Notes and References

Introduction: Regulation and the Level Playing Field

1. In 1998, this legislation passed the US House of Representatives but died in the Senate. In 1999, it was resurrected and eventually enacted as the Gramm-Leach-Bliley Act.
2. Dean Anason, 'Citicorp Decides to Back House Reform Bill', *American Banker*, 16 April 1998, p. 4.
3. Travelers Group Inc. (1998), *Federal Reserve Bulletin*, vol. 84, p. 985.
4. This principle was endorsed by the US Supreme Court in *Chevron U.S.A. Inc.* v. *National Resources Defense Council*, 467 U.S. 837 (1984).
5. Glass-Steagall was the familiar name for a group of national laws enacted by Congress in 1933 to bar banks from the securities business and securities firms from the banking business. In 1999, Congress repealed two key provisions of Glass-Steagall (Sections 20 and 32) to permit affiliations and management interlocks between banks and securities firms.
6. Originally, Section 20 securities affiliates could earn up to 5 percent of their total revenues from 'ineligible' securities activities, such as corporate securities underwriting and dealing, without being considered by the Federal Reserve Board to be 'engaged principally' in impermissible securities activities. (The other 95 percent of their revenues came from 'eligible' securities activities, such as dealing in US Treasury securities, that were not expressly forbidden to banks by Glass-Steagall.) The Federal Reserve soon increased the revenue limitation to 10 percent and later to 25 percent, where it remained until Section 20 was repealed in 1999.
7. *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, 839 F.2d 47 (2d Cir.), *cert. denied*, 486 U.S. 1059 (1988).
8. David Harrison, 'Banks See a 16,000 Branch Rival as State Farm Gets Thrift Charter', *American Banker*, 13 November 1998, p. 1.
9. Thomas K. McCraw (1984), *Prophets of Regulation* (Cambridge: Harvard University Press), p. 305.
10. Brian P. Volkman (1998), 'The Global Convergence of Bank Regulation and Standards for Compliance', *The Banking Law Journal*, vol. 115, pp. 550–76.
11. George L. Priest (1993), 'The Origins of Utility Regulation and the "Theories of Regulation" Debate', *Journal of Law and Economics*, vol. 36, p. 290.
12. E.g., Alfred E. Kahn (1990), 'Deregulation: Looking Backward and Looking Forward', *Yale Journal on Regulation,* vol. 7, pp. 349–50.
13. These market developments are described from the banking industry's perspective by Helen A. Garten (1991), *Why Bank Regulation Failed: Designing a Bank Regulatory Strategy for the 1990s* (Westport, CT: Quorum Books), pp. 1–20, and from the securities industry's perspective by Joseph Auerbach and Samuel L. Hayes, III (1986), *Investment Banking and Diligence: What Price Deregulation?* (Boston: Harvard Business School Press), pp. 86–94.

14. This legislation was the Federal Deposit Insurance Corporation Improvement Act of 1991, especially Subtitle E.

1. How to Think About Financial Regulation

1. E.g., Ellis W. Hawley (1966), *The New Deal and the Problem of Monopoly* (Princeton: Princeton University Press), pp. 304–9 (tracing 1930s-era US banking legislation to the uniquely American fear of concentration of financial power).
2. E.g., Edwin J. Perkins (1971), 'The Divorce of Commercial and Investment Banking: A History', *Banking Law Journal*, vol. 88, p. 485 (tracing 1930s-era US banking legislation to English precedent).
3. E.g., Ferdinand Pecora (1939), *Wall Street Under Oath: The Story of Our Modern Money Changers* (New York: Simon and Schuster), pp. 283–92, especially p. 283 (arguing that legislators adopted Depression-era financial regulation after congressional hearings revealed 'a shocking corruption in our banking system').
4. E.g., George J. Benston (1996), 'The Origins of and Justification for the Glass-Steagall Act', in Anthony Saunders and Ingo Walker (eds), *Universal Banking: Financial System Design Reconsidered* (Chicago: Irwin), pp. 59–65 (arguing that legislators adopted Depression-era financial regulation to further their constituents' private political and commercial interests).
5. For example, economists have credited federal insurance of bank deposits, created by Congress in 1933, with 'achieving what had been a major objective of banking reform for at least a century, namely, the prevention of banking panics'. Milton Friedman and Anna Jacobson Schwartz (1963), *A Monetary History of the United States, 1867–1960* (Princeton: Princeton University Press), p. 440.
6. This phrase was used to characterize the attitude of today's economists toward now-discredited 'business cycle' theories that influenced US monetary policy in the early 1930s. J. Bradford DeLong (December 1990), '"Liquidation" Cycles: Old-Fashioned Real Business Cycle Theory and the Great Depression' (Washington: National Bureau of Economic Research), Working Paper No. 3546. Similarly, today's financial scholars fault drafters of Depression-era financial legislation for relying on now-discredited banking theories such as the 'real bills' doctrine, which posited that 'excessive' money creation might be avoided by limiting bank credit to short-term self-liquidating loans, e.g., Walter M. Cadette (1996), 'Universal Banking: A U.S. Perspective', in Anthony Saunders and Ingo Walter (eds), *Universal Banking: Financial System Design Reconsidered* (Chicago: Irwin), pp. 711–12.
7. For the origins of public choice theory, see Richard A. Posner (1974), 'Theories of Economic Regulation', *The Bell Journal of Economic and Management Science*, vol. 5, p. 335.
8. *Camp v. Pitts*, 411 U.S. 138 (1973).
9. The power to set interest rate ceilings on retail time deposits, provided to government regulators by 1933 legislation, was gradually eliminated in the 1980s, beginning with the Depository Institutions Deregulation and Monetary Control Act of 1980.

10. *Investment Company Institute v. Camp*, 401 U.S. 617 (1971).
11. E.g., Gregory A. Mark (1995), 'Some Observations on Writing the Legal History of the Corporation in the Age of Theory', in L.E. Mitchell (ed.), *Progressive Corporate Law* (Boulder: Westview Press), p. 80.
12. 401 U.S. at 631–4, especially 634.
13. Representative Luce noted that, since most banks had already abandoned the securities business voluntarily by 1933, the abuses described by Senator Bulkley were not likely to reoccur. 77 *Congressional Record* H.3917 (22 May 1933).
14. For an example of this approach, see Benston, *op. cit.*, note 4, pp. 31–65.
15. *Camp* involved a challenge to a regulation of the Comptroller of the Currency allowing national banks to operate investment funds; the Supreme Court read the purposes of the Glass-Steagall Act broadly to invalidate the Comptroller's action. 401 U.S. 636.
16. E.g., *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 839 F.2d 47 (2nd Cir.), *cert. denied*, 486 U.S. 1059 (1988).
17. E.g., Benston, *op. cit.*, note 4, pp. 49–59.
18. For descriptions of the operations of J.P. Morgan and other 'private' banks in the pre-Glass-Steagall era, see Pecora, *op. cit.*, note 3, pp. 4–19; Ron Chernow (1990), *The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance* (New York: Atlantic Monthly Press), pp. 205–377.
19. Perkins, *op. cit.*, note 2, pp. 496, 506 ; Benston, *op. cit.*, note 4, p. 62. Many scholars have relied upon Perkins' 1971 account of the origins of Glass-Steagall for the proposition that the legislation was adopted at the behest of established investment banking firms (such as Morgan and Kuhn Loeb) that had been losing the competitive battle with the bank securities affiliates. See Benston, *op. cit.*, note 4, p. 62, quoting Perkins, *op. cit.*, note 2, p. 516. Perkins' study however focused exclusively on the provision of Glass-Steagall that forced banks to divest their securities affiliates (Section 20) and not on the equally important provisions that forced private investment banks like Morgan and Kuhn Loeb to give up their power to take deposits. Moreover, Perkins actually concluded his study by suggesting that both industries – banking and securities – may have welcomed the relief from competitive pressure that the separation of commercial and investment banking promised. Perkins, *op. cit.*, note 2, pp. 524–5. In any event, Perkins' suggestion that established investment banks like Morgan and Kuhn Loeb tacitly approved of Glass-Steagall is contradicted by more recent studies, such as Chernow, *op. cit.*, note 18, pp. 374–84, that find evidence that Morgan strongly opposed the legislation and argued unsuccessfully against its passage.
20. According to a 1932 account, five major banks had terminated or limited their securities operations by the end of 1931, Steven L. Osterweis (October 1932), 'Security Affiliates and Security Operations of Commercial Banks', *Harvard Business Review*, p. 125 n.11. This was before the introduction in Congress of the first version of the Glass-Steagall Act (which occurred in 1932) and before the commencement of congressional hearings on the alleged abuses of bank securities operations (which began in 1933). Perkins, *op. cit.*, note 2, p. 515; Pecora, *op. cit.*, note 3.
21. Arthur N. Johnson (1968), *Winthrop W. Aldrich: Lawyer, Banker, Diplomat*

