GRAHAMFISHER

Statement of Joshua Rosner

Managing Director, Graham Fisher & Co.

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Subcommittee on Financial Institutions and Consumer Protection

"Examining Financial Holding Companies: Should Banks Control Power Plants, Warehouses, and Oil Refineries?"

July 23, 2013

Banking and Commerce:

Chairman Brown, Ranking Member Toomey, and members of the Subcommittee, thank you for inviting me to testify today on this important subject.

We stand on the other side of the largest financial crisis since the Great Depression, a crisis that occurred less than a decade after the repeal and erosion of long standing separations of commercial and investment banking and of banking and nonfinancial business.

Since 2003, our government and central bank have allowed an unprecedented mixing of banking and commerce. So far, that grand experiment has gone better for the banks than it has for consumers. Electricity users appear to pay more because of Wall Street involvement, aluminum for airplanes and soda cans costs more, and some say gasoline at the pump costs more -- without any measurable benefit to anyone but the banks. This is partially the result of unilateral decision-making by the Federal Reserve, which Congress empowers to use its judgment to grant exemptions to a half-century-old law. Our largest bank holding companies now seek further control over other nonfinancial infrastructure assets through the long-term leasing and control over America's patrimony, in return for short-term influxes of cash. We're on the threshold of a new Gilded Age, where the fruits of all are enjoyed by a few.

Only Congress can prevent this unfortunate consolidation of American business. The Federal Reserve Board should not allow banks to be in businesses that don't directly support the resilience of the payments system or the stability of FDIC insured deposits. “Left unchecked, the trend toward the combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. This must not be permitted to happen; it would be bad for banking, bad for business, and bad for borrowers and consumers.”[1]

President Richard M. Nixon said that in 1969. At the time, a generation had enjoyed relative tranquility in the banking system. That was because in 1935, Congress recognized risks associated with the combination of commercial banking and investment banking. And in 1956, recognizing failures to protect the public interest from the competitive and systemic risks arising from bank’s control of nonfinancial businesses, congress then passed legislation to prevent bank holding companies from exercising such control. Nixon's remarks came as Congress debated closing a loophole in the 1956 Act, and in 1970, Congress did just that.

The line did not hold.

In 1987, as rumors began to circulate that the White House was considering supporting the creation of “financial leviathans” or “Superbanks”[2], Federal Reserve Chairman Volcker echoed Nixon’s warning of two decades earlier: “Widespread affiliations of commercial firms and banks [carry] the ultimate risk of concentrating banking resources into a very few hands, with decisions affecting these resources influenced by the commercial ownership links, resulting in inevitable conflicts of interest and impairment of impartial lending judgment.”

At the time, large U.S. banks claimed prohibitions against the combination of commercial and investment banks and commercial banks and nonfinancial businesses were putting the United States’ economy at a competitive disadvantage

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[1] (DOC 02-1-71) The 1970 Amendments to the Bank Holding Company Act: Opportunities to Diversify By ALFRED HAYES President, Federal Reserve Bank of New York, speech before the New York Scale Bankers Association in New York City on January 25. 1971, MONTHLY REVIEW. FEBRUARY 1971 available at: http://www.newyorkfed.org/research/monthly_review/1971_pdf/02_1_71.pdf

[2] “BUSINESS FORUM: DOES THE U.S. NEED SUPERBANKS? Why Bigger Isn't Better in Banking”, Thomas Olson, The New York Times, June 28,1987 available at: http://www.nytimes.com/1987/06/28/business/business-forum-does-the-us-need-superbanks-why-bigger-isn-t-better-in-banking.html

to the Japanese banks – then the largest and most concentrated in the world and also at disadvantage to the German banks which had no such structural restrictions. Volcker's response was clear: "I have not heard any concern over the years that American banks are not active competitors internationally. They have been at the cutting edge of international banking competition and we have very active international competitors among the American banks". But the United States' "money center" banks were not ready to give up.

