank’s “living wills” gives regulators the power to do so.



The Public Debate Surrounding TBTF

“Big Banks: Now Even Too Bigger to Fail”

by David J. Lynch,

April 19, 2012, *BloombergBusinessweek*

- In 2011, the largest five banks comprise \$8.5 trillion in assets, 56% of U.S. GDP, compared with 43% of GDP just five years earlier.
- These “giant institutions sheltered under an invisible government umbrella pose ‘a clear and present danger to the U.S. economy’...” quoting our Annual Report.



The Public Debate Surrounding TBTF

“Break Up the Megabanks? We Could Do a Lot Worse”

by Camden Fine, president & CEO of the Independent Community Bankers of America,
April 17, 2012, *American Banker Bank Think*

- Market-focused break-up is far less radical than quasi-nationalization (as in, 2008-2009.)
- “Taxpayers should never underwrite the mismanagement or overreach of any firm.”

“Those Who Call for an End to TBTF Are in Good Company”

by Camden Fine,
April 26, 2012, *American Banker Bank Think*

- *Too Big to Govern*: Financial institutions should not be bigger than their regulatory agencies.
 - “A small handful of banks are beyond the ability of regulatory agencies to adequately and effectively impose regulatory discipline on them.”



The Public Debate Surrounding TBTF

“Will We Listen to the Dallas Fed on TBTF?”

by Christopher L. Williston, CEO of the Independent Bankers Association of Texas, April 23, 2012, *American Banker Bank Think*

- We need policymakers to tackle the TBTF problem and address the onslaught of new, and in many cases unintended, regulatory burdens on community banks. Quoting the Annual Report, “As a nation, we face a distinct choice. We can perpetuate TBTF, with its inequities and dangers, or we can end it.”

“The Economy Needs a Big-Bank Break-Up”

by Dale R. Kluga, president of Cobra Capital & former Continental Illinois banker, April 27, 2012, *American Banker Bank Think Feedback*

- There’s potential economic payoff from breaking up the big banks: The parts may be more valuable than the whole.
- Decreased concentration and complacency will benefit competition—a benefit for small businesses and U.S. growth.



The Public Debate Surrounding TBTF

“Telling Strength From Weakness”

by **Gretchen Morgenson**,

April 28, 2012, *New York Times*

- Quoting former Fed governor Kevin Warsh, “We cannot have a durable, competitive, dynamic banking system that facilitates economic growth if policy protects the franchises of oligopolies atop the financial sector.”
- In the spirit of the Fed stress tests: We need enhanced disclosure and market discipline, more rigorous regulation and the credible end to implicit government backing of the continued hegemony of big banks.

“Warren Stephens: How Big Banks Threaten Our Economy”

by **Warren A. Stephens**, head of financial services firm, Stephens Inc.,

April 28, 2012, *Wall Street Journal* Op-Ed

- *Too Big to Insure*: banks so large that the FDIC and other agencies could not deal with them
- Size and scale: They are the *problem*, not the *advantages* they were thought to be.



