Glass–Steagall Act

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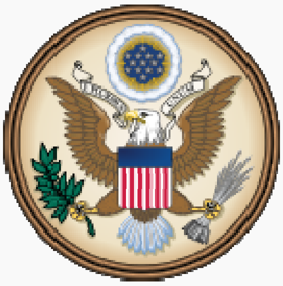
This article is about the 1933 Act establishing the FDIC. For the 1932 Act by the same sponsors, see Glass–Steagall Act of 1932.

Glass–Steagall Act



Full title	Banking Act of 1933
Acronym / colloquial name	Glass–Steagall Act
Enacted by the	73rd United States Congress
Effective	June 16, 1934
Citations	
Stat.	48 Stat. 162 (1933)
Codification	
Legislative history	

- **Introduced in the House of Representatives as** H.R. 5661 **by** Rep. Henry B. Steagall (D-AL) **on**
- **Signed into law by President** Franklin Delano Roosevelt **on** June 16, 1933

Major amendments

American Homeownership and Economic Opportunity Act, Gramm–Leach–Bliley Act, Depository Institutions Deregulation and Monetary Control Act

The **Banking Act of 1933** was a law that established the Federal Deposit Insurance Corporation (FDIC) in the United States and introduced banking reforms, some of which were designed to control speculation[1]. It is most commonly known as the **Glass–Steagall Act**, after its legislative sponsors, Carter Glass and Henry B. Steagall.

Some provisions of the Act, such as Regulation Q, which allowed the Federal Reserve to regulate interest rates in savings accounts, were repealed by the Depository Institutions Deregulation and Monetary Control Act of 1980. Provisions that prohibit a bank holding company from owning other financial companies were repealed on November 12, 1999, by the Gramm–Leach–Bliley Act.[2][3]

Overview

Two separate United States laws are known as the Glass–Steagall Act. Both bills were sponsored by Democratic Senator Carter Glass of Lynchburg, Virginia, a former Secretary of the Treasury, and Democratic Congressman Henry B. Steagall of Alabama, Chairman of the House Committee on Banking and Currency.

The first Glass-Steagall Act of 1932 was enacted in an effort to stop deflation and expanded the Federal Reserve's ability to offer rediscounts on more types of assets such as government bonds as well as commercial paper[4]. The second Glass–Steagall Act (the Banking Act of 1933) was a reaction to the collapse of a large portion of the American commercial banking system in early 1933. It introduced the separation of bank types according to their business (commercial and investment banking), and it founded the Federal Deposit Insurance Corporation for insuring bank deposits. Literature in economics usually refers to this simply as the Glass–Steagall Act, since it had a stronger impact on US banking regulation.[5]

"Rediscount" is a way of providing financing to a bank or other financial institution. Especially in the 1800s and early 1900s banks made loans to their customers by "discounting" the customer's note. The note is a paper document, in a specified form, where the borrower promises to repay a certain amount at a specified date. One example assumes that the customer wants to borrow $1000. The bank may ask him to sign a note promising to repay $1100 in one year. The bank is "discounting" the note by paying less than the $1100 face amount. The extra $100, of course, is the bank's compensation for paying before the note matures. The Federal Reserve System could provide financing by "rediscounting" this note, or would probably give the bank $1050 for the note.

Although Republican President Herbert Hoover had lost reelection in November 1932 to Democratic Governor Franklin D. Roosevelt of New York, the administration did not change hands until March 1933. The lame-duck Hoover Administration and the incoming Roosevelt Administration could not, or would not, coordinate actions to stop the run on banks affiliated with the Henry Ford family that began in Detroit, Michigan, in January 1933. Federal Reserve chairman Eugene Meyer was equally ineffectual.