On April 7, 1998, in defiance of Glass-Steagall, Citibank announced a merger with Travelers Group, creating the world's largest financial services company[3]. In 1999, with the passage of Gramm-Leach-Bliley, banks were given the ability to combine commercial and investment banking and, as a result, were able to expand more deeply into nonfinancial businesses. At the November 12, 1999 signing ceremony, President Clinton offered the promise that "this historic legislation will modernize our financial services laws, stimulating greater innovation and competition in the financial services industry" and "Removal of barriers to competition will enhance the stability of our financial services system"[4].

Unfortunately, less than a decade after those words were uttered, our financial services industry was more concentrated, more cartel-like and less stable. The result was the biggest financial calamity since the Great Depression. While the actions of many parties, from policymakers and banks, investors and consumers all led us to crisis the fact remains that structured products innovated and sold as a result of the combination of commercial and investment banking, devastated Main Street USA and ravaged consumers and businesses alike. Banks, which had previously been prevented from investment banking activities, had stimulated demand for faulty mortgage products. When the house of cards collapsed, the Federal Reserve and FDIC were called on to support activities that are clearly outside of their legal purpose.

In 2003, with the stroke of a pen, the Federal Reserve razed the walls between deposits and commerce with its approval of Citi's ownership of Phibro, a nonfinancial business. It did so again, in 2005, when it approved JPM's entry into the physical commodities business. This kind of unilateral extra-legal decision-making by an entity not directly accountable to voters or Congress or

[3] "Citicorp and Travelers Plan to Merge in Record $70 Billion Deal: A New No. 1:Financial Giants Unite", The New York Times, Mitchell Martin, April 7, 1998, available at: http://www.nytimes.com/1998/04/07/news/07iht-citi.t.html

[4] http://www.presidency.ucsb.edu/ws/index.php?pid=56922#axzz1aV0pqgub

even the executive branch has proven perilous to the public and anti-democratic. Lawmakers ought to remove the Federal Reserve's right to rewrite securities laws.

Today, regulators remain unprepared for the future demands that will be put on them and have failed to even manage those early forays that are primary to the discussion today. With "systemically important financial institutions'"(SIFIs) involvement in global and regulated nonfinancial assets there are now too many regulators across too many jurisdictions for the public to hope for any regulatory effectiveness. While the Federal Reserve remains the primary regulator of our Federally chartered bank holding companies, today these banks operate businesses overseen by the Federal Energy Regulatory Commission, state utility regulators, the Commodity Futures Trading Commission, the Securities and Exchange Commission, commodity exchanges and their international counterparts.

In 2005, the Federal Reserve decided that JP Morgan's ownership of commodities would be ancillary to their financial business. They determined that: "Based on JPM Chase's policies and procedures for monitoring and controlling the risks of Commodity Trading Activities, the Board concludes that consummation of the proposal does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally and can reasonably be expected to produce benefits to the public that outweigh any potential adverse effects. "

In issuing their approval, they took pains to make it clear that: "To minimize the exposure of JPM Chase to additional risks, including storage risk, transportation risk, and legal and environmental risks, JPM Chase would not be authorized (i) to own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities; or (ii) to process, refine, or otherwise alter commodities."

Yet that is precisely what JPM proceeded to do.

In 2008, RBS sought Federal Reserve Board approval proposed to enter into physical commodity trading including in certain commodities not approved by the CFTC for trading on a futures exchange, long-term energy supply contracts, energy tolling and energy management services. The Federal Reserve ruled[5] that each of these activities would be ancillary to their financial services businesses assuming

[5] Federal Reserve Bulletin, Volume 94, First Quarter 2008, "The Royal Bank of Scotland Group plc Edinburgh, Scotland, "Order Approving Notice to Engage in Activities Complementary to a Financial Activity", available at: http://www.federalreserve.gov/pubs/bulletin/2008/legal/q108/order7.htm

certain safety and oversight regimes, including the ability to ensure proper position limits, were in place[6].

