AMERICAN BANKER

Will QE3 'Spell Doom for Financial Business Models'?

By Marc Hochstein
AUG 31, 2012

Receiving Wide Coverage ...

Fed Watch: The papers preview the speech Chairman Ben Bernanke is scheduled to deliver today at the central bank's annual retreat in Jackson Hole, Wyoming. "He must once again address whether there is more the Fed can do to get the economy going and whether it is worth taking chances on controversial new programs," says the *Journal*. "All along he has argued these efforts are worth it and appears likely to stick to that line." In an op-ed in the *Journal*, Gerald O'Driscoll, a veteran of the Dallas Fed and Citigroup now at the Cato Institute, argues against a third round of quantitative easing, warning it would "would act as a sugar rush to financial markets while spurring little if any growth." PIMCO's Mohamed El-Erian writes in the *FT* that some have urged Bernanke to set a nominal GDP target, which "certainly would be viewed by markets as a favorable development as a GDP target would effectively re-price the 'Fed put.'" However, El-Erian doubts Bernanke will endorse any specific policy in Jackson Hole; instead, expect the Fed chairman to lay out "future options and [reiterate] the general commitment to do more if needed." Last but never least, Izabella Kaminska of the *FT*'s Alphaville blog wrote a characteristically thought-provoking post the other day on the less-obvious objections to further easing — not that it's inflationary, as the goldbugs and Austrian economists say, but that it's potentially deflationary and, perhaps more to the point for this audience, could "ultimately spell doom for many of today's financial business models." Kaminska quotes some examples from a working paper by Bill White of the Dallas Fed: "Futures brokers demand margin, and customers often over margin. The broker can invest the excess, and often a substantial portion of their profits comes from this source. Low interest rates threaten this income source and perhaps even the whole business model. A similar concern might arise concerning the viability of money market mutual funds, supposing that asset returns were not sufficient to even cover operating expenses." And in the interest rate swap markets, White cautions, "unexpectedly low policy rates can punish severely those that bet the wrong way. This could lead to bankruptcies and other unintended consequences." Any traders hoping for more cheap money from the Fed should perhaps be careful what they wish for.

Wall Street Journal

Following the Knight Capital nail-biter a few weeks ago, JPMorgan is reviewing its clearing and settlement business, assessing the risk and profitability of its dozens of brokerage clients. It may stop doing business with some clients, and will cut back on dealings with others (though Knight itself is not on the "to-dump" list, anonymice tell the *Journal*).

The *Journal*'s editorial page praises Chicago Mayor Rahm Emanuel for opposing the use of eminent domain to seize certain mortgages for principal writedowns. Aside from the "sketchy constitutionality," the writers say, "seizing mortgages could roil the mortgage-backed securities market and reduce what's left of private investment in housing, not to mention mire municipalities in expensive lawsuits." Sounds mighty foolish, as Emanuel himself once said of another idea (though not in precisely those words).

An article looks at the pros and cons of "deferred prosecution" and "nonprosecution agreements," in which the government extracts fines from companies for criminal wrongdoing and puts them on probation rather than sealing their fates with indictments. Settlement negotiations in the Libor probe have rekindled the debate over the effectiveness of this tactic.

New York Times

Although the SEC nixed Mary Schaprio's proposal to overhaul regulation of money market funds, columnist Peter Eavis says the Financial Stability Oversight Council could still impose new rules on the sector. Specifically, under Title VIII of Dodd-Frank, the council "could designate a single activity or feature of money funds as a systemically important utility function," and use that designation to justify things like capital requirements.

"Why Are the Big Banks Suddenly Afraid?" wonders Simon Johnson, noting that megabank executives and lobbyists, after keeping quiet for years on the question of size limits, are now speaking up against the idea. These institutions have good reason to worry, Johnson writes, as "serious people on the right and on the left are reassessing if we really need our largest banks to be so large and so highly leveraged."