While many economic historians attribute the collapse to the economic problems which followed the Stock Market Crash of 1929, some economists attribute the collapse to gold-backed currency withdrawals by foreigners who had lost confidence in the dollar and by domestic depositors who feared that the United States would go off the gold standard,[6] which it did when Roosevelt signed Executive Order 6102, The Gold Confiscation Act of April 5, 1933.[7]

According to a summary by the Congressional Research Service of the Library of Congress:

> In the nineteenth and early twentieth centuries, bankers and brokers were sometimes indistinguishable. Then, in the Great Depression after 1929, Congress examined the mixing of the "commercial" and "investment" banking industries that occurred in the 1920s. Hearings revealed conflicts of interest and fraud in some banking institutions' securities activities. A formidable barrier to the mixing of these activities was then set up by the Glass Steagall Act.[8]

The Act has influenced the financial systems of other areas such as China, which maintains a separation between commercial banking and the securities industries.[9][10] In the aftermath of the financial panic of 2008–9, support for maintaining China's separation of investment and commercial banking remains strong.[11]

Repeal

See also Depository Institutions Deregulation and Monetary Control Act of 1980, the Garn-St. Germain Depository Institutions Act of 1982, and the Gramm–Leach–Bliley Act of 1999.

The bill that ultimately repealed the Act was introduced in the Senate by Phil Gramm (Republican of Texas) and in the House of Representatives by Jim Leach (R-Iowa) in 1999. The bills were passed by a Republican majority, basically following party lines by a 54–44 vote in the Senate[12] and by a bi-partisan 343–86 vote in the House of Representatives.[13] After passing both the Senate and House the bill was moved to a conference committee to work out the differences between the Senate and House versions. The final bill resolving the differences was passed in the Senate 90–8 (one not voting) and in the House: 362–57 (15 not voting). The legislation was signed into law by President Bill Clinton on November 12, 1999.[14]

The banking industry had been seeking the repeal of Glass–Steagall since at least the 1980s. In 1987 the Congressional Research Service prepared a report which explored the case for preserving Glass–Steagall and the case against preserving the act.[8]

The argument for preserving Glass–Steagall (as written in 1987):

1. Conflicts of interest characterize the granting of credit — lending — and the use of credit — investing — by the same entity, which led to abuses that originally produced the Act.

2. Depository institutions possess enormous financial power, by virtue of their control of other people's money; its extent must be limited to ensure soundness and competition in the market for funds, whether loans or investments.

3. Securities activities can be risky, leading to enormous losses. Such losses could threaten the integrity of deposits. In turn, the Government insures deposits and could be required to pay large sums if depository institutions were to collapse as the result of securities losses.

4. Depository institutions are supposed to be managed to limit risk. Their managers thus may not be conditioned to operate prudently in more speculative securities businesses. An example is the crash of real estate investment trusts sponsored by bank holding companies (in the 1970s and 1980s).

The argument against preserving the Act (as written in 1987):

1. Depository institutions will now operate in "deregulated" financial markets in which distinctions between loans, securities, and deposits are not well drawn. They are losing market shares to securities firms that are not so strictly regulated, and to foreign financial institutions operating without much restriction from the Act.

2. Conflicts of interest can be prevented by enforcing legislation against them, and by separating the lending and credit functions through forming distinctly separate subsidiaries of financial firms.

3. The securities activities that depository institutions are seeking are both low-risk by their very nature, and would reduce the total risk of organizations offering them – by diversification.

4. In much of the rest of the world, depository institutions operate simultaneously and successfully in both banking and securities markets. Lessons learned from their experience can be applied to our national financial structure and regulation.[8]

Events following repeal

The repeal enabled commercial lenders such as Citigroup, which was in 1999 the largest U.S. bank by assets, to underwrite and trade instruments such as mortgage-backed securities and collateralized debt obligations and establish so-called structured investment vehicles, or SIVs, that bought those securities.[15] Elizabeth Warren,[16] co-author of *All Your Worth: The Ultimate Lifetime Money Plan* (Free Press, 2005) (ISBN 0-7432-6987-X) and one of the five outside experts who constitute the Congressional Oversight Panel of the Troubled Asset Relief Program, has said that the repeal of this act contributed to the Global financial crisis of 2008–2009,[17] [18] although some believe that the increased flexibility allowed by the repeal of Glass–Steagall mitigated or prevented the failure of some American banks.[19]

The year before the repeal, sub-prime loans were just five percent of all mortgage lending. By the time the credit crisis peaked in 2008, they were approaching 30 percent. This correlation is not necessarily an indication of causation, however, as there are several other significant events that have impacted the sub-prime market during that time. These include the adoption of mark-to-market accounting, implementation of the Basel Accords, the rise of adjustable rate mortgages etc.[20]