Between 2008 and 2010, through its purchase of Bear Stearns and parts of RBS Sempra, JP Morgan acquired a number of power plants, electricity tolling agreements, and the metals concentrates and warehouses of Henry Bath.

By 2011, warnings were being sounded before the United Kingdom's House of Commons: "I believe there is a lot we can do just by enforcing correct commercial law. For example, on the London Metal Exchange there are four very large companies that own the very warehouses that people deliver metal into. J.P. Morgan[2] is one of them. They own a company called Henry Bath. They are, therefore, a ring-dealing member of the exchange and they also own the warehouse. That is restrictive. They were also reported, at one point, to have had 50% of the stock of the metal on the London Metal Exchange. That is manipulative. These are things that we can do something about here. That would mean the copper price probably would not be $10,000 a tonne, which is higher than for some forms of titanium. That price is not down to the fact that the metal is not being mined, it is because of such actions.[7]"

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[6] Note: UNITED STATES OF AMERICA Before the COMMODITY FUTURES TRADING COMMISSION, CFTC Docket No. 12-37, "ORDER INSTITUTING PROCEEDINGS PURSUANT TO." Last modified 2012, available at: http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfJP Morganorder092712.pdf (On September 27, 2012, the CFTC issued an Order against JP Morgan for violations of Section 4a(b)(2) of the Commodity Exchange Act: "deficiency in its newly created automated position limit monitoring system for the commodity business…used by commodity traders to track their current positions in particular futures contracts …after learning of this deficiency, JPMCB utilized a manual position limit monitoring procedure pending correction of the automated monitoring system. Despite adoption of this manual position limit monitoring procedure, JPMCB violated its short-side speculative position limit on several occasions.")

[7] House of Commons of the United Kingdom, Select Committee on Science and Technology, "Strategically important metals - Science and Technology Committee", "Examination of Witnesses (Question Numbers 70-107)", February 16, 2011, available at: http://www.publications.parliament.uk/pa/cm201012/cmselect/cmsctech/726/11021602.htm

Limits on Nonfinancial Assets:

Among the key legal requirements that the Federal Reserve must address when considering Gramm-Leach-Bliley Act's allowance of 'nonfinancial activities' is: "the attributed aggregate consolidated assets of the company held by the holding company pursuant to this subsection, and not otherwise permitted to be held by a financial holding company, are equal to not more than 5 percent of the total consolidated assets of the bank holding company, except that the Board may increase that percentage by such amounts and under such circumstances as the Board considers appropriate, consistent with the purposes of this Act"[8].

When Banks are as large as they are able to lever as much as they do, perhaps we should consider whether five percent is still an appropriate threshold. When one company can have its hands on 50% of all metals on LME and still be less than 5% of total assets, the question becomes one of competition rather than arbitrary thresholds.

Moreover, given the various forms of "control", one should ask how much can that threshold can be gamed and what the banks are counting as being in their control? As we have now seen, the banks may abide by the letter of the regulation but not its spirit, finding various loopholes to exploit as they conduct their business.

Such is the approach of Goldman when it states that their warehouse unit, Metro, never *owns* the metal in its sheds, rather it merely stores it. After all, it is prohibited from owning metal it stores. Similarly, JP Morgan's "tolling agreements" with electricity generators are a means for them to buy and sell power without having to *own* it. Five-percent appears to be an arbitrary number and easily manipulated as a liar loan.

Even if the Federal Reserve was serious about its efforts to limit nonfinancial activities, the task may be too large because of all of the legal loopholes available to banks, witnessed by the proliferation of shell companies, differing ownership structures and subsidiaries. According to research from the Federal Reserve Bank of New York, the four biggest bank holding companies had, combined, about 3,000 subsidiaries in 1990. By 2011, the top four had more than 11,000[9].