(Boston: Harvard Graduate School of Business Administration Division of Research), pp. 149–53.

22. Chernow, *op. cit.*, note 18, pp. 374–91; Pecora, *op. cit.*, note 3, p. 54; Johnson, *op. cit.*, note 21, pp.151–2 (quoting New York *World Telegram* banner); Arthur M. Schlesinger, Jr. (1958), *The Coming of the New Deal*, vol. 2 of *The Age of Roosevelt* (Boston: Houghton Mifflin Company), p. 443.
23. Chernow, *op. cit.*, note 18, p. 374.
24. E.g., Joseph P. Kalt and Mark A. Zupan (1990), 'The Apparent Ideological Behavior of Legislators: Testing for Principal-Agent Slack in Political Institutions', *Journal of Law and Economics*, vol. 33, pp. 103–31.
25. Louis D. Brandeis (1914), *Other People's Money and How the Bankers Use It* (New York: Frederick A. Stokes).
26. Hawley, *op. cit.*, note 1, p. viii.
27. E.g., Mark D. Flood (July/August 1992), 'The Great Deposit Insurance Debate', Federal Reserve Bank of St. Louis *Review*, vol. 74, pp. 53–6.
28. Flood, *op. cit.*, note 27, p. 55 (quoting Roosevelt).
29. Joseph Auerbach and Samuel L. Hayes, III (1986), *Investment Banking and Diligence: What Price Deregulation?* (Boston: Harvard Business School Press), pp. 17–21.
30. Hawley, *op. cit.*, note 1, p. 305; Pecora, *op. cit.*, note 3, at 283–85; Raymond Moley (1966), *The First New Deal* (New York: Harcourt, Brace & World), p. 317.
31. For examples, see Flood, *op. cit.*, note 27.
32. 76 *Congressional Record* S.2508 (25 January 1933) (Senator Long); 75 *Congressional Record* S.2987 (1 February 1932) (reprinting Lippmann column).
33. 77 *Congressional Record* H.3955–6 (22 May 1933) (summarizing US Chamber of Commerce arguments in opposition to legislation).
34. 76 *Congressional Record* S.1405 (9 January 1933).
35. Arthur M. Schlesinger, Jr. (1960), *The Politics of Upheaval*, vol. 3 of *The Age of Roosevelt* (Boston: Houghton Mifflin Company), p. 301.
36. David T. Llewellyn (1996), 'Universal Banking and the Public Interest: A British Perspective', in Anthony Saunders and Ingo Walter (eds), *Universal Banking: Financial System Design Reconsidered* (Chicago: Irwin), p. 177.
37. Rankings are from *Euromoney*, June 1984, p. 80; *American Banker,* 27 July 1992, p. 16A; *American Banker*, 2 July 1998, p. 11.
38. For a similar argument that government regulation encourages industry innovation, see Edward J. Kane (1980), 'Accelerating Inflation, Regulation and Banking Innovation', *Issues in Bank Regulation*, vol. 4, p. 7.
39. Chernow, *op. cit.*, note 18, pp. 302–8; Auerbach and Hayes, *op. cit.*, note 29, pp. 10–21.
40. Perkins, *op. cit.*, note 2, pp. 491–5.
41. Auerbach and Hayes, *op. cit.*, note 29, pp. 12–22.
42. Stephen Prouse (1996), 'Comments', in Anthony Saunders and Ingo Walter (eds), *Universal Banking: Financial System Designed Reconsidered* (Chicago: Irwin), p. 551.
43. Compare the Federal Deposit Insurance Corporation Improvement Act of 1991, section 301 (imposing interest rate caps on brokered deposits) with the Depository Institutions Deregulation and Monetary Control Act of 1980 (removing interest rate ceilings).

44. Senate Report 101–19 (13 April 1989), p. 40 (quoting Federal Reserve Chairman Alan Greenspan).

2. Is Regulation Beneficial?

1. E.g., Jeffrey Kutler, 'U.S. Firms Seen Best-Placed On World Financial Speedway', *American Banker*, 4 June 1998, p. 1; James R. Kraus, 'U.S. Banks Look Like Leaders in the Euro Race', *American Banker*, 16 July 1998, p. 1.
2. *The Economist*, 'Survey: International Banking', 30 April 1994, p. 40.
3. Suggested revisions included a proposal to allow nationally chartered banks to underwrite securities subject to the approval of the Comptroller of the Currency (which passed the Senate but was eliminated in conference with the House of Representatives), and a proposal to repeal the requirement that private banks that continued to accept deposits would henceforth be subject to federal bank regulation (which passed the House of Representatives but was eliminated from the final legislation). See 79 *Congressional Record* S.11 827 (25 July 1935); 79 *Congressional Record* H.13 703 (19 August 1935).
4. Securities and Exchange Commission (1963), *Report of Special Study of Securities Markets*, Part I, Chap. 3, p. 395.
5. Joseph Auerbach and Samuel L. Hayes, III (1986), *Investment Banking and Diligence: What Price Deregulation?* (Boston: Harvard Business School Press), p. 94.
6. Some of these market and regulatory changes were discussed in the Introduction and also in Auerbach and Hayes, *op. cit.*, note 5, pp. 85–105.
7. This changed in 1998 with the combination of Citicorp and Travelers and the merger of BankAmerica and NationsBank. James R. Kraus, '2 Merging U.S. Banks to Crack Top 10 in Assets', *American Banker*, 2 July 1998, p. 11.
8. Citicorp's change of heart is noted in Dean Anason, 'Little Change in House as Reform Bill Faces Second Date for Vote', *American Banker*, 11 May 1998, p. 4. Despite the strength of a powerful pro-reform coalition, however, Glass-Steagall reform failed in 1998.
9. For example, see James R. Kraus, 'Europe's Universal Banks: Flawed Models', *American Banker*, 8 June 1998, p. 10A.
10. Gordon Matthews, 'Global Titans' Market Cap Sinks; U.S. Share Steady', *American Banker*, 12 November 1998, p. 1.
11. Statistics are reprinted in Kutler, *op. cit.*, note 1, p. 1.
12. Kraus, *op. cit.*, note 9, p. 10A.
13. Adolf A. Berle, Jr. (1926), 'Non-Voting Stock and "Bankers' Control"', *Harvard Law Review*, vol. 39, p. 676.
14. Adolf A. Berle, Jr. and Gardiner C. Means (1932; rev. ed. 1948), *The Modern Corporation and Private Property* (New York: Macmillan). As this author has pointed out, Berle and Means' data, which documented the dispersal of equity ownership in the largest US corporations, was collected in 1930 and reflected market changes that had occurred in the 1920s, including (1) the growth of public securities markets as the favored avenue for corporate financing; (2) a significant increase in individual ownership of corporate stock, both directly and through collective investment vehicles such as mutual funds; (3) the development of active secondary trading markets,

