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## *New Rules Let Big Banks Compete Abroad*

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NEW YORK ([TheStreet](#)) -- Big banks in Europe and Asia that compete with those considered "too big to fail" in the States may actually be helping U.S. banks maintain a competitive edge.

The House Financial Services Committee and Treasury Department have come up with a plan to unwind large banks in a more orderly fashion and monitor their operations more closely. The most controversial segment of the legislation announced on Tuesday is the one that forces shareholders, debt holders and competitors -- rather than taxpayers -- to suffer the cost of a large bank's failure.

One might ask why the government isn't simply making big banks get small, a la the Glass-Steagall Act that followed the Great Depression, which built a wall between investment and commercial banking. The answer is simple: Counterparts overseas aren't doing the same.

"Like it or not, we're going to have some financial services entities that are going to be T.B.T.F.," says Walt Mix, a managing director at the consultancy LECG, using an increasingly common acronym for "too big to fail." "There's an inexorable economic pressure that operates on a global basis. You have huge European banks, Japanese banks -- look at **Deutsche Bank**([DB Quote](#))!"

Mix, a former commissioner of the California Department of Financial Institutions, worked on the regulatory side during the fallout of the savings and loan crisis nearly two decades ago, and is now advising on deals regarding troubled West Coast banks. He notes that out of the top 20 global banks, only a few are based in the United States.

Because the United States was the crucible of the downturn, domestic banks have been the most hobbled, creating immense opportunity for competitors abroad. Deutsche Bank, **Credit Suisse**([CS Quote](#)), **Barclays**([BCS Quote](#)), **UBS**([UBS Quote](#)), **Mitsubishi**, **Sumitomo Mitsui** and **Nomura** have all made moves to capitalize on the crisis, whether by hiring employees, grabbing clients or making acquisitions and investments on the cheap. Mix notes that Chinese competitors, like **Bank of China**, **China Construction Bank** and **Bank of Communications**, want to expand globally as well.

"There's a U.S. T.B.T.F. issue," says Mix, "but there's also a huge global issue to deal with as well."

Now that the crisis has abated, it's clear that the big U.S. banks that survived remain big players. **JPMorgan Chase**([JPM Quote](#)) and **Goldman Sachs**([GS Quote](#)) appear to be moving ahead of the rest, as they and **Morgan Stanley**([MS Quote](#)) have already exited government programs. **Bank of America**([BAC Quote](#)) and **Citigroup**([C Quote](#)) have a ways to go toward independence, but they still rank high on a global competitive scale, with Citi focused on its international presence, especially in emerging markets. In the meantime, **Wells Fargo**([WFC Quote](#)) is building its reputation in the [capital markets](#) where everyone competes for business.

The fact remains, though, that these entities truly are too big to fail without causing chaos. And many have only grown larger following the flurry of deals prompted by the crisis in 2008. But their size isn't necessarily the problem; big banks are better protected from economic and market swings because of

the diversity and scale of their operations. The problem arises when a pervasive issue sweeps the market and the economy, as the housing crisis did, and regulators lack information and flexibility to handle big bank failures in an orderly manner.

For instance, when **American International Group** ([AIG Quote](#)) teetered on the brink, there were no set guidelines for how regulators ought to handle the situation, especially since AIG is an insurer. Regulators at the Treasury, Federal Reserve and Securities and Exchange Commission appeared to not have even considered the derivatives that were sinking AIG's ship in the chaos that preceded its collapse. But had AIG been allowed to fail, or had its counterparties not been paid, it could have caused more panic to cascade through the system, as the smaller combustion of Lehman Brothers proved a few days earlier on Sept. 15, 2008.

The Financial Stability Improvement Act proposed on Tuesday will create a council of regulators to monitor such systemic risk and give bank regulators the authority to oversee any large market players, including "non-bank banks" -- like AIG, **General Electric** ([GE Quote](#)), **GMAC Financial Services** and **Chrysler's** financing arm, which also received government support. But now investors and the industry will suffer the cost when banks fail, instead of taxpayers.

James Wheeler, who represents banks at the law firm Bryan Cave, points out the injustice of this system, saying "the promise of higher costs for compliance...may reduce profits and put stress on the successful banks - the exact institutions we need to lead the economic recovery." Brad Sherman (D., Calif.), agrees, saying that what the draft legislation termed a "polluter pays" model is misleading.

The polluter "pays nothing," says Sherman. "Instead, prudent financial institutions must compete against the high-flyers in the good times, and then pay to bail out their high-flying competitors in the bad times."

But ultimately, someone has to pay and shareholder and bondholder equity will only go so far. The proposal also doesn't change very much from what is already occurring; it simply makes regulators' tactics official. For instance, the Federal Deposit Insurance Corp. has been levying higher fees on banks to handle a raft of failures of small institutions. The fees are based on deposit size, implicitly punishing bigger institutions. Few have taken issue with this tactic.

"Don't we already do that with the FDIC?," says [Dennis Nason](#), a former banker who now runs an executive-search firm for financial institutions. "I believe that concept is not really a new concept."

Academics will debate the nuances of each portion of the proposal. But if implemented as promised, the legislation will certainly achieve the goal of financial stability, and will allow U.S. banks to maintain the size and scale needed to compete with their competitors abroad. At least one bank executive -- Jamie Dimon, the CEO of JPMorgan and darling of regulators and Wall Street alike -- endorsed the plan on Tuesday.

"We think everything should be allowed to fail," Dimon said at a conference in New York, according to the *Financial Times*. "But we need a resolution mechanism so that the system isn't destroyed."

-- *Written by Lauren Tara LaCapra in New York.*