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[8] GRAMM–LEACH–BLILEY ACT, PUBLIC LAW 106–102—NOV. 12, 1999, available at:
http://www.gpo.gov/fdsys/pkg/PLAW-106publ102/pdf/PLAW-106publ102.pdf

[9] "Fed Reviews Rule on Big Banks' Commodity Trades After Complaints", Bloomberg, Bob Ivry, July 20, 2013 available at:

The Risks are Real:

As we have witnessed during and since the financial crisis, when business-line profitability declines or regulatory or reputational risks rise banks tend to exit markets.

In the world of narrow banking this behavior would pose little risk to our system of financial intermediation. Unfortunately, in the various businesses within investment banking, and in critical nonfinancial businesses, withdrawals of liquidity that are manageable during normal periods create dislocations during crisis. Contagion and the failure of firms within an industry are acceptable realities within a competitive economy. However, we must guard against the risk that such dislocations lead to contagion within our banking sector, where the explicit guarantees of depositors and direct access to the Federal Reserve's discount window engender systemic risks to the public.

Conflict between the private motives of managements, with their primary obligation to shareholders, and the public interest are not rare. They exist and are the fundamental reason for regulation within industries. Where these conflicts lead to abuses that circumvent regulation they often can lead to failure, as was the case with Enron. Unfortunately, where Enron could be shut down easily, the reality is that our systemically important financial institutions are more complex. Unlike a bank, Enron did not have ability to drive capital away from competitors and this reduces the development of natural competitors and possible successor firms. Enron did not have the explicit guarantee that backs the deposits of our banks or the implied guarantees still conferred by the market, even in the wake of the Dodd-Frank Act. While banks have 4 types of risk, only the failure of reputational risk management drives necessary collapse. Enron's reputational risk posed no systemic risk.

While operational, liquidity and credit risks can cause the downfall of a firm the value of the core assets can typically be transferred, even at a loss, to other industry participants. Unfortunately, reputational risk within a systemically important financial institution can result in requirements that the firm backstop assets, even those that were legally isolated. In 2008 Citi was obligated to guarantee and then repurchase $17.4 billion of structured investment vehicles (SIVs)[10]. As a result, the failure of the federal government to backstop a firm's

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http://www.bloomberg.com/news/2013-07-20/fed-reviews-rule-on-big-banks-commodity-trades-after-complaints.html

[10] "Citi Finalizes SIV Wind-down by Agreeing to Purchase All Remaining Assets",

reputation against such losses during a time of crisis could exacerbate panics and lead to contagion and the creation of larger systemic problems.

While there is no suggestion that the current reputational problems in banks' nonfinancial businesses are of a scale that could create a systemic crisis, the possibility of such failures occurring in the future must still be considered by prudential regulators and policymakers.

This past weekend the New York Times demonstrated how Goldman Sachs became a key middleman in the aluminum industry, possibly adding cost to consumers without any real benefit[11]. The warehouse business worked fine without them; now, with their presence in the market, it can be argued that it is neither better nor more efficient, only more expensive.

Similarly, in January 2013, the FERC took action against the JP Morgan for its attempts at preventing the implementation of state-requested changes to two Huntington Beach, California, power plants owned by AES Corporation[12]. The state deemed the work necessary in order to replace lost power capacity that resulted from the shutdown of the San Onofre nuclear plant.[13] JPM sought to prevent the changes and claimed its marketing contract with AES gave them the right to veto the work. While the bank's motives were not stated it is reasonable to consider that the firm sought to profit from the higher peak energy prices that would have resulted from its actions to prevent new capacity from coming on line. While the Federal Reserve, as the primary regulator of the holding company, had authorities over the bank's activities it appears not to have asserted any authority.

