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Record Home Foreclosures across America

Banking Act of 1999 has opened a Pandora's Box

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The desire of commercial banks to gut the Glass-Steagall Act(GS) of 1933 so they could get back into the lucrative investment banking business has resulted in today's subprime mortgage mess, the dean of the Massachusetts School of Law(MSL), a former Justice Department anti-trust lawyer, says.

> "When federal agencies began making inroads on Glass-Steagall in the 1980's and 1990's, so that banks were allowed by the agencies to do things that Glass-Steagall forbade, I was amazed," says MSL Dean Lawrence Velvel, of Andover. He noted GS "had deliberately separated commercial banking from investment banking because Congress felt in the 1930's that the combination of both types of banking in a single institution was one of the reasons for the Great Depression."

During that era, "when both types of banking were combined in one institution and a bank's stock business and stock investments went down, the *whole* bank went down because of huge losses and capital impairments," Velvel explained. And it was to avoid any repeat of the nation's financial collapse GS was enacted.

Once the GS safeguards were removed by enactment of the Gramm-Leach-Bliley Act of 1999 (GLBA), Velvel says, "Horrible loans were made, horrible securities were packaged and sold from these loans, and when one side of the bank got into problems, they quickly spread to the other side. As a result, huge banking companies such as Citicorp and Merrill Lynch are in big trouble."

"If delinquencies in the fourth quarter of 2007 for subprime adjustable-rate mortgages hit an all-time record 5.29%, it's because the visionary protections in the New Deal legislation(GS) have been abandoned," Velvel says. Banks are holding billions in mortgage-related instruments for which there is no market.

In a related article published in MSL's opinion journal "*Long Term View,"* law Professor Holly Vietzke writes GLBA has more closely connected "the banking industry to the U.S. stock market, ensuring that any significant dive on Wall Street will have disastrous effects on the nation's financial system."

Some analysts link GLBA to the Enron scandal and other corporate crises, writes Vietzke: "Enron's financial backers Citigroup, Inc. (which earned millions of dollars in fees as one of Enron's biggest backers) and J.P. Morgan Chase are accused of committing securities fraud in connection with the formation and use of Enron Corporation's special purpose partnerships."

"It appeared that, with the cooperation of Citigroup and J.P. Morgan Chase, Enron intended to inflate profits and income over debt, and it tried to fool investors by hiding debt from the analysts," Vietzke continues. The *Wall Street Journal,* she noted, reported Citigroup and

Chase made more than $200 million in fees for transactions that helped Enron among other energy companies, "boost cash flow and hide debt."

Vietzke asserted this kind of activity is one of the reasons why Congress passed GS in the first place. "The GLBA is, as Enron shows, fermenting stock market manipulations that allow corporate executive to cash in" while their bank loans are outstanding.

GLBA triggered a wave of mergers, including Citigroup with major insurer Travelers and the American-based bank holding company Citicorp, a $70 billion combination. "After the merger, Citigroup's business included insurance, lending, banking, investing and asset management," Vietzke pointed out.

If Citigroup expected to reap a profit upwards of $700 million from the deal, Vietzke said, stockholders "saw no such gain." Before the merger, Citicorp stock was up to $182 and Travelers was $73. After the merger, however, Citicorp dropped to $84 and Travelers to $37.

Other financial institutions that combined: Chase Manhattan joined with J.P. Morgan in a $35 billion merger to form J.P. Morgan Chase; First Union Corp. acquired Wachovia Corp; insurance giant MetLife bought New Jersey-based Grand Bank; Washington Mutual took over Homeside Lending; First Merchants bought Lafayette Bancorp; FleetBoston Financial purchased Summit Bancorp, and, in Ohio, National Bancshares Corp acquired Peoples Financial.

These, and similar mergers, have not always yielded positive results. Vietzke writes: "In addition to causing higher fees, a decline in personal service, privacy issues for consumers, and a decrease in value for stockholders, these unions have suffered internally as well."

Geoffrey Boisi, the engineer of the J.P. Morgan Chase deal, resigned just two years after the merger as did Allan Wheat (Credit Suisse First Boston) and John Mack (Morgan Stanley) before him.

In a poll of 50 executives, Professor Robert Bruner of the University of Virginia found only 37% of them believed the mergers actually created value for buyers.

Until the GLBA, Vietzke writes, "banks had regularly circumvented the restrictions of the Glass-Steagall Act by sharing office space with securities firms, creating the illusion to consumers that the bank insured securities transactions."

"The securities firm would benefit from the bank's steady flow of customers, and the bank would receive a portion of the firm's commission. The customer often never knew it was conducting business with separate entities. The GLBA effectively made this practice legal," Vietzke said.

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