The Public Debate Surrounding TBTF

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

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

Change the “do-or-die” decisionmaking paradigm

- Reduce the likelihood of politics driving taxpayer assistance

End banking oligopoly power

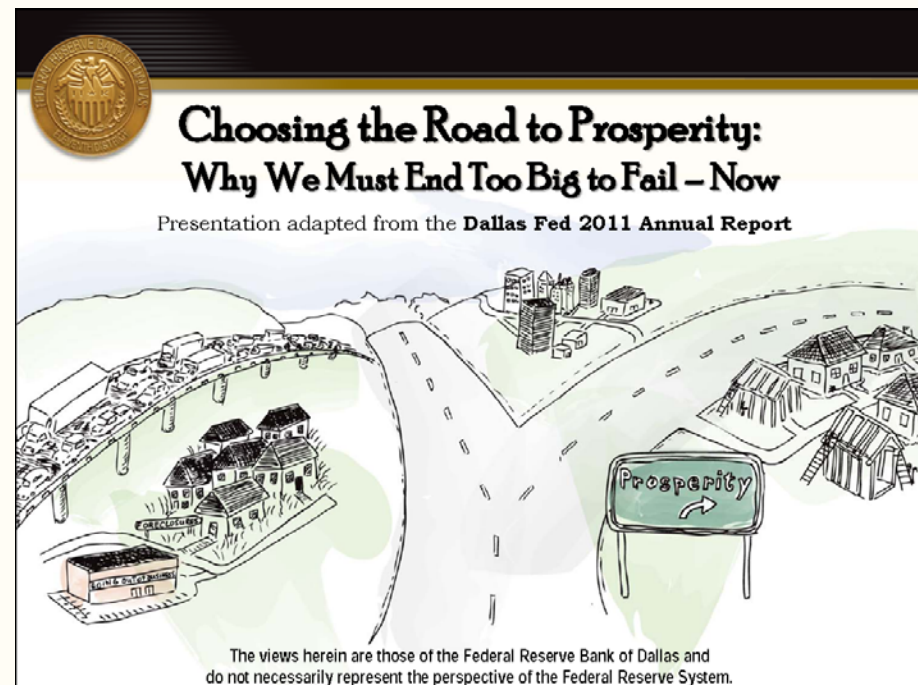
- Reduce concentration & TBTF subsidies

Harness market forces and incentives

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

Punish failure quickly

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





The Public Debate Surrounding TBTF

[“Breaking Up Four Big Banks”](#)

by Simon Johnson, author, professor at M.I.T. Sloan & former IMF chief economist,
May 10, 2012, *New York Times Economix*

- The idea of breaking up very large banks has gained momentum—implicit subsidies of these institutions undermine fairness and efficiency.
- Advocates a binding leverage ratio for the largest banks, requiring 10% equity relative to total (not “risk-adjusted”) assets and a cap on the size of a bank’s liabilities.

[Dallas Fed Chief: We Shouldn’t Have Banks That Are ‘Too Big to Fail’](#)

by Kris Hudson & Michael S. Derby,

May 11, 2012, *Wall Street Journal Real Time Economics*

- Fisher reiterates: “If you’re ‘too big to fail’, you’re *too big*.”



The Public Debate Surrounding TBTF

[“The Lesson of JP Morgan's \\$2 Billion Loss: Break Up the Big Banks”](#)

by **David Rhode**,

May 11, 2012, *The Atlantic*

- Concern about industry concentration; the American public continues to lack confidence in the stability of the U.S. banking industry

[“Size Matters and Matters Even More”](#)

by **Gillian Tett**,

May 13, 2012, *Financial Times*

- *“Too Big to Manage”*: The five biggest U.S. banks account for more than half the industry’s assets and ~95% of major derivatives markets activity. If perhaps our best-managed big bank [JPM] cannot manage its own risk, what does that say about the state of the rest of the banking industry?



The Public Debate Surrounding TBTF

“Tom Frost: The Big Danger With Big Banks”

by Tom C. Frost, chairman emeritus of Frost Bank,
May 15, 2012, *Wall Street Journal* Op-Ed

- Separate the lending culture from the culture of investment, hedging and speculative services.
- The implicit understanding that taxpayers will support the broker-dealer operations is a perversion of capitalism.

“Bank Investors Bail on Too-Big-to-Fail”

by David Reilly,
May 16, 2012, *Wall Street Journal* *Heard on the Street*

- Market is already providing incentives to downsize, simplify and restructure; rewarding reduced complexity.



The Public Debate Surrounding TBTF

“Size Can Be Deadly in a Low-Rate World”

by Gillian Tett,

May 17, 2012, *Financial Times*

- Low interest rate, cash-rich banking world is struggling to invest and “hedge,” leading to dangerous concentration of the biggest market players.

