Into the Heart of Darkness

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Saule T. Omarova, From Graham-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act, 89 **N.C. L. Rev.** 1683 (2011).

The GW Center for Law, Economics & Finance, under the leadership of the redoubtable Lisa Fairfax, last spring held its first Junior Faculty Business and Financial Law Workshop. I was one of the old fogies called in to do commentary. It was a successful event. The papers were strong and I was glad of the opportunity to acquaint myself with their authors.

One of the papers has loomed particularly large in the memory—*From Graham-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve* Act, by Professor Saule T. Omarova of North Carolina Law.

You can see from the title that to take up this paper is to journey into the darkest jungles of banking regulation. Prior to 2008 this was a subject matter of which I was blissfully ignorant. Since then it's been a forced march through the law and economics of systemic risk and safety and soundness. (I now regularly check into the websites of the Federal Reserve and the Bank for International Settlements.) But, still not having been asked to teach the banking course, I remain hazy on many regulatory nuts and bolts.

That's where this paper comes in. Professor Omarova takes a sustained look at section 23A of the Federal Reserve Act, a piece of Depression-era legislation that regulates financial relationships between banks and affiliates within holding company structures. The idea is to make sure that the bank, with its deposit insurance subsidy, does not in turn subsidize risky business undertaken elsewhere in the holding company. Section 23A, as originally enacted, worked in tandem with the Glass-Steagall prohibition on investment banking by banks. The paper shows how the section's operation changed materially when Graham-Leach-Bliley dismantled the wall of separation, and changed again in the wake of the financial crisis.

The operator is the Federal Reserve and the modus operandi is exemption from the section's operation at the application of a regulated bank. Professor Omarova takes us through decades of Federal Reserve exemption orders. It is amazing stuff. For example, we see Citibank go the well repeatedly. It acquired little nonbanks that churned out subprime mortgages and then, claiming administrative cost savings, subsumed them into the bank (and its subsidy) with the Fed's blessing. Starting in 2007, as the Fed tore up its own rulebook to spread liquidity, it granted section 23A exemptions of enormous magnitude. Finally, with Dodd-Frank the Congress amended the section, extending its reach.

It is all very complicated, but Professor Omarova makes it intelligible. The journey proves well worth the effort. The author is to be congratulated for digging up the details on this crucial zone of administrative practice and holding the results out for public inspection. The faults are laid bare for all to see. But Professor Omarova is much too astute to cast easy stones. We are told to take the occasion to rethink the whole, asking ourselves what we want out of banking regulation. Unfortunately, as we work our way to that sensible conclusion, we see that the occasion was not taken in the run up to Dodd-Frank.

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