Citigroup, Press Release, November 19, 2008, available at: http://www.citigroup.com/citi/press/2008/081119a.htm

[11] "A Shuffle of Aluminum, but to Banks, Pure Gold", The New York Times, David Kocieniewski, July 20, 2013, available at: https://www.nytimes.com/2013/07/21/business/a-shuffle-of-aluminum-but-to-banks-pure-gold.html?ref=todayspaper&_r=0

[12] "JP Morgan Unit Can't Block Calif. Power Project, FERC Says", Law 360, Daniel Wilson, January 07, 2013, available at: http://www.law360.com/articles/405284/JP Morgan-unit-can-t-block-calif-power-project-ferc-says

[13] "Feds rule JP Morgan can't block California power plant changes." *The Sacramento Bee*, Mary Lynne Vellinga, January 5, 2013, available at: http://www.sacbee.com/2013/01/05/5093370/feds-rule-JP Morgan-cant-block.html#mi_rss=Capitol%20and%20California

The Goal is Control Rather than Consolidating Ownership:

Today, there are few financial assets classes left to support growth of the size necessary to generate returns proportional to our largest banks' needs. Seeking new returns, our largest and most systemically interconnected banking firms, under the guise of infrastructure development, are turning their focus to an expansion of their control of nonfinancial assets. Bank ownership and control of physical commodities and the warehouses that store those commodities is the subject that brings us here today, but they are only a small part of the larger systemic risks being created by those excursions across the commercial divide.

Our largest bank holding companies now seek to "control" other nonfinancial infrastructure assets and will again wrap their intentions in the flag of this great nation – arguing that "public private partnerships" are the key to redevelopment of our infrastructure. This is the same strategy employed, through the largest public-private partnership in our history, the National Partners in Homeownership, which was supposed to be the key to a stable future for homeowners[14].

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[14] Rosner, Joshua, Housing in the New Millennium: A Home Without Equity is Just a Rental with Debt, June 29, 2001, p.5. Available at SSRN: http://ssrn.com/abstract=1162456 or http://dx.doi.org/10.2139/ssrn.1162456 (See: "In an effort to restore the promises of the "American dream", the Clinton Administration embarked on a major initiative to increase homeownership. In 1993, the Census Bureau recommended ways to do so. Lowering down payment requirements and increasing available down payment subsidies were suggested. In early 1994, HUD Secretary Henry Cisneros met with leaders of major national organizations from the housing industry. By early fall, the Clinton Administration, along with over 50 public and private organizations agreed on 'working groups', a basic framework and the core objectives of what they named the "National Homeownership Strategy". The creators of the strategy of the National Partners in Homeownership ('NPH') include, among others: HUD, Federal Deposit Insurance Company, Fannie Mae, Freddie Mac, the Mortgage Bankers Association, the American Institute of Architects, America's Community Bankers, the U.S. Dept. of Treasury and the National Association of Realtors. Their primary goal was "reaching all-time high national homeownership levels by the end of the century". This was to be achieved by "making homeownership more affordable, expanding creative financing, simplifying the home buying process, reducing transaction costs, changing conventional methods of design and building less expensive houses, among other means". 4 It was almost unprecedented for regulators to partner this

The benefits and risks of public investment in essential infrastructure, as well as the privatization of non-essential and non-utility infrastructure, can be debated. The control of assets in which the public has funded and invested, often for generations, by our largest financial firms should give elected officials and regulators pause.

Today, the Asset Management units of several of these firms are seeking "controlling interests"[15] nonfinancial assets without ownership of those assets.

To effect these goals the firms are pitching pension and other investors on investments in the leasing, operation and control of infrastructure assets. To date, these firms have attained "controlling interests"[16] and have "active control strategies"[17] – in the U.S. and abroad. They currently control ports, airports, electric utilities, water utilities, sewer utilities, wind power farms, parking meters, solar power generation, parking garages, rail leasing, charter schools and other assets.

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closely with those that they have been charged to regulate.")