Proposed re-enactment

In mid-December of 2009, Republican Senator John McCain of Arizona and Democratic Senator Maria Cantwell, who represents Washington State, jointly proposed re-enacting the Glass-Steagall Act, to re-impose the separation of commercial and investment banking that had been in effect from the original Act in 1933, to the time of its initial repeal in 1999[21] [22][23] Legislation to re-enact parts of Glass-Steagall was also introduced into the House of Representatives. Banks such as Bank of America have strongly opposed the proposed re-enactment.[24].

Paul Volcker has been an outspoken advocate for the reimplementation of many aspects of Glass-Steagall.[25].

In Mainland Europe, notably in France, Germany and Italy, an increasing number of experts are calling for the adoption of stricter bank regulation based on the Glass-Steagall Act.[26].

See also

- Subprime mortgage crisis
- Global financial crisis of 2008

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External links

- Glass-Steagall Act – further readings
- On the systematic dismemberment of the Act from PBS Frontline
- Back to the Twenties Through the Looking Glass – Steagall Hour long Wizards of Money MP3 explaining the Glass–Steagall Act, background to it and impact of it.

Investopedia

What Was The Glass-Steagall Act?

by Reem Heakal (Contact Author | Biography)

Filed Under: Banking, Bonds, Economics, Insurance

In 1933, in the wake of the 1929 stock market crash and during a nationwide commercial bank failure and the Great Depression, two members of Congress put their names on what is known today as the Glass-Steagall Act (GSA). This act separated investment and commercial banking activities. At the time, "improper banking activity", or what was considered overzealous commercial bank involvement in stock market investment, was deemed the main culprit of the financial crash. According to that reasoning, commercial banks took on too much risk with depositors' money. Additional and sometimes non-related explanations for the Great Depression evolved over the years, and many questioned whether the GSA hindered the establishment of financial services firms that can equally compete against each other. We will take a look at why the GSA was established and what led to its final repeal in 1999.

Reasons for the Act - Commercial Speculation

Commercial banks were accused of being too speculative in the pre-Depression era, not only because they were investing their assets but also because they were buying new issues for resale to the public. Thus, banks became greedy, taking on huge risks in the hope of even bigger rewards. Banking itself became sloppy and objectives became blurred. Unsound loans were issued to companies in which the bank had invested, and clients would be encouraged to invest in those same stocks.

Effects of the Act - Creating Barriers

Senator Carter Glass, a former Treasury secretary and the founder of the U.S. Federal Reserve System, was the primary force behind the GSA. Henry Bascom Steagall was a House of Representatives member and chairman of the House Banking and Currency Committee. Steagall agreed to support the act with Glass after an amendment was added permitting bank deposit insurance (this was the first time it was allowed).

As a collective reaction to one of the worst financial crises at the time, the GSA set up a regulatory firewall between commercial and investment bank activities, both of which were curbed and controlled. Banks were given a year to decide on whether they would specialize in commercial or in investment banking. Only 10% of commercial banks' total income could stem from securities; however, an exception allowed commercial banks to underwrite government-issued bonds. Financial giants at the time such as JP Morgan and Company, which were seen as part of the problem, were directly targeted and forced to cut their services and, hence, a main source of their income. By creating this barrier, the GSA was aiming to prevent the banks' use of deposits in the case of a failed underwriting job.

The GSA, however, was considered harsh by most in the financial community, and it was reported that even Glass himself moved to repeal the GSA shortly after it was passed, claiming it was an overreaction to the crisis.

Building More Walls

Despite the lax implementation of the GSA by the Federal Reserve Board, which is the regulator of U.S. banks, in 1956, Congress made another decision to regulate the banking sector. In an effort to prevent financial conglomerates from amassing too much power, the new act focused on banks involved in the insurance sector. Congress agreed that bearing the high risks undertaken in underwriting insurance is not good banking practice. Thus, as an extension of the Glass-Steagall Act, the Bank Holding Company Act further separated financial activities by creating a wall between insurance and banking. Even though banks could, and can still can, sell insurance and insurance products, underwriting insurance was forbidden.

