Hughes Hubbard & Reed

The Curious Case of the Glass-Steagall Act

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

December 5, 2016 - There is at least one thing that both President-Elect Donald Trump and Senator Elizabeth Warren claim to agree on: restoring the Glass-Steagall Act. Senators John McCain and Bernie Sanders are on record in agreement, as well. This strange collection of bedfellows in support of reviving a depression-era law gives simultaneous reason for optimism and suspicion that restored legislation will be achieved.

The Glass-Steagall Act is the common reference to Sections 16, 20, 21, and 32 of the Banking Act of 1933, which separated commercial banking from investment banking. In particular, the Glass-Steagall Act:

- prohibited banks that are members of the Federal Reserve System from underwriting any issue of securities (Section 16);
- restricted banks from affiliating with securities dealers (Section 20);precluded securities companies from acting as depository institutions (Section 21); and
- limited the directors and officers of banks from being directors and officers of securities companies (Section 32).

The separation of commercial banks and investment banks eroded over time and then was reversed in the Clinton Administration. The Financial Services Modernization Act of 1999, more commonly known as the Gramm-Leach-Bliley Act, repealed Sections 20 and 32 of the Glass-Steagall Act. That allowed for the creation of financial holding companies that offered an array of financial services through banking, securities, and insurance subsidiaries.

Some have argued the repeal of the Glass-Stegall Act and the creation of large financial holding companies contributed to the collapse of large banks, securities dealers, and insurance companies in 2008. The Senate Permanent Subcommittee on Investigations, for example, concluded that the changes to financial institutions after repeal "made it more difficult for regulators to distinguish between activities intended to benefit customers versus the financial institution itself." As a result, repeal critics say, some large banks engaged in high risk investments with conflicts of interest and without adequate regulatory oversight.

Restoring the Glass-Steagall Act had been associated with liberal Democrats – like Senator Warren who introduced the "21st Century Glass-Steagall Act of 2015" in the 114th Congress – and non-traditional Democrats like Lyndon LaRouche. But the "21st Century Glass-Steagall Act of 2015" was co-sponsored by Republican Senator and former Presidential candidate John McCain. The 2016 Republican Party Platform supported "reinstating the Glass-Steagall Act of 1933 which prohibits commercial banks from engaging in high-risk investment." Candidate Donald Trump blamed "lifting Glass-Steagall" as a primary cause of the financial recession and called for "a 21st century Glass Steagall."

In theory, the Glass-Steagall Act could be restored based on what appears to be broad support across the aisle, with both sides claiming victory. A unified Republican government could attempt to restore it in the 115th Congress in order to appeal to the populist groundswell in the 2016 election. Restoring the Glass-Steagall Act could be offered as a compromise to placate Democrats for deregulating other aspects of the financial services sector.

As a practical matter, in spite of the bi-partisan election year support for restoring some form of the Glass-Steagall Act, there are good reasons for skepticism.

Separating commercial banks from investment banks would require significant government intervention and regulation of the financial services market. That degree of intervention and regulation is opposed to other pervasive Republican-led efforts to reverse the perceived over-regulation of banks. The call for "reinstating the Glass-Steagall Act" in the Republican Party Platform appears in a section on the "quiet tyranny" of federal regulation that "hamstrings American businesses and hobbles economic grown." If the Volcker Rule is too much regulation for the Republican majority, then it is hard to see how a 21st Century Glass-Steagall Act could succeed.

The largest and most powerful banks and companies in the financial services sector oppose restoring the Glass-Steagall Act. The financial institutions most affected by restoring the Glass-Steagall Act are the largest banks in the United States, which have grown larger during and emerging from the recent financial crisis. President-Elect Trump currently is forming a cabinet and enlisting the help of strategic advisors from among investment bankers and Wall Street executives whose businesses benefited from the repeal of the Glass-Steagall Act.

Since the election and at the time of this post, there has been no mention of Glass-Steagall from the President-Elect, although he and his team continue to advocate dismantling the Dodd-Frank Act and federal regulations adopted during the Obama Administration. As a consequence, restoring the Glass-Steagall Act will likely remain merely a campaign promise.

Related Areas of Focus

Corporate Reorganization & Bankruptcy