[15] Citi Capital Advisors, Overview, last accessed July 22, 2013, available at: https://www.citicapitaladvisors.com/ciiOverview.do (See: "Citi Infrastructure Investors (CII) manages Citi Infrastructure Partners (CIP), a multi-billion infrastructure fund that has controlling interests in mature transportation and utility infrastructure assets. CIP's portfolio includes: Kelda, owner of Yorkshire Water, a regulated UK water and sewer company; Itínere Infraestructuras S.A., a Spanish toll road concessionaire; DP World Australia, a container terminal business in Australia; and Vantage Airport Group, an airport investment and management company with airports in Canada and the UK.")

[16] See, as example, https://www.citicapitaladvisors.com/ciiOverview.do and https://www.JP Morgan.com/cm/ContentServer?pagename=Chase/Href&urlname=JP Morgan/am/ia/investment_strategies/investmentsGroupLHK and http://www.morganstanley.com/infrastructure/portfolio.html and http://www.goldmansachs.com/what-we-do/investing-and-lending/direct-private-investing/equity-folder/gs-infrastructure-partners.html

[17] JP Morgan IIF Acquisitions LLC Maher Terminals, LLC, Letter to: Mr. Ryan Pedraza
Program Manager, Virginia Office of Transportation Public-Private Partnerships, last accessed July 22, 2013, available at:
http://www.vappta.org/resources/RREEF%20and%20JP Morgan_Detailed%20Proposal.pdf

According to the firms' own marketing materials, these assets are attractive, because of the "monopolistic" and "quasi-monopolistic" nature of the assets. They can "support more debt / leverage without incurring more risk than real estate" and have "attractive inflation protection characteristics"[18]. Though the firms have control over these assets and are responsible for the management and operations of the assets, investors in the funds in fact, own the assets. Through their control, these firms can target majority and control positions to enable the implementation of their business plans and other strategic initiatives via a disciplined "active asset management approach."[19].

There are Substantial Public Policy Issues to be Considered:

Besides the reputational risks of the projects failing[20], leaving investors with losses and municipalities with long-term leases and the possibility of limited refinancing opportunities, there are other risks to the bank operators that should be of concern.

Conflicts of Interest

While, as example, JP Morgan claims to be "a long-term infrastructure owner who understands its responsibilities to all stakeholders"[21] the reality is, that as a

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[18] CIPFA Scotland Asset Management Workshop, "Investing in Infrastructure", JP Morgan, Larry Kohn, Managing Director, March 1, 2007, last accessed July 22, 2013, available at: http://www.slideshare.net/Jacknickelson/cipfa-scotland-asset-management-workshop-investing-in

[19] JP Morgan IIF Acquisitions LLC Maher Terminals, LLC, Letter to: Mr. Ryan Pedraza
Program Manager, Virginia Office of Transportation Public-Private Partnerships, last accessed July 22, 2013, available at: http://www.vappta.org/resources/RREEF%20and%20JP Morgan_Detailed%20Proposal.pdf

[20] PPP Failures, Scribd, last accessed July 22, 2013, available at: http://www.scribd.com/doc/155206053/PPP-Failures

[21] JP Morgan IIF Acquisitions LLC Maher Terminals, LLC, Letter to: Mr. Ryan Pedraza
Program Manager, Virginia Office of Transportation Public-Private Partnerships, last accessed July 22, 2013, available at: http://www.vappta.org/resources/RREEF%20and%20JP Morgan_Detailed%20Proposal.pdf

fiduciary, there are internal conflicts in these transactions. The firms have a fiduciary obligation that may be unmanageable to pension and other investors – as they did during the expansion of the Residential Mortgage Backed Securities (RMBS) and Collateralized Debt Obligation (CDO) markets. Even if these investments are legally isolated, as we witnessed with Citi's SIVs, the firm may be pressed or required to reconsolidate. Moreover, contractual obligations to the lessor, operating and contracted partners (that may also be investment-banking clients[22]) and obligations to customers of the operating entity all pose risks that become difficult for a bank holding company to manage.