“The Banks That Are Too Complex to Exist”

by Gillian Tett,

June 7, 2012, *Financial Times*

- Professor Henry Hu of UT Austin: The 21st century financial system is becoming “*too complex to depict,*” and thus *exist*.
- Financial institutions need to be shrunk and simplified to avoid being “*too big to understand.*”



The Public Debate Surrounding TBTF

[“Wrestling with Giants: Fed's Fisher Leads Charge to Kill TBTF”](#)

by **Donna Borak**,

May 22, 2012, *American Banker*

- The argument to end TBTF has been joined by Bullard, Lacker, Hoenig, Bair and others—and the debate is likely to intensify.
- “Right-sizing” megabank institutions will help get back to the basics of good banking judgment and “knowing your customer.”
- A depository institution with insured deposits should be limited in the risk it can take.



The Public Debate Surrounding TBTF

“JPMorgan shows fighting complexity is futile”

by Sallie Krawcheck, former head of Merrill Lynch wealth management,
May 23, 2012, *Financial Times* Op-Ed

- Regulators should turn their attention to understanding how much risk banks are taking in total and require enough capital to support that risk.
- Reregulating the credit agencies would also produce an unbiased partner in assessing bank risk.

“Rep. Bachus: Protecting Taxpayers by Ending Bailouts”

by Rep. Spencer Bachus, (R) AL, House Financial Services Committee chairman,
May 31, 2012, CNBC.com

- Dodd–Frank does not end TBTF but may actually leave TBTF entrenched.
- Under Dodd–Frank, money needed to resolve a failing firm—up to 90% of the value of an institution’s assets—may be borrowed from the Treasury.
- “The only fair and transparent way to wind down failed institutions and protect taxpayers is through *bankruptcy, not bailouts.*”



The Public Debate Surrounding TBTF

“Breaking Up Chase: Good for Shareholders and Taxpayers”

by Sheila Bair, former FDIC chairman,

May 25, 2012, *Fortune*

- Big, complex banks are *too difficult to manage*: Economies of scale/scope are offset by conglomerate management challenges.
- Shareholders should push for downsizing: “Competitive return on equity is going to become even harder for megabanks as their capital requirements go up, trading and derivatives activities are reined in, and their cost of borrowing rises as bond investors recognize that TBTF is over ...”

“Henry Kaufman: Big Banks Are Not the Future”

by Henry Kaufman, author, economist, investor and former banker,

June 5, 2012, *Wall Street Journal* Op-Ed

- “Regulation is not the solution ... a well-run financial system cannot be micromanaged through elaborate regulatory codes.”
- Giant diversified financial institutions are *too conflicted to manage*.



The Public Debate Surrounding TBTF

“Biggest US Banks in Senator’s Sights”

by **Shahien Nasiripour**,

May 23, 2012, *Financial Times*

- Sherrod Brown is reintroducing law to Congress to break up largest six banks and end TBTF.

“An End to ‘Too Big to Fail’”

by **Senator Sherrod Brown**, (D) Ohio

June 6, 2012, *Washington Post* Op-Ed

- Large, complex financial institutions undertake large, complex activities and are simply “*too big to manage*” and are still considered *TBTF*.
- Sen. Brown has reintroduced the SAFE Banking Act, placing size limits on U.S. megabanks: No individual bank could control >10% of federally insured deposits or assume >10% of the industry’s liabilities or grow to >2% of U.S. GDP or borrow more than \$10 for every \$1 of shareholder equity.



The Public Debate Surrounding TBTF

“Crony Capitalism and the Crisis of the West”

by Luigi Zingales, author & professor at University of Chicago Booth,
June 6, 2012, *Wall Street Journal* Op-Ed

- “A truly competitive market has no place for favoritism, but when one institution dominates a market, such practices become inevitable.”
- U.S. tax code needs an overhaul, eliminating special treatment and corporate subsidy—starting with TBTF banks.

