CBS NEWS

Banks too big to jail, fail or nail face new scrutiny

By: Charles Wilbanks – March 15, 2013

If partisanship has divided the country and brought Washington to a virtual standstill, left and right are increasingly making common cause on one issue: Big banks remain a grave danger to the financial system, and it's about time something was done.

To say that liberal Democrats and some hardcore Republicans are united on the risks posed by "too big to fail" banks isn't to say that there is a consensus in Congress on the matter. Most lawmakers -- and the government regulators tasked with policing the financial industry -- seem content with the official government line that the banking sector is stable again after its post-housing crash brush with insolvency. The Obama administration also shows little interest in re-opening the case, which White House officials say was adequately addressed with the 2010 passage of the Dodd-Frank financial reform law.

But a new spirit does appear to be afoot among policy makers, amplified by a growing chorus of media voices, that is willing to challenge Wall Street and push for additional reform. That view is anchored in the widespread public anger over the lack of banker prosecutions, a legal cul de sac that resulted in U.K. financial giant HSBC in December getting off with a fine for laundering hundreds of billions of dollars for the Iranian government and Mexican drug dealers.

The infamous case of the "London Whale" at JPMorgan Chase (JPM), whose bad trades in 2011 could cause at least $6.2 billion in losses, was another stark reminder that even banks with a reputation for shrewd management are vulnerable and opaque.

No one personifies that newfound pugnacity on Capitol Hill better than noted bank scourge Elizabeth Warren. The Massachusetts Democrat made a startling debut as a freshman senator on the Senate Banking Committee in February when she scolded banking regulators for not taking top bankers to trial for financial crimes.

"The question I really want to ask is how tough you are," she said. "Tell me a little bit about the last few times you have taken the biggest financial institutions on Wall Street all the way to a trial." Her question was met with silence by the uncomfortable bureaucrats. Then, like an impatient law professor confronting under-prepared students: "Anybody?"

Several members of the audience broke into applause, an uncommon show of enthusiasm in congressional hearings. The response was one of many indications not only of Warren's popularity, but also of the resurgence of worries about the power held by the country's largest financial institutions.

Meanwhile, two Federal Reserve Board governors have recently called for action to defuse the threat of big banks. Fed board member Jerome Powell spoke in support of stringent regulations on the banks, while Dallas Fed president Richard Fisher has argued that big banks should be broken up, an idea he was expected to reiterate at a meeting of conservatives in National Harbor, Md., on Friday.

Perhaps most tellingly, even Attorney General Eric Holder, widely criticized for taking a soft approach as a prosecutor toward the banks, acknowledged recently what most observers already knew -- that the power and size of the banks gives them legal protection.

"I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if we do prosecute -- if we do bring a criminal charge -- it will have a negative impact on the national economy, perhaps even the world economy," Holder told Senators last week. "I think that is a function of the fact that some of these institutions have become too large."

The issue is also creating unusual alliances among lawmakers normally at ideological odds. Not long after her chastisement of the financial regulators, Warren followed up with sharp questioning of Federal Reserve chief Ben Bernanke, saying that large institutions get to borrow money more cheaply than smaller ones because of expectations that the government will bail such "systemically important" companies out. Citing a Bloomberg study describing that subsidy, she pressed Bernanke into conceding that it is a problem.

That exchange led Sen. David Vitter, R-La., to express his solidarity with Warren. "My top concern is actually the same as Mrs. Warren's -- and that is a statement in and of itself," Vitter said in highlighting the shared thinking between him, a staunch conservative, and the liberal Warren. "There is growing bipartisan concern across the whole political spectrum about the fact -- and I believe it is a fact -- that 'too big to fail' is alive and well."

Vitter has teamed up with liberal Sen. Sherrod Brown, D-Ohio, to craft legislation to address the subject of too big to fail. The bill has not yet been introduced but is expected soon. The measure is unlikely to call for an out and out break-up of the financial behemoths. Instead, people familiar with the bill said, it will seek to limit bailouts, such as by making banks hold more capital and limiting access to safety nets by non-bank firms such as insurer AIG (AIG) and industrial conglomerate General Electric (GE), both big recipients of bailout funds.

Despite the bipartisan resurgence in hostility to large financial institutions, it's not clear that such legislation has much of a chance for now. Mark Calabria, director of financial regulation studies at the libertarian Cato Institute, thinks neither Senate Banking Committee Chairman Tim Johnson, D-S.D., nor Majority Leader Harry Reid, D-Nev., support taking on the banks. He predicts that whatever the Brown-Vitter bill looks like, it won't make it out of committee. Between 40 and 45 senators support the measure, Calabria said, although that doesn't mean that all would ultimately vote for it.

The prospects for meaningful movement on financial reform look even bleaker in the GOP-controlled House. There, the Financial Services Committee has been expanded to more than 70 members, effectively enabling new or financially needy panel members to tap into Wall Street's deep coffers.

"The committee has taken away a row of viewership seats to make room for the new members to rake in the campaign donations," said law professor and former savings and loan prosecutor William Black.

Then there's Jack Lew, the new Secretary of the Treasury. Lew is a former Citibank (C) investment banker and budget wonk who has to date expressed no interest in overhauling big banks. In fact, many people are angry that the top job at Treasury appears to change hands between top officials at Goldman Sachs (GS) and Citigroup.

Still, advocates aren't completely pessimistic about the chances for further reforms of big banks. "I think momentum will continue to build in the spring and summer and real traction will be achieved in the fall" for the bill by Brown and Vitter, said Camden Fine, president and CEO of the Independent Community Bankers of America, an industry trade group that has pushed for big lenders to be downsized. "Between now and the midterm elections, you'll see bipartisan legislation pass the Congress that attempts to deal with too big to fail and too big to jail."