which facilitated the dispersal of equity ownership; and (4) enhanced competition and innovation in the market for financial services. All of this occurred, and was documented by Berle and Means, *before* regulation such as Glass-Steagall took aim at the traditional structure of the financial industry. See Helen A. Garten (1992), 'Institutional Investors and the New Financial Order', *Rutgers Law Review*, vol. 44, pp. 585–603.

15. As described in Chapter 1, as a result of Glass-Steagall, private banks like Morgan were forced to opt between deposit banking and investment banking. Morgan chose deposit banking, spinning off its securities business to the new firm of Morgan Stanley. For more on this decision and its competitive implications, see Ron Chernow (1990), *The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance* (New York: Atlantic Monthly Press), pp. 378–91.
16. Arnoud W.A. Boot and Anjan V. Thakor (1996), 'Banking Structure and Financial Innovation', in Anthony Saunders and Ingo Walter (eds), *Universal Banking: Financial System Design Reconsidered* (Chicago: Irwin), pp. 420–9.
17. E.g., George W. Mitchell (1967), 'Exogenous Forces in the Development of Our Banking System', *Law and Contemporary Problems*, vol. 1997, p. 3 (accusing the banking industry of 'a pattern of traditional services, an imposed molecular structure, and a pedestrian operating technology').
18. Helen A. Garten (1991), *Why Bank Regulation Failed: Designing a Bank Regulatory Strategy for the 1990s* (Westport, CT: Quorum Books), pp. 81–8.
19. Carter H. Golembe, 'Commentary: A Little Moral Hazard', *Bank Expansion Reporter*, vol. 8, 20 November 1989, p. 5; Helen A. Garten (1994), 'A Political Analysis of Bank Failure Resolution', *Boston University Law Review*, vol. 74, pp. 447–9.
20. For an historical treatment of US regulators' reliance on market discipline, see Helen A. Garten (1991), 'Whatever Happened to Market Discipline of Banks?' *Annual Survey of American Law*, vol. 1991, pp. 749–800.
21. For a colorful description of the thrift industry and regulation in the 1980s, see Martin Mayer (1990), *The Greatest Ever Bank Robbery: The Collapse of the Savings and Loan Industry* (New York: Charles Scribner's Sons), especially pp. 63–4.
22. These points have been made by, among many others, Kraus, *op. cit.*, note 9, at 10A; Peter Martin, 'Ghosts of Business Future', *Financial Times (London)*, 11 December 1997, p. 20.
23. For example, when the Citicorp/Travelers merger was announced, not all experts were predicting that megabanks were the wave of the future of banking in the US. See, e.g., Edward Kulkosky, 'Citi-Travelers Deal Magnifies Risks', *American Banker*, 8 June 1998, p. 4A.
24. In 1999, an example of the former was J.P. Morgan; an example of the latter was NationsBank.
25. In the 1990s, the US financial press made these points, see sources cited in note 1. So did some non-US observers. E.g., 'Being All You Want to Be', *The Economist*, 30 April 1994, pp. 30–43.
26. Statistics come from US General Accounting Office (1996), *Foreign Banks: Assessing Their Role in the US Banking System* (GAO/GGD-96–26).
27. US General Accounting Office, *op. cit.*, note 26.

28. US General Accounting Office, *op. cit.*, note 26.
29. Louis Whiteman, 'Some Banks Find Good Cause to Form Holding Companies', *American Banker*, 9 February, p. 6.
30. Rob Garver, 'Foreign Banks Say US Reforms Leave Them at a Disadvantage', *American Banker*, 16 March 2000, p. 1.

3. Deposit Insurance and the Politics of Regulatory Subsidy

1. In another context, I have characterized traditional US bank regulatory strategy as reflecting the viewpoint of the typical private debtholder, who uses contract to restrict the borrower's discretion to alter its risk posture in the future. In US bank regulation, these regulatory 'covenants' have included laws restricting bank investments, diversification and payment of excessive dividends to shareholders. Helen A. Garten (1990), *Why Bank Regulation Failed: Designing a Bank Regulatory Strategy for the 1990s* (Westport, CT: Quorum Books), pp. 23–59.
2. This special responsibility occasionally has been mandated by law, such as the Community Reinvestment Act of 1977, a national statute that compels banks (but not non-banks) to meet the credit needs of the local communities in which they are chartered.
3. Carter H. Golembe (1960), 'The Deposit Insurance Legislation of 1933: An Examination of Its Antecedents and Its Purposes', *Political Science Quarterly*, vol. 76, p. 188; Jesse H. Jones (with Edward Angly) (1951), *Fifty Billion Dollars: My Thirteen Years with the RFC (1932–1945)*, (New York: Macmillan), pp. 45–6; Arthur M. Schlesinger, Jr. (1958), *The Coming of the New Deal,* vol. 2 of *The Age of Roosevelt* (Boston: Houghton Mifflin Company), p. 443.
4. Milton Friedman and Anna Jacobson Schwartz (1963), *A Monetary History of the United States, 1867–1960* (Princeton: Princeton University Press), pp. 421–42, especially p. 427.
5. Federal Deposit Insurance Corporation (1934) *Annual Report*, p. 47.
6. Friedman and Schwartz, *op. cit*, note 4, p. 434; also Golembe, *op. cit.*, note 3, p. 194 ('the primary function of deposit insurance is, and has always been, protection of the circulating medium from the consequences of bank failures').
7. The alternative solution, once popular among banking scholars but unacceptable politically, was to restrict banks to making only short-term, self-liquidating loans, a theory of banking known as the 'real bills' doctrine. This solution, however, would have been virtually impossible to legislate and would not have addressed the urgent demand for long-term capital that, after the stock market crash, was not forthcoming from moribund securities markets.
8. (1939) 'Behavior of Deposits Prior to Suspension in a Selected Group of Banks–Analysis By Size of Account', *Federal Reserve Bulletin*, vol. 25, p. 178.
9. Jones, *op. cit.*, note 3, pp. 61–6; Arthur M. Schlesinger, Jr. (1957), *The Crisis of the Old Order 1919–33,* vol. 1 of *The Age of Roosevelt* (Boston: Houghton Mifflin Company), pp. 475–6.
10. Golembe, *op. cit.*, note 3, p. 193; Federal Deposit Insurance Corporation (1934) *Annual Report*, p. 61.