“Why I Was Won Over by Glass-Steagall”

by Luigi Zingales,
June 10, 2012, *Financial Times* Op-Ed

- Complexity, concentration and interconnectedness kills.
 - Banking industry has disproportionate power in shaping the political agenda.
 - This excessive power has damaged the financial sector and overall economy.
- Perverse incentives and conflicts of interest: Bring back Glass-Steagall and separate commercial insured deposits from the risky casino-type activities.



The Public Debate Surrounding TBTF

[“GE Weighs Cuts to Lending Unit”](#)

by **Kate Linebaugh**,

June 10, 2012, *Wall Street Journal*

- *Breaking up and restructuring isn't so radical*: General Electric has continued to work to slim down GE Capital since the crisis—prodded by investors' desires for a simplified conglomerate.
- GE Capital Chairman Mike Neal addressed questions about the possibility of selling the private-label credit-card business ...
"Is it *severable*? Sure. *Everything is.*"



The Public Debate Surrounding TBTF

'No More Welfare For Banks'

by Thomas Hoenig, director at the FDIC & former Kansas City Fed president,
June 10, 2012, *Wall Street Journal* Op-Ed

- “In the end, nobody—not managements, the market or regulators—could adequately assess and control the risks of these firms.”
- *Proposes “Glass-Steagall for today”*: Strengthen the U.S. financial system “by simplifying its structure and making its institutions more accountable for their mistakes.”
- There will always be crises; however, “the direct and indirect expansion of the safety net to cover an ever-increasing number of complex and risky activities” *makes crises much more severe.*



The Public Debate Surrounding TBTF

[“Anna Schwartz”](#)

June 21, 2012, *Wall Street Journal Review & Outlook*

- "The Fed has gone about as if the problem is a shortage of liquidity. That is not the basic problem. The basic problem for the markets is that [uncertainty] that the balance sheets of financial firms are credible."
- "Firms that made wrong decisions should fail. You shouldn't rescue them. And once that's established as a principle, I think the market recognizes that it makes sense. Everything works much better when wrong decisions are punished and good decisions make you rich."



The Public Debate Surrounding TBTF

[“Moody’s Cuts Credit Ratings of 15 Big Banks”](#)

by **Peter Eavis and Susanne Craig**,

June 21, 2012, *New York Times Dealbook*

- Moody’s Investors Service, which warned banks in February that downgrades were possible, cut banks’ credit scores to new lows to reflect risks that the industry has encountered since the financial crisis.
- In its report, Moody’s said it saw several weaknesses in the banks’ Wall Street operations, including their complexity and opacity.
 - Moody’s highlighted a history of volatile profits, problems with risk management and also noted the industry's continued dependence on short-term loans to finance their investment banking operations.



The Public Debate Surrounding TBTF

[“Does Dodd-Frank Legislation End Too Big to Fail?”](#)

by **Steve Liesman,**

June 22, 2012, CNBC.com

- “On the one hand, Moody’s sees the resolution plan in Dodd–Frank ending too big to fail by forcing creditors at the *bank holding companies* to take losses. On the other hand, it sees the regulators practically enshrining it in law by offering support to the *operating company* creditors.”
 - *Holding company creditors* are viewed as more vulnerable; investors believe there has been progress in ending too big to fail.
 - But leaving stable the outlook for the *operating company* shows big bank creditors could still get a “bailout.”



The Public Debate Surrounding TBTF

[“Shareholders Can Cure Too Big to Fail”](#)

by Phil Purcell, former chairman & CEO of Morgan Stanley,
June 25, 2012, *Wall Street Journal* Op-Ed

- The market valuation of TBTF firms is low because of earnings volatility and opacity inherent in investment banking and trading.
- “Breaking up these banks and isolating their investment banking and capital-markets businesses solve the shareholder-valuation problem. And by not allowing investment banks to fund the assets on their balance sheets with insured deposits, the risk to taxpayers is largely reduced.”