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Former Fed official: Keep banks from getting too big

By Harold Brubaker

Inquirer Staff Writer

It is "outrageous" that the federal government - more than a year after the collapse of the Bear Stearns Cos. Inc. - has not begun a serious discussion of how to create a more stable financial system, former Federal Reserve Bank of St. Louis president William Poole said yesterday in Philadelphia.

Poole, who grew up in Wilmington and graduated from Swarthmore College, said the nation could face "10 to 20 years of limping along in this very uncertain and unsatisfactory situation" if things continue as they are, with the government bailing out companies deemed too big to fail.

The key, Poole told a crowd at the Global Interdependence Center's 27th annual Monetary and Trade Conference at Drexel University, is to establish an easier way for investors to prevent banks from getting too big.

"There must be a market mechanism that forces them to scale back," he said.

Poole would require banks to issue a certain kind of debt that would equal 10 percent of their liabilities and part of which would have to be renewed each year.

If the bank had trouble selling that debt because investors were concerned about its condition, the bank would have to get smaller and healthier by allowing some loans to be paid off or taking other action to strengthen its finances, said Poole, who was at the St. Louis Fed from 1998 to 2008 and is now a senior fellow at the conservative Cato Institute.

Poole would start by converting the federal Troubled Asset Relief Program money that has been invested in banks into the sort of debt he advocates - known as subordinated debt - that would start maturing in two years.

What is not clear about Poole's proposal is whether investors would do their job any better under his scenario than they did during the credit bubble when they gobbled up trillions of dollars of shady mortgage-backed securities during the housing bubble.

Regulators, himself included, did not do any better, he conceded: "I missed it."

Contact staff writer Harold Brubaker at 215-854-4651 or hbrubaker@phillynews.com.