11. Jones, *op. cit.*, note 3, pp. 28–9; Helen A. Garten (1994), 'A Political Analysis of Bank Failure Resolution', *Boston University Law Review*, vol. 74, pp. 460–1.
12. Jones, *op. cit.*, note 3, pp. 25, 30–2.
13. Garten, *op. cit.*, note 11, pp. 461–4.
14. Golembe, *op. cit.*, note 3, pp. 195–9.
15. This legislation was the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.
16. For discussion, see Garten, *op. cit.*, note 11, pp. 453–4.
17. Compare *Weir v. United States*, 92 F.2d 634 (7th Cir. 1937) (upholding FDIC's authority to enforce substantive banking laws against state-chartered insured banks).
18. The political organization and status of each of these three bank regulatory agencies is somewhat complicated. The Federal Deposit Insurance Corporation (FDIC), like the Federal Reserve Board, is an independent agency whose staff is theoretically insulated from political influence. (The Federal Reserve may be more independent than the FDIC because it is self-funding and therefore does not have to rely on appropriations by Congress to meet its budget.) The Comptroller of the Currency is an official of the Department of the Treasury, which is part of the executive branch of government; in addition, the Comptroller automatically serves as one of the FDIC's five directors. Complicating matters further, within the Federal Reserve, much supervisory responsibility over banks is exercised by the 12 Federal Reserve banks, which themselves are independent entities. Each of these agencies is responsible for applying many of the same federal banking laws to its own stable of banks as well as for formulating its own regulation. The result is occasional regulatory conflict but, as Chapter 4 explains, on balance this conflict is welcomed as promoting efficient regulatory competition and innovation.
19. Stephen K. Halpert (1988), 'The Separation of Banking and Commerce Reconsidered', *Journal of Corporation Law*, vol. 13, pp. 497–8; Helen A. Garten (1990), 'Subtle Hazards, Financial Risks, and Diversified Banks: An Essay on the Perils of Regulatory Reform', *Maryland Law Review*, vol. 49, p. 344.
20. An example of the former approach was Glass-Steagall, which barred deposit-taking banks from entering most securities businesses (and securities firms from accepting deposits). An example of the latter approach was the Bank Holding Company Act, which allowed banks to enter certain financial businesses through separately incorporated and separately capitalized non-bank affiliates that could not accept insured deposits.
21. This policy is discussed in greater detail in Chapter 7.
22. The best known example, described in Chapter 7, was the 1984 rescue of Continental Illinois, which protected the investments of all creditors of both the bank and the bank's holding company.
23. When Penn Central filed for bankruptcy, it had $82 million of commercial paper (short-term unsecured debt) outstanding. Wary investors withdrew from the market, and other issuers were unable to roll over their maturing paper. In three weeks, outstanding commercial paper contracted by $3 billion. For details, see William C. Melton (1985), *Inside the Fed: Making Monetary Policy* (Homewood, Illinois: Dow Jones-Irwin), pp. 157–8.
24. Statistics are from US General Accounting Office (1991), *Deposit Insurance: A Strategy for Reform* (GAO/GGD-91–26), pp. 156–8.

25. Robert Oshinsky (1999), *Effects of Bank Consolidation on the Bank Insurance Fund* (Federal Deposit Insurance Corporation), p. 5.
26. US General Accounting Office, *op. cit.*, note 24, pp. 152–3.
27. This change in regulatory direction is described in Helen A. Garten (1993), 'United States Bank Failure Policy', *The International Journal of Regulatory Law & Practice*, vol. 1, pp. 239–44, and is explored in greater detail in Chapter 7.
28. Gregory Elliehausen (1998), 'The Cost of Banking Regulation: A Review of the Evidence', *Federal Reserve Staff Study* No. 171, pp. 30–1.
29. Elliehausen, *op. cit.*, note 28, p. 29.
30. As I have suggested elsewhere, after the Continental Illinois rescue, in wholesale deposit markets, investors probably used size as a proxy for risk. Helen A. Garten (1986), 'Banking on the Market: Relying on Depositors to Control Bank Risks', *Yale Journal on Regulation,* vol. 4, pp. 145–8.
31. The procedure that regulators must now follow to complete a bailout, however, is complex, possibly discouraging its use. For details, see Garten, *op. cit.*, note 27, p. 242, as well as Chapter 7.
32. E. Gerald Corrigan (1982), 'Are Banks Special?' *Federal Reserve Bank of Minneapolis Annual Report.*
33. Melton, *op. cit*, note 23, pp. 157–8.
34. Remarks Prepared for Delivery by Federal Reserve Board Chairman Alan Greenspan Before the House Committee on Banking and Financial Services Re: 'Private-Sector Refinancing of the Large Hedge Fund, Long-Term Capital Management', *Federal News Service*, 1 October 1998 (available in LEXIS, News Library, FEDNEW file).
35. *National Credit Union Administration* v. *First National Bank & Trust Company*, 118 S. Ct. 927 (1998).
36. Dean Anason, 'Senate Passes Credit Union Bill; Big Loss For Banks', *American Banker*, 29 July 1998, pp. 1–2. In 1999, small banks again tried to obtain relief from the Community Reinvestment Act. Again, Congress refused to exempt them, but did ease their examination burden somewhat.

4. Results Matter

1 Business and financial data come from the Federal Reserve's decision approving Travelers' application to become a bank holding company by acquiring Citicorp. Travelers Group Inc. (1998), *Federal Reserve Bulletin*, vol. 84, p. 985.
2. According to the Federal Reserve, these non-conforming activities accounted for 'less than 40 percent' of Travelers' total revenues, although how much less is unclear.
3. The combined entity proposed to do business under the name of Citigroup.
4. The statute required the Federal Reserve to consider the financial and managerial resources and future prospects of the companies and banks involved in the transaction, the convenience and needs of the communities to be served (for example, the applicants' record of compliance with the lending obligations of the Community Reinvestment Act) and antitrust and other competitive factors – and, of course, the legality of the transaction under existing banking laws.

5. Up to and even after the announcement on 6 April 1998 of its proposed merger with Travelers, Citicorp had lobbied against the Leach bill. Finally, on 14 April, Citicorp's chairman John Reed announced a change of heart, promising to support the legislation. Travelers' chairman Sanford Weill already favored the bill. Dean Anason, 'Citicorp Decides to Back House Reform Bill', *American Banker*, 16 April 1998, p. 4.
6. The McCarran-Ferguson Act, adopted in 1945, was an anti-preemption statute; in other words, Congress gave state statutes regulating the business of insurance priority over any potentially conflicting federal statute unless that federal statute specifically related to the business of insurance.
7. As will be discussed, state authority to block affiliations between insurance firms and nationally chartered banks was challenged in the 1990s by several decisions of the Comptroller of the Currency, chief regulator of national banks, and of the Supreme Court. In 1995, congressional supporters of states' rights responded by attaching a provision that would have barred future entry by national banks into the insurance business over the objections of the states to pending national legislation to repeal Glass-Steagall. Since any limitations on national bank powers were unacceptable to the banking industry and to the US Treasury Department (and their supporters in Congress), the addition of this provision effectively killed Glass-Steagall reform, at least in 1995. For background on this political stalemate, see Helen A. Garten (1996), 'Devolution and Deregulation: The Paradox of Financial Reform', *Yale Law and Policy Review*, vol. 14, pp. 68–75. After 1995, however, it became apparent that there was insufficient support in Congress for passage of new restrictions on national bank insurance powers. Many states, recognizing that they could no longer bar national banks from conducting an insurance business within their jurisdictions, began to capitulate, dismantling their anti-affiliation laws so that their own state-chartered banks would have equal opportunities to diversify. For a description of state law as of 1998, see Michael D. White (1998), *A Comprehensive Guide to Bank Insurance* (Cincinnati, Ohio: The National Underwriter Company), pp. 80–95.
8. This amendment was added to the Bank Holding Company Act by the Garn-St Germain Depository Institutions Act of 1982.
9. *Board of Governors of the Federal Reserve System* v. *Dimension Financial Corporation*, 474 U.S. 361 (1986).
10. This revision was contained in the appropriately named Competitive Equality Banking Act of 1987, which provides a good illustration of the handicapping process. In this case, regulation expanding the definition of bank was designed to restore a level playing field by ensuring that non-banks could not obtain the benefits of the deposit insurance subsidy without bearing the same regulatory burden as real banks (including the barriers to diversification contained in the Bank Holding Company Act).
11. Interestingly, banks traditionally were the exception: state-chartered banks were required to locate their deposit-taking offices within their state of incorporation and, at least until recently, were not permitted to establish branches across state lines. But, as will be described, banks had a national chartering option that could be exercised at any time without having to relocate their deposit-taking branches.

