ask the Fed®

Take Five (with Bill Emmons)

“Are the Biggest Banks Too Complex?”

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2012 Dialogue With the Fed

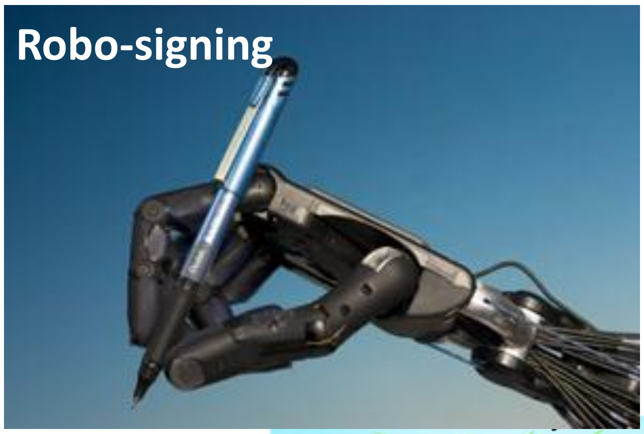
- What: A discussion of the "megabanks", led by Bill Emmons, open to the public
- When: Monday, Oct. 1, 2012, 6:45 to 8:15 pm
- Where: St. Louis Fed, downtown St. Louis, register at www.stlouisfed.org/dialogue; or streaming online at www.stlouisfed.org/live
- Why: To enhance public understanding of key issues in today's financial headlines

Last year's Dialogue sessions are on-line at www.stlouisfed.org/newsroom/displayNews.cfm?article=1344

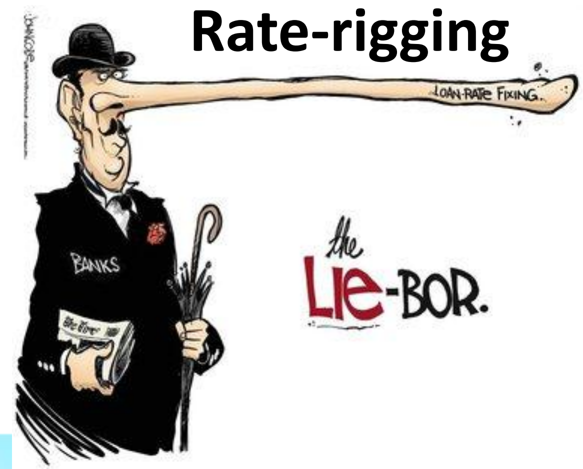
Part 1

Big banks misbehaving

Robo-signing

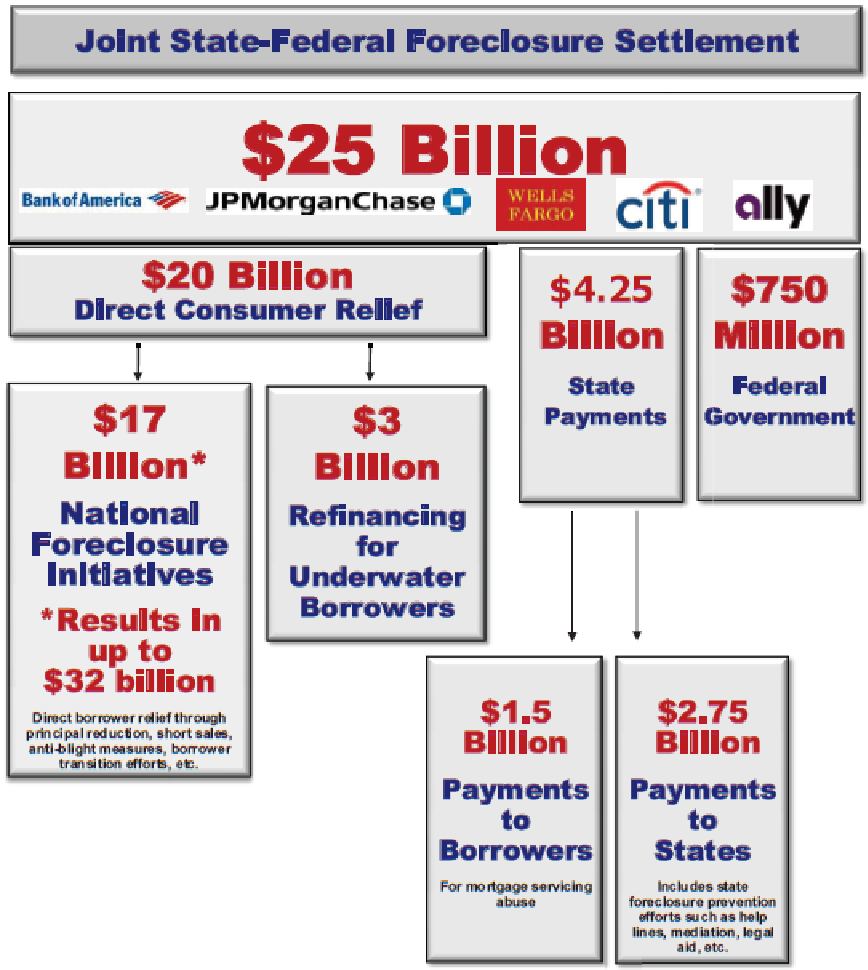


Rate-rigging



Botched hedging

The Servicer-Settlement Flowchart



Source: U.S. Department of Housing and Urban Development, http://portal.hud.gov/hudportal/HUD?src=/mortgageservicingsettlement

The London Whale

- Many JPMC employees associated with the London Whale have left the bank, including the trader, Bruno Iksil, the head of the bank's Chief Investment Office, Ina Drew, and a number of others.
- CEO Jamie Dimon testified before several Congressional committees in June.
- JPMC restated its first-quarter 2012 earnings.
- Investigations are underway at several federal and state agencies in the U.S. and in the U.K. targeting inadequate disclosures.

LIBOR Rate-Rigging

- Barclay's admitted in June 2012, as part of a settlement with the Commodity Futures Trading Commission (CFTC), the Department of Justice (DOJ) and the U.K. Financial Services Authority (FSA), that it knowingly had submitted false LIBOR estimates over a multi-year period.
- Barclay's agreed to pay $450 million and forced out CEO Bob Diamond, board chairman Marcus Agius, and the CFO.
- Many other banks are under investigation in the U.S., the U.K., and elsewhere in connection with LIBOR rate-rigging.

Part 2

- Why do big banks exist?
- Conclusions
  - There are some economies of scale in banking, creating incentives to grow.
  - But scale advantages do not appear sufficient to justify trillion-dollar banks.
  - Moreover, megabanks create systemic risks.
  - Megabanks may be undesirable overall.

Part 3

- Dealing with complex banks
- Conclusions
  - Important internal forms of governance do not appear to work well in many megabanks, including corporate culture and board oversight.
  - Depositor discipline of banks—bank runs—would be destabilizing, so we have a safety net and regulation.
  - Overall, megabanks face imperfect controls on their risk-taking behavior.

Part 4

- Better to deal with the devil we know?
- Conclusions
  - The devil we don’t know: Radical reforms
    - Break up the megabanks.
    - Create “narrow banks.”
  - The devil we know: More regulation
    - Dodd-Frank and Basel III purport to mitigate or eliminate the too-big-to-fail problem.
    - We won’t know if they work until we have used the new powers successfully; many are skeptical.
    - What about a strict “death-penalty” regime? Any bank that requires government assistance will be nationalized.

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