Were the Walls Necessary? - The New Rules of the Gramm-Leach-Bliley Act
The limitations of the GSA on the banking sector sparked a debate over how much restriction is healthy for the industry. Many argued that allowing banks to diversify in moderation offers the banking industry the potential to reduce risk, so the restrictions of the GSA could have actually had an adverse effect, making the banking industry riskier rather than safer. Furthermore, big banks of the post-Enron market are likely to be more transparent, lessening the possibility of assuming too much risk or masking unsound investment decisions. As such, reputation has come to mean everything in today's market, and that could be enough to motivate banks to regulate themselves.

Consequently, to the delight of many in the banking industry (not everyone, however, was happy), in November of 1999 Congress repealed the GSA with the establishment of the Gramm-Leach-Bliley Act, which eliminated the GSA restrictions against affiliations between commercial and investment banks. Furthermore, the Gramm-Leach-Bliley Act allows banking institutions to provide a broader range of services, including underwriting and other dealing activities.

Conclusion
Although the barrier between commercial and investment banking aimed to prevent a loss of deposits in the event of investment failures, the reasons for the repeal of the GSA and the establishment of the Gramm-Leach-Bliley Act show that even regulatory attempts for safety can have adverse effects.

by Reem Heakal,

Börsenlexikon

Glass-Steagall-Gesetz (Glass-Steagall Act)

In den USA 1931 eingeführte Vorschrift, wonach alle in den USA tätigen Banken entweder das Einlagegeschäft betreiben (commercial banks) oder aber sich dem Wertpapiergeschäft widmen (investment banks, auch broker banks genannt) dürfen. Beide Geschäftstätigkeiten zugleich zu betreiben sind einer Bank danach verboten. -Die Verknüpfung von Commercial Banking, Investment Banking und anderen Aktivitäten (etwa Versicherungsleistungen) ist seit 1999 unter bestimmten Bedingungen über eine Holding möglich. Siehe Deregulierung, Trennbanksystem.

BusinessWeek

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House Considers Reinstating Glass-Steagall

Looking for ways to pressure banks to lend more, Democrats may revisit the 1999 law that allowed Citigroup and others to combine consumer and investment banking

By James Rowley and Christine Harper

(Bloomberg) — The U.S. House is considering reinstituting the Depression-era Glass-Steagall Act, which barred bank holding companies from owning other financial companies, Majority Leader Steny Hoyer said.

A renewal of the 1933 law "is certainly under discussion" by House members, Hoyer told reporters in Washington today. The Glass-Steagall law was repealed in 1999 to help pave the way for the formation of Citigroup (C). by the $46 billion merger of Citicorp and Travelers Group Inc.

"As someone who voted to repeal Glass-Steagall, maybe that was a mistake," said Hoyer, a Maryland Democrat.

Hoyer made the comments when asked whether Congress and President Barack Obama's administration could do more to persuade banks to make more business loans and get credit flowing into the economy. Obama met yesterday with the chief executive officers of U.S. banks, urging them to lend more money.

The Glass-Steagall law barred banks that took deposits from underwriting securities. The 1999 law that repealed it enabled the creation of "financial holding companies" that combine banks with insurers or investment banks.

Enactment of that law has generated debate about whether it helped spawn reckless lending practices and financial speculation that led to the meltdown of credit markets last year and the $700 billion U.S. bailout of troubled banks, including Citigroup.

House Legislation

Legislation passed by the House on Dec. 11 to overhaul regulation of Wall Street didn't include a reinstatement of Glass-Steagall. It did include an amendment that would give federal regulators the power to take apart large, healthy firms if their size poses a risk to the U.S. financial system. The legislation is pending before the Senate.

Treasury Secretary Timothy Geithner testified on Oct. 29 that regulators need authority "to force the major institutions to reduce their size or restrict the scope of their activities" if they become too risky.

The 1999 repeal of Glass-Steagall made it possible for Goldman Sachs Group (GS) and Morgan Stanley (MS), the two biggest U.S. securities firms, to convert into bank holding companies, enabling them to get cheap funding from the Federal Reserve during the financial crisis. If the law hadn't been repealed, Bank of America (BAC). wouldn't have been allowed to acquire Merrill Lynch & Co.