12. Examples of the corporate literature on charter competition that raise these and other issues include William L. Cary (1974), 'Federalism and Corporate Law: Reflections upon Delaware', *Yale Law Journal*, vol. 83, p. 663 (citing dominance of Delaware in corporate charter competition as evidence of a race to the bottom); Ralph K. Winter, Jr. (1977), 'State Law, Shareholder Protection, and the Theory of the Corporation', *Journal of Legal Studies*, vol. 6, p. 251 (citing equilibrium in corporate charter competition as evidence of a race to the top); Lucian A. Bebchuk (1992), 'Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law', *Harvard Law Review*, vol. 105, p. 1435 (citing agency problems that affect the decision to incorporate).
13. For application of charter competition theory to banking, see Kenneth E. Scott (1977), 'The Dual Banking System: A Model of Competition in Regulation', *Stanford Law Review*, vol. 30, p. 1.
14. For more of this argument, see Garten, *op. cit.*, note 7, pp. 65–97.
15. Federal Reserve membership historically provided some benefits to banks, such as access to the Federal Reserve's payment system and discount window borrowing. Although these privileges are less exclusive than they once were, membership still conveys some prestige, and most large state-chartered banks remain members.
16. This argument, as well as other objections to interagency competition, have been made by, among others, John C. Coffee, Jr. (1995), 'Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation', *The Business Lawyer*, vol. 50, pp. 447–84.
17. Merchants National Corporation (1987), *Federal Reserve Bulletin*, vol. 73, p. 878.
18. Before passage of the International Banking Act of 1978, non-US banks were not subject to the branching restrictions applicable to US banks. Subsequent to that Act, however, non-US banks, like their US counterparts, had to choose a home state and were not permitted to establish branches outside of that state. As a result, for non-US banks as well as for US banks, the holding company structure became the favored option for expansion across state lines.
19. Coffee, *op. cit.*, note 16, p. 447.
20. Some notable examples from the 1990s are cited in note 24. One exception, described in Chapter 3, was the Supreme Court's decision invalidating the National Credit Union Administration's expansive reading of the common bond requirement that had allowed credit unions to broaden their membership. *National Credit Union Administration* v. *First National Bank & Trust Company*, 118 Sup. Ct. 927 (1998).
21. *Barnett Bank of Marion County, N.A.* v. *Nelson*, 517 U.S. 25 (1996).
22. Citicorp, Order Denying the Acquisition of a Bank (1985), *Federal Reserve Bulletin*, vol. 71, p. 789.
23. This provision appeared in the Federal Deposit Insurance Corporation Improvement Act of 1991, which was enacted in response to the thrift crisis and resulting public concern over the solvency of the banking industry and bank insurance fund; as might be expected, it reflected strong, although perhaps short-lived, political preference for reregulation of the banking industry.

24. *NationsBank of North Carolina* v. *Variable Annuity Life Insurance Company*, 513 U.S. 251 (1995) (upholding Comptroller's annuity ruling); *Independent Insurance Agents of America* v. *Ludwig*, 997 F.2d 958 (D.C. Cir. 1993) (upholding Comptroller's insurance agency interpretation).
25. *Barnett Bank of Marion Country, N.A.* v. *Nelson*, 517 U.S. 25 (1996).
26. White, *op. cit.*, note 7, pp. 80–95.
27. White, *op. cit.*, note 7, pp. 37–8.
28. White, *op. cit.*, note 7, pp. 38–9.
29. For the text of the Federal Reserve's interpretations, commonly referred to as the Section 20 decisions, see Citicorp, J.P. Morgan & Co. Incorporated and Bankers Trust New York Corporation (1987), *Federal Reserve Bulletin*, vol. 73, pp. 473–509 and J.P. Morgan & Co. Incorporated, The Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp and Security Pacific Corporation (1989), *Federal Reserve Bulletin*, vol. 75, pp. 192–217.
30. Citicorp, J.P. Morgan & Co. Incorporated and Bankers Trust New York Corporation, *op. cit.*, note 29, pp. 505–6.
31. *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, 839 F.2d 47 (2d Cir.), *cert. denied*, 486 U.S. 1059 (1988).
32. 'OCC Approves Zions Application to Underwrite Municipal Revenue Bonds', Office of the Comptroller of the Currency News Release 97–110, 11 December 1987.
33. The full decision is printed in *Federal Reserve Bulletin*, vol. 84, p. 985 et seq.
34. Congress also required that real estate and, temporarily, merchant banking be conducted only by financial holding company affiliates. Non-US banks need not form US financial holding companies to own financial affiliates in the US, but they are subject to the same regulation (by the Federal Reserve) that governs US financial holding companies.

5. Regulatory Conflict and Competitive Equality

1. Testimony of Eugene A. Ludwig, Comptroller of the Currency, Before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce, Office of the Comptroller of the Currency News Release 94–40, 14 April 1994.
2. David W. Roderer, quoted in Jaret Seiberg, 'Regulatory Conflicts Seen Better for Banking Than a Superagency', *American Banker*, 30 November 1998, p. 2.
3. US General Accounting Office (1996), *Bank Oversight Structure* (GAO/GGD-97–23).
4. *Investment Company Institute* v. *Federal Deposit Insurance Corporation*, 815 F.2d 1540 (D.C. Cir. 1987) (upholding this reading of sections 16 and 20 of Glass-Steagall).
5. At the time, many federal judges and constitutional scholars believed that congressional authority under the US Constitution to regulate interstate commerce did not extend to corporate firms, such as state-chartered banks, that operated solely in local markets. Questions as to the reach of national congressional authority over financial firms were repeatedly raised in the 1930s by critics of both the new federal banking legislation and the new federal laws regulating the securities markets. These questions

subsequently were resolved in the favor of the national government, and today's judges and scholars take a far more generous view of the scope of congressional power to regulate financial markets and firms.

