It’s Hard to Summon Sympathy for Big Banks

Alex Wong/Getty Images

A protest earlier this year in Washington against foreclosures targeted banks.

By Floyd Norris, *The New York Times*
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It’s no fun to be a banker these days.

It is not just the increased regulation. It’s the lack of trust. “At what point does this stop?” asked Gary Lynch, the former director of enforcement for the Securities and Exchange Commission who has gone on to jobs with many leading Wall Street firms and is now global general counsel at Bank of America. He was referring to the escalation in penalties being levied on banks, culminating in the $13 billion JPMorgan Chase was forced to pay for a series of transgressions.

Speaking at a banking industry conference last month in New York, Mr. Lynch recalled that he had been working at Morgan Stanley in London before he returned to this country in

2011 to join Bank of America. He had thought, he said, that by then — three years after the collapse of Lehman Brothers set off the financial crisis — anger at banks would have declined.

He was wrong: “It was worse.”

Bankers don’t feel very popular in Europe, either. In Germany, Jürgen Fitschen, the co-chief executive of Deutsche Bank, the largest bank in the country, is furious with Wolfgang Schäuble, the German finance minister, for saying that “banks still show great creativity in evading regulation.” That meant, he said, that it was necessary to keep pushing on new bank regulations.

“It’s irresponsible to comment in such a populist manner,” Mr. Fitschen complained.

Deutsche Bank’s latest brush with regulators sounds positively puny by JPMorgan standards. It was forced by the European Union to pay 725 million euros — nearly $1 billion — for its role in fixing and manipulating the Libor rate.

Mr. Fitschen evidently views those sins as irrelevant now, explaining that it is wrong to think “things haven’t changed since 2008 or 2009.” Actually, the Libor violations at some banks continued until at least 2011, although we don’t know whether that was true at Deutsche as well.

It was only 11 years ago that the S.E.C., outraged by accounting fraud at Xerox, levied a $10 million fine. That was a record, recalled Steve Cutler, who was the commission’s director of enforcement at the time, speaking on the same panel as Mr. Lynch at the banking conference sponsored by The Clearing House, an organization of large banks.

“We should all be concerned that there doesn’t seem to be a natural end point to how high fines could go,” said Mr. Cutler, who is now the general counsel of JPMorgan and was involved in negotiating the $13 billion settlement. “One hundred million dollars is still meaningful,” he added, in what might be labeled wishful thinking.

It may not be easy to be sympathetic to the big banks, but it is easy to understand their surprise and frustration. They have gone from being viewed as national champions — proof of a country’s standing in the world — to being seen as a potential source of national disaster. Iceland and Ireland went broke because they had to, or chose to, bail out their irresponsible banks.

That no top bankers went to jail may be proper — it is not a crime to make stupid mistakes, and much of what happened in the years before the financial crisis was more foolish than venal — but it grated to see few of them fired while those who stayed went back to collecting multimillion-dollar bonuses.

Eric H. Holder Jr., the attorney general, did not help when he said last spring that the Justice Department had to keep in mind that filing criminal charges against a large bank could "have a negative impact on the national economy, perhaps even the world economy." He quickly backtracked, but the perception was reinforced.

It seems likely that the reaction to his first statement played a role in causing the government to demand JPMorgan pay so much money.

This week five United States regulators — the Federal Reserve, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Commodity Futures Trading Commission and the S.E.C. — jointly issued new rules on the Volcker Rule passed as part of the Dodd-Frank law in 2010.

The regulators had some choice in details, because the rule, as passed by Congress, is a contradiction in terms. It bans "proprietary trading" by banks, or trading for their own gain, but carves out exceptions for "hedging" and "market making." Define them broadly enough, and almost nothing would remain of the rule. Define them narrowly enough and the exceptions could be meaningless.

This rule seems to try to cut it down the middle, but what it does not do is give the banks clear permission to do trades simply because they contend the purpose falls into an exemption. The banks will have to spend money on creating and monitoring policies to assure compliance, and even then they face the possibility of second-guessing by regulators.

If these rules had been issued two years ago, they might have been more friendly to the banks, which still had some significant support from regulators, notably in the Office of the Comptroller of the Currency. Then came the "London Whale" fiasco at JPMorgan Chase, in which traders lost $6 billion trading complex derivatives. When that first came out, the man in charge of regulating JPMorgan for the comptroller told Senate staff members that he agreed with the bank that the trades came within the hedging exemption. The new rule makes clear that is not the case.

Under the comptroller's policies, big banks have groups of inspectors who spend all their time at the bank's offices. That is supposed to assure they know their banks intimately, but

it may also mean they are in no position to know that their bank is doing things other banks do not do. Nor does it foster the appearance of independence. The comptroller is now considering whether to end that system.

It is hardly unprecedented for banks to lose a lot of money on trading errors, points out Robert B. Ahdieh, a professor and vice dean at Emory University Law School who studies regulatory law. But while “they may not be more frequent now, they are more salient.” In the aftermath of bailouts, the fear that new ones might be necessary is always there.

In fighting the Volcker Rule, banks warned that customers might suffer if the banks had to curtail their market-making activities and added that proprietary trading had not caused the financial crisis anyway. Such arguments may be correct, but they miss the actual thrust of what is going on in bank regulation now.

Having learned that big banks can be hazardous to a nation’s wealth, regulators would be quite happy if their big banks were smaller, or less diversified. If the end result of the Volcker Rule were that big banks became less competitive in areas peripheral to commercial banking, that might be a good thing.

Banks are special because they provide loans and operate payment systems. They are blessed with deposit insurance, assuring access to money at lower rates than others would have to pay. Regulators used to assume, if they thought about it at all, that other activities were fine because they would provide profits that could support essential functions. Now they fear potential losses.

The Volcker Rule as adopted virtually exempts small banks from most of its rules. That may reflect political reality; smaller banks have a lot of lobbying power because they are in every congressional district. But it also reflects the fact that failures of small banks do not threaten the system.

Two of the six largest United States banks in 2007 — Wachovia and Washington Mutual — were taken over by others during the crisis. Now the remaining four — Bank of America, JPMorgan, Wells Fargo and Citigroup — are so dominant that there is no one left to buy any of them. If the fifth-largest bank by deposits, U.S. Bancorp, were to acquire the three banks just below it on the list — Bank of New York Mellon, PNC and Capital One — it would still be No. 5.

That helps to explain why regulators seem determined to raise the costs of being big. The giant banks are to face higher capital requirements and increased costs in dealing with regulations like the Volcker Rule.

In hindsight, it might have been better to not let the behemoths get so big, or to have kept Depression-era restrictions that left market-making to investment banks and insured deposits to commercial ones, but that did not happen.

We have the giant banks and must live with them.

We don't, however, have to like them. If Mr. Schäuble, who comes from the conservative, pro-business Christian Democratic Union, does not trust Germany's biggest bank to behave, the correct answer to Mr. Lynch's question may be, "Don't hold your breath."

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