Undoing Transactions

Resurrecting Glass-Steagall might require undoing some of those transactions unless Congress included an exception for those already carried out.

Such a change in law also would reduce the need for the taxpayer bailouts that added between 9 percent and 49 percent to the profits of the 18 biggest U.S. banks in 2009, according to Dean Baker, co-director of the Center for Economic & Policy Research in Washington.

Even so, Fed Chairman Ben Bernanke told the Economic Club of New York on Nov. 16, "Plenty of firms got into trouble making regular commercial loans, and plenty of firms got into trouble in market-making activities."

"The separation of those two things per se would not necessarily lead to stability," Bernanke said.

Obama's meeting with the bankers yesterday "was a good thing for the president to do," Hoyer said. "The president needs to make it very clear that we expect some help from the private sector to help bring this economy back."

Lending From TARP

Obama "has got to go further than that," Hoyer said, noting that the administration is considering direct lending from the Troubled Asset Relief Program to small businesses.

Former Citibank Chairman John S. Reed apologized in a Nov. 6 interview for helping engineer the bank's merger with Travelers and for his role in building a company that took $45 billion in U.S. assistance. Reed also recanted his advocacy of the repeal of Glass-Steagall.

The 1998 merger depended on Congress repealing Glass- Steagall before a five-year deadline that otherwise would have required Travelers to sell its insurance underwriting business.

"We learn from our mistakes," Reed said in the interview. "When you're running a company, you do what you think is right for the stockholders," Reed said. "Right now, I'm looking at this as a citizen."

Jim Leach, the former Republican chairman of the House Financial Services Committee, defended the repeal in an April 22 speech at a conference on financial reform sponsored by Boston University Law School and the Bretton Woods Committee.

"Changes in Glass-Steagall did not precipitate this crisis," according to a text of the speech by Leach, an Iowan who now is chairman of the National Endowment for the Humanities.

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Reuters

Reinventing Glass-Steagall

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CITI | CITIGROUP | FINANCIAL CRISIS | GLASS STEAGALL | GOLDMAN SACHS | HOUSE OF REPRESENTATIVES | INSURANCE | INSURANCE BUSINESS | JOHN MCCAIN | JPMORGAN | JPMORGAN CHASE | MORGAN STANLEY | REGULATORY REFORM BILL | WELLS FARGO

by Michael

With Congress already debating a sweeping overhaul of financial regulation, perhaps the most enduring regulatory stricture of the Depression era is again getting an airing in Washington. The venerable Glass-Steagall laws that barred large banks from affiliating with securities firms and engaging in the insurance business were repealed in 1999. Now, as the banks try to move on from the dreaded salary caps and the humiliation of TARP, lawmakers are wondering whether getting rid of Glass-Steagall was such a good idea.

Financial giants such as Goldman Sachs could be broken up under two bills introduced in Congress on Wednesday, one with the backing of former Republican presidential nominee John McCain. Both would reinstate Glass-Steagall. Passage of the Cantwell-McCain bill would force firms at the center of last year's financial crisis — such as Goldman Sachs, Morgan Stanley, Citigroup, JPMorgan Chase and Wells Fargo — to spin off investment and insurance operations, according to Demos, a progressive think tank in New York. A similar measure was offered on Wednesday by six Democrats in the House of Representatives.

To be fair, many have wondered whether dumping Glass-Steagall was such a good idea. What's odd is that the discussion about bringing it back comes as almost an afterthought to the massive regulatory reform bill now before Congress. Rather than start from scratch, it may have made more sense to try to reinstate laws that the marketplace was already familiar with, and add new bits around the edges.

While the banks may think they are strong enough to shed TARP, it's hard to see how they would survive the cleaving of Glass-Steagall at this stage of their recovery. Perhaps by forcing the sector to resplit itself, the remaining banks would be forced to go back on TARP. While that might have some political appeal, analysts say restoring Glass-Steagall is probably a non-starter because it would be seen as stoking unemployment. Going back to more Depression-era regulation would also be difficult to sell as a progressive approach to modern day problems.