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Goldman Sachs and the Mega Banks: Too Big To Obey The Law

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On a short-term tactical basis, Goldman Sachs clearly has little to fear. It has relatively deep pockets and will fight the securities "Fab" allegations tooth and nail; resolving that case, through all the appeals stages, will take many years. Friday's announcement had a significant negative impact on the market perception of Goldman's franchise value – partly because what they are accused of doing to unsuspecting customers is so disgusting. But, as a Bank of America analyst (Guy Mozkowski) points out this morning, the dollar amount of this specific allegation is small relative to Goldman's overall business and – frankly – Goldman's market position is so strong that most customers feel a lack of plausible alternatives.

The main action, obviously, is in the potential widening of the investigation. This is likely to include more Goldman deals as well as other major banks, most of which are generally presumed to have engaged in at least roughly parallel activities – although the precise degree of nondisclosure for adverse material information presumably varied. Two congressmen have reasonably already drawn the link to the AIG bailout (how much of that was made necessary by fundamentally fraudulent transactions?), Gordon Brown is piling on (a regulatory sheep trying to squeeze into wolf's clothing for election day on May 6), and the German government would dearly love to blame the governance problems in its own banks (e.g., IKB) on someone else.

But as the White House surveys the battlefield this morning and considers how best to press home the advantage, one major fact dominates. Any pursuit of Goldman and others through our legal system increases uncertainty and could even cause a political run on the bank – through politicians and class action lawsuits piling on.

And, as no doubt Jamie Dimon (the articulate and very well connected head of JP Morgan Chase) already told Treasury Secretary Tim Geithner over the weekend, if we "demonize" our big banks in this fashion, it will undermine our economic recovery and could weaken financial stability around the world.

Dimon's points are valid, given our financial structure – this is exactly what makes him so very dangerous. Our biggest banks, in effect, have become too big to be held accountable before the law.

On a more positive note, the administration continues to wake from its deep slumber on banking matters, at least at some level. As Michael Barr said recently to the New York Times,

> "The intensity, ferocity and the ugliness of the lobbying in the financial sector — it's gotten worse. It's more intense."

This is exactly in line with what we say in 13 Bankers – just take a look at the introduction (free), and you'll see why our concerns about "The Wall Street Takeover and the Next Financial Meltdown" have grabbed attention in Mr. Barr's part of official Washington.

But at the very top of the White House there is still a remaining illusion – or there was in the middle of last week – that big banks are not overly powerful politically. "Savvy businessmen" is President Obama's most unfortunate recent phrase – he was talking about Dimon and Lloyd Blankfein (head of Goldman). After all, some reason, auto dealers are at least as powerful as auto makers – so if we break up our largest banks, the resulting financial lobby could be even stronger.

But this misses the key point, which Senator Kaufman will no doubt be hammering home this week: There is fraud at the heart of Wall Street.

And we can only hold firms accountable, in both political and legal terms, if they are not too big.

It is much harder to sue a big bank and win; ask your favorite lawyer about this. Big banks can more easily hold onto their customers despite so obviously treating them as cannon fodder (take this up with the people who manage your retirement funds). Big banks spend crazy amounts on political lobbying – even right after being saved by the government (chapter and verse on this in 13 Bankers.)

When you really do want to take on megabanks through the courts – and have found the right legal theory and compelling lines of enquiry – they will threaten to collapse or just contract credit.

No auto dealer has this power. No Savings and Loan could ultimately stand against the force of law – roughly 2,000 S&Ls went out of business and around 1,000 people ended up in jail after the rampant financial fraud of the 1980s.

We should not exaggerate the extent to which we really have equality before the law in the United States. Still, the behavior and de facto immunity of the biggest banks is out of control.

These huge banks will behave better only when and if their executives face credible criminal penalties. This simply cannot happen while these banks are anywhere near their current size.

Fortunately there is precisely zero evidence that we need banks anywhere near their current size – we document this at length in 13 Bankers (in fact, this was a major motivation for writing the book).

Break up the big banks before they do even more damage.

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