6. Sections 3(a)(4) and (5) of the original Securities Exchange Act of 1934 excluded banks from the statutory definition of 'broker' and 'dealer'. In 1999, Congress amended this blanket exemption to require banks engaged in most securities activities to register as broker-dealers.
7. For examples, see John C. Coffee, Jr. (1995), 'Competition versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation', *The Business Lawyer*, vol. 50, pp. 458–9.
8. The details of the transaction whereby Travelers, an insurance company, became a bank holding company by acquiring Citicorp were described in Chapter 4.
9. Ferdinand Pecora, general counsel to the committee, later wrote that all three statutes (and the Public Utility Holding Company Act of 1935) were enacted in direct response to his hearings. Ferdinand Pecora (1939), *Wall Street Under Oath: The Story of Our Modern Money Changers* (New York: Simon and Schuster), pp. 284–92.
10. The exchange took place between Thomas Corcoran, an administration official intimately involved in drafting the Exchange Act, and a member of the House Interstate and Foreign Commerce Committee that was considering the legislation. When Mr Corcoran noted that 'banks cannot normally go into the business, like a broker, of dealing in securities', the congressman objected, 'But they do.' Mr Corcoran responded that banks 'are not allowed to do those things any longer, under the Glass-Steagall bill. They cannot go into a business of dealing in securities'. When the congressman then asked Mr Corcoran to clarify what businesses were forbidden to banks after Glass-Steagall, Mr Corcoran replied, 'You may be able to answer that better than I can.' At that point, discussion of Glass-Steagall ended. 'Stock Exchange Regulation', Hearing Before the House Interstate and Foreign Commerce Committee, 73rd Congress, 16 February 1934, p. 86.
11. In the colloquy described in note 10, a source of confusion is whether the parties were referring to securities dealing (trading as principal) or securities brokerage (executing trades as agent for customers). The relevant section of Glass-Steagall provided that the 'business of dealing in investment securities by [banks] shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account'. Thus, after Glass-Steagall, banks could no longer act as securities dealers (principals). Nevertheless, Glass-Steagall's language did leave some room for banks to act as securities brokers (agents), and the particular provision of the Securities Exchange Act under discussion would have affected securities brokers as well as securities dealers.
12. This story is told in James Landis (1938), 'The Legislative History of the Securities Act of 1933', *George Washington Law Review*, vol. 28, pp. 44–5.
13. This exemption appeared in section 3 of the Securities Act of 1933.
14. This exemption derived from sections 3(a)(4) and (5) of the Securities Exchange Act of 1934; it was greatly narrowed in 1999.
15. The original version of the Securities Exchange Act of 1934 did not exempt banks from the periodic disclosure requirements applicable to all firms

with public shareholders, but the Securities and Exchange Commission quickly exempted banks by rule. Later, Congress amended the Exchange Act to provide that banks were subject to the law's periodic disclosure requirements, but that they would be administered and enforced against banks by their own bank regulators.

16. These provisions originally appeared in sections 7 and 8(a) of the Securities Exchange Act of 1934. In 1996, section 7 was substantially amended and section 8(a), which had required broker-dealers to borrow against securities only from banks approved by the Federal Reserve, was repealed.
17. 'Stock Exchange Practices' (1934), Hearings Before the Senate Committee on Banking and Currency, 73rd Cong., 2d Sess., vol. 16, p. 7555.
18. Congress eventually made this explicit in an amendment to the Securities Exchange Act, *op. cit.*, note 15.
19. It is possible that Congress hoped to 'soften' disclosure regulation as applied to banks by delegating enforcement authority to friendly bank regulators who might be more sympathetic than securities regulators to pleas by banks to delay or omit negative disclosures. Yet such a policy surely would have proved counterproductive, since knowledgeable investors, fearing that some banks' disclosure was not as timely or trustworthy as disclosure by other firms, would avoid all banks' securities. In any event, the evidence supporting this explanation of the bank exemption is scanty at best, and it certainly does not reflect modern attitudes of US bank regulators toward disclosure. See Helen A. Garten (1986), 'Banking on the Market: Relying on Depositors to Control Bank Risks', *Yale Journal on Regulation*, vol. 4, pp. 139–43.
20. The statutory language that admitted of these two very different readings was quoted in note 11.
21. *American Bankers Association* v. *Securities and Exchange Commission*, 804 F.2d 739 (D.C. Cir. 1986).
22. *Barnett Bank of Marion County, N.A.* v. *Nelson*, 517 U.S. 25 (1996), is discussed in Chapter 4.
23. Seiberg, *op. cit.*, note 2, p. 2 (quoting banking industry representatives).
24. Some securities industry representatives say yes. Yvette D. Kantrow, 'Umbrella Regulator Would Stifle Creativity', *American Banker*, 24 March 1998, p. 15 (quoting securities trade group official).
25. *Barnett Bank of Marion County* v. *Nelson*, 517 U.S. 25. In 1999, Congress reaffirmed state authority to license and regulate insurance firms.
26. Prepared Statement of Arthur Levitt, Chairman, Securities and Exchange Commission, Before the Senate Committee on Banking, Housing and Urban Affairs, Federal News Service, 25 June 1998 (available in LEXIS, News Library, FEDNEW file).
27. It is suggested in Chapter 6 that bank regulators as well as securities regulators are taking an aggressive approach to policing the marketing practices of banks that sell retail securities products.
28. Securitization comes to mind. In the securitization process, a bank product (loans) is marketed as a securities product (undivided interests in a pool of similar loans) and secured by an insurance product (financial guarantees). Even under a regime of functional regulation, the hybrid product may be subject to three different regulatory schemes.

29. For descriptions of these efforts, see Geoffrey R.D. Underhill (1997), 'Private Markets and Public Responsibility in a Global System: Conflict and Co-operation in Transnational Banking and Securities Regulation', in Geoffrey R.D. Underhill (ed.), *The New World Order in International Finance* (London: Macmillan), pp. 17–44; Brian P. Volkman (1998), 'The Global Convergence of Bank Regulation and Standards for Compliance', *Banking Law Journal*, vol. 115, pp. 550–96.
30. Underhill, *op. cit.*, note 29, p. 29; Volkman, *op. cit.*, note 29, pp. 558–9.
31. E.g., Underhill, *op. cit.*, note 29, p. 36.
32. For description of these organizations and their members, see Underhill, *op. cit.*, note 29, pp. 23–38.
33. Underhill, *op. cit.*, note 29, pp. 38–43; Volkman, *op. cit.*, note 29, p. 561.
34. Underhill, *op. cit.*, note 29, pp 43–4

6. The Level Playing Field and Rules of Fair Play

1. This story is recounted in Ferdinand Pecora (1939), *Wall Street Under Oath: The Story of Our Modern Money Changers* (New York: Simon and Schuster), pp. 84–8.
2. The Term Trusts are described in the order issued by the Securities and Exchange Commission *In the Matter of NationsSecurities and NationsBank, N.A.*, 4 May 1998, available at 1998 SEC LEXIS 833.
3. Pecora, *op. cit.*, note 1, p. 89.
4. Elsewhere I have called this change in regulatory orientation the 'consumerization' of financial regulation. Helen A. Garten (1999), 'The Consumerization of Financial Regulation', *Washington University Law Quarterly,* vol. 77, pp. 287–318. This chapter expands upon some of the ideas developed in that paper.
5. 401 U.S. 617, 633 (1971).
6. *Jefferson Parish Hospital District No. 2* v. *Hyde*, 466 U.S. 2 (1980).
7. *Alabama Association of Insurance Agents* v. *Board of Governors of the Federal Reserve System*, 533 F.2d 224, 250 (5th Cir. 1976).
8. Garten, *op. cit.*, note 4, p. 304.
9. For citations to populist opponents of Glass-Steagall, see notes 32 and 33 to Chapter 1.
10. For example, see George J. Benston (1996), 'The Origins of and Justification for the Glass-Steagall Act', in Anthony Saunders and Ingo Walker (eds), *Universal Banking: Financial System Design Reconsidered* (Chicago: Irwin), pp. 47–59 (noting that modern researchers have found little evidence to support allegations of retail customer abuses in 1920s securities markets).
11. Garten, *op. cit.*, note 4.
12. For further discussion of this point, see Garten, *op. cit.*, note 4.
13. *In the Matter of NationsSecurities and NationsBank, N.A.*, *op. cit.*, note 2.
14. Benston, *op. cit.*, note 10, pp. 47–59, especially p. 53.
15. National Westminster Bank, PLC (1986), *Federal Reserve Bulletin*, vol. 72, p. 584.
16. Bank of New England Corporation (1988), *Federal Reserve Bulletin*, vol. 74, p. 700.
17. 'Retail Sales of Nondeposit Investment Products: Interagency Statement',

Federal Reserve Regulatory Service 3–1579.51 (November 1995).