Furthermore, in a concentrated financial industry, the presence of a bank affiliate as an operator of nonfinancial businesses poses significant risks to competition. These risks include:

- Informational advantage that can result from ineffective controls and therefore allow a firm's trading desk to gain market information about underlying financial contracts or securities that can be used to benefit the firm or its customers or disadvantage customers and competitors.
- The risk that a firm that controls an electric utility and also, through a separate affiliate, has tolling agreements, can manipulate the availability of energy for advantage.
- The risk that a bank may choose to deny lending or underwriting to a competitor of their commercial affiliate.
- The risk that a bank may choose to lend, at preferential rates, to a commercial affiliate.
- The risk that a bank may, legally or illegally, tie loans to the purchase of a commercial affiliate's products.

Concentration of Economic Power within Banking

When Glass-Steagall was enacted, recent history served as a reminder of the risks that existed with the combination of banking and commerce and with the

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[22] FDIC Banking Review, "The Future of Banking in America The Mixing of Banking and Commerce", Current Policy Issues, Christine E. Blair, last updated February 11, 2005, last accessed July 22, 2013, available at: http://www.fdic.gov/bank/analytical/banking/2005jan/article3.html#30 (See: "Several banks have recently faced losses from lines of credit that were extended to corporate customers in return for receiving that corporation's underwriting business. In this sense, legal tying or cross-selling can lead to losses that could threaten the bank's safety and soundness.")

concentration of power within a small number of financial companies. The need to protect against these dual risks remains as much of an imperative today as it did then.

Only a generation before the Great Depression, J.P. Morgan began to amass his power over both banking and, with the powers of the purse, commerce. The over-indebted railroad industry, plagued by falling rates provided Morgan with an opportunity and by 1900 he had consolidated the industry and controlled one-sixth of the nations rail network.

Soon, he turned his attention to the control of the electricity and steel industries. “As a result of this extreme consolidation, most of which occurred under Morgan’s watch, businesses depended on Wall Street and Morgan’s money. Because most had no choice but to give up managerial control, it was the bankers who approved mergers, handled legal matters, underwrote securities, appointed managers and framed policies. Even more importantly, the bankers set initial stock values for companies and marketed them on an international level. Therefore, if a company did not get Morgan’s approval, it did not make it to market; it was doomed.”[23]

In the aftermath of the crisis, with our largest financial institutions having become ever larger and more concentrated, there is an opportunity for those firms designated as SIFIs to use their market power to subvert and distort competition and development in the real economy. Moreover, if they are allowed to control vast networks of nonfinancial assets, either as principal or agent, they will have the power to pick winners and losers in the commercial world, not based on the productivity or competitive advantages of those firm’s operations but as a result of their own profit motives.

As Cam Fine of the ICBA warned in 2007: “Over time, the individual, the small business owner, small towns, and rural countryside will suffer economically. More power will devolve to fewer and fewer hands, and economic diversity will whither, and with it, choices. While population centers may flourish, the decline of rural and small town America will accelerate...The less advantaged of our society will become

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[23] J.P. Morgan: a Biography, Liz Bowen, Fordham University, last accessed July 22, 2013, available at: http://www.fordham.edu/academics/colleges__graduate_s/undergraduate_colleg/fordham_college_at_l/special_programs/honors_program/hudsonfulton_celebra/homepage/biographies/jp_morgan_32212.asp

even more disadvantaged."[24]

Others have argued that the strong regulatory oversight by US regulators and the clear separation of banking and affiliates ameliorate these risks but their arguments were largely disproved during the crisis as bank holding companies demonstrated that their first the impulse was to use bank resources in support of failing commercial affiliates, potentially jeopardizing the bank's safety and soundness. Such an effort was followed by a focused effort to move affiliate obligations into the banks to be supported by the FDIC and the Federal Reserve.

