Gramm-Leach-Bliley Did Not Cause the Financial Crisis

Some policy makers are pointing fingers at the Gramm-Leach-Bliley Act (GLBA) of 1999 as a primary cause of the credit crisis. GLBA did not have anything to do with subprime mortgages, mortgage underwriting practices, packaging of mortgages into securities or credit default swaps. It did not have anything to do with the failure of the non-bank mortgage lenders or the bailout of Fannie Mae or Freddie Mac, none of which were subject to bank regulation. GLBA did not have anything to do with AIG, Lehman Brothers or Bear Stearns, which could have made the same bad investment and liquidity decisions under the pre-GLBA structure. Nor did it change the types of financial products that could be sold to investors by these Wall Street securities firms. Wall Street firms were already able, prior to GLBA, to invest in and trade the same assets that have wreaked such havoc.

Diversified Income Streams have Provided a Buffer

By eliminating the artificial separations between financial firms required by Glass-Steagall, GLBA allowed financial firms to diversify their activities and provide customers with a full range of banking and brokerage services. The return to health by some diversified financial firms, which has been faster than most observers expected, is in part due to a diversified flow of income which helped offset some of the loan losses of traditional banking resulting from the recession.

Absent GLBA, Several Troubled Securities and Brokerage Firms Would Have Failed, Which Would have Exacerbated an Already Fragile Financial System

GLBA also played an important role in enabling an orderly resolution of troubled investment banks by allowing their assets and liabilities to be absorbed into a bank holding company with its full complement of regulation, strong capital requirements, and on-site examination. Without GLBA, these Wall Street firms would have faced limited options – *and several would have failed* – which would have destroyed what little confidence remained in the midst of the global financial crisis.

Now these investment firms will have to conform to commercial bank and bank holding company capital requirements and activity restrictions. This will reduce the amount of leverage at these firms, as they will be subject to an equity to risk-weighted assets ratio of at least six percent in order to be considered a "well-capitalized" bank. They will also be subject to heightened bank oversight, and they will have to conform their nonbanking investments and activities to the requirements of the Bank Holding Company Act. The bank regulatory system, while certainly stressed over the past year, has shown a great deal of resilience, and GLBA provided a mechanism to put securities firms on the same footing as banks.

Proprietary Trading by Commercial Banks is Strictly Limited by Regulation

Additionally, these investment firms will now be subject to the same restrictions on proprietary trading in securities that have long been applicable to commercial banks and bank holding companies. Proprietary activities by commercial banks are strictly limited by regulation, primarily to U.S. government and agency debt and municipal bonds. Bank holding company proprietary trading activities are also subject to strong capital and prudential limitations and, under some circumstances, are capped at five percent of the companies' voting shares. Importantly, banks are, as a practical matter, prevented from using the insured institution's funds to finance the propriety trading or any other activities of their bank holding company securities affiliates.

Simply put, the Gramm-Leach-Bliley Act did not cause the current financial crisis and, in fact, has provided an avenue to rescue troubled securities firms, which helped to mitigate the fallout from the financial crisis.