18. NASD Rule 2350, 'Broker/Dealer Conduct on the Premises of Financial Institutions', 1997 NASD Notice to Members 89.
19. *In the Matter of NationsSecurities and NationsBank, N.A.*, *op. cit.*, note 2.
20. *Federal Register*, vol. 63, p. 14 803 (27 March 1998).
21. For example, in its 1998 decision approving the Citicorp/Travelers combination, the Federal Reserve cited the public benefits of cross-marketing, such as increased customer convenience, as a reason to permit the combined Citigroup to cross-market retail bank and insurance products. See Travelers Group Inc. (1998), *Federal Reserve Bulletin*, vol. 84, p. 985.
22. Bank antitying law, created by section 106(b) of the Bank Holding Company Act Amendments of 1970, treated as a coercive tying arrangement any promise by a bank to vary the consideration for one product conditioned on the purchase of a second product. In the 1990s, however, the Federal Reserve created exceptions to this rule permitting banks to offer certain discounts for joint purchases of bank and securities products, e.g., Federal Reserve System, 'Revisions Regarding Tying Restrictions', *Federal Register*, vol. 60, p. 20 186 (25 April 1995).
23. *Alabama Association of Insurance Agents* v. *Board of Governors of the Federal Reserve System,* 533 F.2d 224, 250 (6th Cir. 1976) (considering evidence of a bank lender's 'penetration rate' – the percentage of borrowers who actually purchased insurance from the bank – as well as the competitiveness of the relevant lending market as indicators of voluntary tying).
24. Bernard Schull (1993), 'Tying and Other Conditional Agreements Under Section 106 of the Bank Holding Company Act: A Reconsideration', NERA Working Paper #19.
25. Kelley Holland, 'Fed Probing Alleged Ties Of Loans to Underwriting', *American Banker*, 13 October 1992, at 1.
26. 'New Derivatives Safeguards Imposed As Bankers Trust, Fed Reach Agreement', *BNA's Bank Report*, vol. 63, p. 895 (12 December 1994).
27. For example, see Geoffrey R.D. Underhill (1997), 'Private Markets and Public Responsibility in a Global System: Conflict and Cooperation in Transnational Banking and Securities Regulation', in Geoffrey R.D. Underhill (ed.), *The New World Order in International Finance* (London: Macmillan), pp. 36–8, for a description of how international regulatory organizations have accepted private industry risk measurement models in arriving at international capital standards for financial institutions with substantial derivatives portfolios.
28. For example, the US securities laws treat high net worth individuals as accredited investors who may freely purchase unregistered securities in private offerings. In the past, at least the Federal Reserve has also treated these individuals as wholesale customers, excluding them from the category of retail bank customers who must receive special disclosures when buying nondeposit investment products from their bank. Garten, *op. cit.*, note 4, p. 109.
29. Individuals are not included as 'qualified institutional buyers' who may participate in the Rule 144A market, an institution-only private trading market for unregistered securities.

7. Failure on a Level Playing Field

1. A. Dale Tussing (1967), 'The Case for Bank Failure', *The Journal of Law and Economics*, vol. 10, pp. 129–47, especially p. 136 ('Banks which mismanage their own assets are poor managers of the nation's financial processes and should be replaced. Low profits, losses, and at the extreme failure are appropriate devices for accomplishing this replacement, either through changes in management or closure of the bank.').
2. There is a distinction: technically, deposit insurance is self-funding, with monies coming solely from premiums paid by the banking industry.
3. The story of Long-Term Capital Management is told later in this chapter.
4. For discussion of the liquidation function of federal deposit insurance, see Helen A. Garten (1994), 'A Political Analysis of Bank Failure Policy', *Boston University Law* Review, vol. 74, pp. 443–5.
5. John Hanna (1936), 'The Banking Act of 1935', *Virginia Law Review*, vol. 22, pp. 638–9.
6. For background on the RFC and its relation to the federal deposit scheme in the 1930s, see Garten, *op. cit.*, note 4, pp. 429–79. Among today's generation of US banking scholars, the history of the RFC is little known. The best contemporaneous account of its operations, written by its long-time chairman, is Jesse H. Jones (with Edward Angly) (1951), *Fifty Billion Dollars: My Thirteen Years with the RFC (1932–45)* (New York: Macmillan).
7. Garten, *op. cit.*, note 4, pp. 462–3.
8. E.g., Hanna, *op. cit.*, note 5, pp. 638–9.
9. Tussing, *op. cit.*, note 1, p. 136.
10. Tussing, *op. cit.*, note 1, p. 140.
11. Between 1930 and 1933, demand deposits of $100 000 and up were withdrawn at a faster rate than deposits of $200 and under. See (1939) 'Behavior of Deposits Prior to Suspension in a Selected Group of Banks – Analysis by Size of Account', *Federal Reserve Bulletin*, vol. 25, p. 178.
12. For background on changes in bank liability structure during the 1980s, see Helen A. Garten (1991), 'Whatever Happened to Market Discipline of Banks?' *Annual Survey of American Law*, vol. 1991, pp. 761–2. As Chapter 3 noted, these trends have continued into the 1990s, with all domestic deposits continuing to decline as a funding source especially for large banks. Robert Oshinsky (1999), 'Effects of Bank Consolidation on the Bank Insurance Fund' (Federal Deposit Insurance Corporation), p. 5.
13. In a traditional purchase and assumption transaction, the financial assistance provided by the deposit insurance fund equaled (1) the value of the failed bank's liabilities less (2) the value of the failed bank's performing assets less (3) the franchise premium. The FDIC typically retained and liquidated assets, usually non-performing, that the acquiring bank refused to take. Joseph F. Sinkey, Jr. (1979), *Problem and Failed Institutions in the Commercial Banking Industry* (Greenwich, CT: JAI Press), pp. 34–9.
14. In fact, although perhaps the largest, Penn Square was certainly not the first bank to be liquidated; between 1934 and 1983, the FDIC liquidated 328 banks and merged 340. Federal Deposit Insurance Corporation (1983), *Annual Report*, p. 14.
15. Helen A. Garten (1986), 'Banking on the Market: Relying on Depositors to

Control Bank Risks', *Yale Journal on Regulation*, vol. 4, p. 146 n.99.