Catastrophic Risk

By allowing bank holding companies to "control" these assets and accept the operating risks of those assets, regulators are supporting the accumulation of potentially catastrophic and systemic risks associated with the underlying operations[25]. Imagine if a systemically important financial institution was in the business of transporting oil and was unfortunate enough to own the Exxon Valdez? The systemic implications to the financial system and un-priced risks to counterparties could result in the risk of a series of systemically significant failures.

Conclusion

While our banks claim they provide efficiencies and that they must be able to compete with the largest global banks it must be pointed out that many of these efficiencies were merely an arbitrage with the benefits accruing to executives and losses apportioned to investors and the public.

European governments have, through actions and deeds in Greece, Ireland, Cyprus,

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[24] Chicago Fed Letter, "The Mixing of Banking and Commerce: A conference summary", Nisreen H. Darwish, Douglas D. Evanoff, Essays on Issues, The Federal Reserve Bank of Chicago, Number 244a, November 2007, last accessed July 22, 2013, available at: http://qa.chicagofed.org/digital_assets/publications/chicago_fed_letter/2007/cflnovember2007_244a.pdf

[25] CIPFA Scotland Asset Management Workshop, "Investing in Infrastructure", JP Morgan, Larry Kohn, Managing Director, March 1, 2007, last accessed July 22, 2013, available at: http://www.slideshare.net/Jacknickelson/cipfa-scotland-asset-management-workshop-investing-in p.4 (See: Debt represents 84% of Skyway's $1.83 billion concession price. Under a concession structure, the private sector concessionaire captures projected revenue growth in exchange for assuming operating risk)

Italy and elsewhere, explicitly accepted their banks as sovereign obligations. In the United States both parties have stated their intent, whether or not we have yet become successful in our efforts, that never again will our banks receive any implied or explicit government support for activities outside of the narrow banking function of deposit insurance.

With that goal clearly stated we must recognize the most troubling issue here before us today is that dominance of global banks in our country has set us down a slippery slope where those firms can justify, and convince captured regulators, that whatever they do is in the national interest. And in a way, they are right about that because, should they fail, the entire country will pay the price for it. Make no mistake about that - there is no other way to deal with such a calamity.

The growth of big banks is a case of too much of a good thing metastasizing into a bad thing. What started out with a limited safety net designed to protect the payments system and to provide a safe place for small, unsophisticated depositors to place their savings has morphed into an anticompetitive system where government subsidized banks can use unfair advantage to enter and dominate any market or business, financial or nonfinancial, that they choose. This is inconsistent with those concepts of competition and creative destruction that have done so well for our country.

Let me make it clear, the people running these banks are smart, smarter than many of us. The problem isn't that they are dumb, malevolent, unpatriotic or dishonest. The real problem has three components:

- First, they are human, which means they are fallible and they will fail, repeatedly, just like the rest of us;
- Second, they are motivated by corporate values, which don't allow them to sacrifice or compromise to protect public interests, even if they would personally be inclined to;
- Third, they are huge and of such size because they enjoy public safety net benefits that foster unlimited growth, which includes the sort of inappropriate growth in non-banking businesses discussed here today.

There is much for people across the political spectrum to dislike about this. SIFI activity in the energy markets and other commercial markets paints a clear picture of what we should not allow banks to do. Government subsidized businesses should be boring, low profit, and limited by original purpose.

Reflecting on the Federal Reserve Board's 2005 letter allowing JP Morgan to hold physical commodities while prohibiting them from storing those commodities should lead legislators to reconsider the authorities they have vested in the Fed regarding these activities. One has to look with concern at the poor job of the Fed in policing the limitations of their order allowing banks to enter commodity businesses. Still, let us move past that and on to the real issue. The Federal Reserve Board should not be allowing banks to be in businesses that don't directly support the resilience of the payments system or the stability of FDIC insured deposits.

There is a lot of undoing to be done in banking. The public good and the benefits to Main Street and free enterprise, rather than enrichment of SIFI executives, must be our primary focus.