16. For background on Continental's financial position and the regulators' decision to intervene to prevent failure, see 'Inquiry into Continental Illinois Corp. and Continental Illinois National Bank' (1984), Hearings Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking Finance and Urban Affairs, 98th Cong., 2d Sess., especially pp. 457–69.
17. To non-US observers, the distinction between bank and holding company creditors may not seem important, but it was to US observers, since the holding company was a legal entity distinct from the bank. According to the FDIC, the decision to protect holding company creditors was necessary to avoid violation of several outstanding indentures and irrelevant, since the holding company had sufficient assets to cover its liabilities and its creditors would not have suffered losses even had it been liquidated. 'Inquiry into Continental Illinois Corp. and Continental Illinois National Bank', *op. cit.*, note 16, p. 465. Nevertheless, critics complained that the decision to protect holding company creditors sent a dangerous message to wholesale markets that henceforth the government would subsidize uninsured investors not just in large banks but also in all bank affiliated entities.
18. Garten, *op. cit.*, note 15, p. 148 n.111.
19. Alternatively, the regulators could use an 'insured deposit transfer', a modified version of the purchase and assumption, whereby the acquiring bank assumed only insured deposits (and sufficient assets to cover them), leaving uninsured creditors to recover their investments from the proceeds of the FDIC's liquidation of the bank's remaining assets.
20. The legislation was the Federal Deposit Insurance Corporation Improvement Act of 1991. Its provisions are summarized in Helen A. Garten (1993), 'United States Bank Failure Policy', *The International Journal of Regulatory Law and Practice*, vol. 1, pp. 239–44.
21. Interestingly, the FDIC cited the transactions costs of liquidation as a reason to choose an alternative resolution. Recent thrift failures had glutted the secondary loan market, and a fire sale of CrossLand's assets would probably have yielded very little, certainly not enough to cover the cost of paying off insured depositors. For the same reason, private bids for part or all of CrossLand's assets had been disappointingly low. The FDIC calculated that CrossLand was worth more than could be realized by selling its assets immediately in depressed markets. By delaying liquidation or sale, the agency believed that it would eventually recoup its investment in CrossLand. Garten, *op. cit.*, note 4, p. 474.
22. Oshinsky, *op. cit.*, note 12.
23. William C. Melton (1985), *Inside the Fed: Making Monetary Policy* (Homewood, Illinois: Dow Jones-Irwin), pp. 157–8.
24. For background on LTCM, see Remarks Prepared for Delivery by William J. McDonough, President, Federal Reserve Bank of New York, Before the House Committee on Banking and Financial Services, Federal News Service, 1 October 1998 (available in LEXIS, News Library, FEDNEW file); Walter F. Todd, 'Financial Problems of a Large Hedge Fund', *FOMC Alert*, 22 December 1998, pp. 6–8.
25. Remarks Prepared for Delivery by Federal Reserve Chairman Alan

Greenspan Before the House Committee on Banking and Financial Services Re: 'Private-Sector Refinancing of the Large Hedge Fund, Long-Term Capital Management', Federal News Service, 1 October 1998 (available in LEXIS, News Library, FEDNEW file).
26. Greenspan, *op. cit.*, note 25.
27. Tussing, *op. cit.*, note 1, p. 140.
28. Greenspan, *op. cit.*, note 25.
29. Melton, *op. cit.*, note 23, pp. 157–8.
30. This story is told in James Grant (1992), *Money of the Mind: Borrowing and Lending in America from the Civil War to Michael Milken* (New York: Farrar Straus Giroux), pp. 202–11.
31. Some people believe that other factors were at play: Bank of United States, with its Jewish managers and its substantial involvement in the 'unsavory' (to banks at the time) world of real estate, was simply not part of the bankers' club.
32. Jones, *op. cit.*, note 6, pp. 23–5.
33. Arthur M. Schlesinger, Jr. (1956), *The Crisis of the Old Order 1919–33,* vol. 1 of *The Age of Roosevelt* (Boston: Houghlin Mifflin Company), p. 236.
34. Jones, *op. cit.*, note 6, pp. 26–34.
35. Jones, *op. cit.*, note 6, p. 62.
36. US General Accounting Office (1991), *Deposit Insurance: Overview of Six Foreign Systems* (GAO/NSIAD-91–104).
37. Jesse Jones wrote that Henry Ford felt sure that he was young enough to rebuild if the crash came. Jones, *op. cit.*, note 6, p. 62.
38. For background on this business cycle theory, popularized by economists like Hayek and Schumpeter, see J. Bradford De Long (December 1990), '"Liquidation" Cycles: Old-Fashioned Real Business Cycle Theory and the Great Depression' (Washington: National Bureau of Economic Research), Working Paper No. 3546.
39. McDonough, *op. cit.*, note 24.
40. Greenspan, *op. cit.*, note 25.

8. Let the Market Pick the Winners

1. The term comes from Alistair Duncan, 'Smart Cards in the United States: Swan-in-Waiting or Just an Ugly Duck?', *FutureBanker*, December 1998, p. 125.
2. Information about the New York pilot program comes from news reports, including 'Smart Card Test Is News To New York City Merchants', *Debit Card News*, 30 August 1997; Saul Hansell, 'Got a Dime? Citibank and Chase End Test of Electronic Run', *New York Times*, 4 November 1998, p. C2; Jeffrey Kutler, 'Mondex USA Pulls Back as Smart Cards Lag Forecasts', *American Banker*, 11 January 1999, p. 1.
3. 'The U.S. Smart Card Debate Rages On', *American Banker*, 17 March 1997, p. 10A.
4. 'Bankers Are Cool To Smart Cards, But Other Chip Markets Heat Up', *Debit Card News*, 17 February 1998.
5. Jeffrey Kutler, 'U.K. Adoption of Chip Cards May Affect U.S.', *American Banker*, 15 July 1998, pp. 1, 12.

6. Duncan, *op. cit.*, note 1, p. 125 (citing survey results from 1998).
7. Jeffrey Kutler and Antoinette Coulton, 'Smart Card: Industry Inertia Subdues Conference Mood', *American Banker*, 6 May 1998 (citing industry experts).
8. Duncan, *op. cit.*, note 1, p. 125.
9. Kutler, *op. cit.*, note 5, p. 12.
10. Hansell, *op. cit.*, note 2, p. C1.
11. Saul Hansell, '"Smart" Cards Flunk Manhattan Test', *International Herald Tribune*, 5 November 1998, p. 16.
12. 'The U.S. Smart Card Debate Rages On', *op. cit.*, note 3, p. 10A.
13. Hansell, *op. cit.*, note 2, p. C1.
14. E.g., Antoinette Coulton, 'NationsBank Testing Visa Cash at Air Force Base', *American Banker*, 15 July 1998, p. 13.
15. Kutler, *op. cit.*, note 5, p. 12.
16. Kutler, *op. cit.*, note 2, p. 12 (quoting Mondex officials).
17. Quote from Daniel R. Eitingon, president of global support services, Visa International, cited in Kutler and Coulton, *op. cit.*, note 7.
18. Antoinette Coulton, 'Smart Cards: Visa Using Tokyo as Proving Ground', *American Banker*, 22 July 1998, p. 14.
19. Kutler, *op. cit.*, note 5, p. 12.
20. Kutler, *op. cit.*, note 5, p. 1.
21. Antoinette Coulton, 'Smart Cards: Visa Acting as Smart Technology Guide', *American Banker*, 18 March 1998, p. 19.
22. Quote from 'The U.S. Smart Card Debate Rages On', *op. cit.*, note 3, p. 10A.
23. Charles H. Ferguson, 'Computers and the Coming of the U.S. Keiretsu', *Harvard Business Review*, July-August 1990, pp. 55–70.
24. Jeffrey Kutler, 'Europe Report Gives a Boost to Banks in E-Money Future', *American Banker*, 30 September 1998, p. 11.
25. Debt Collection Improvement Act of 1996, Pub. L. No. 104–134.
26. Dean Anason, 'Electronic Benefits Mandate Gets Caught in Crosswinds', *American Banker*, 23 November 1998, p. 4.

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