A Ten-Point Plan for Making Banking a Public Utility

Lev Menand and Morgan Ricks

Vanderbilt
Policy Accelerator
for Political Economy & Regulation

Introduction

America's system of money and banking is broken. On four occasions in the last fifteen years,[1] the federal government has intervened to prevent a financial collapse. Barring structural reforms, the country is likely to continue to roll from crisis to crisis. To prevent these crises from harming the rest of the economy, the Federal Reserve, the Treasury Department, and the FDIC will likely continue to backstop much of private finance, fueling further rent extraction by Wall Street, the growth of Too Big to Fail institutions, overfinancialization, and the erosion of trust in government. As things stand, regulators often have no choice; to do otherwise would risk a depression.

While a number of policy reforms have been offered—from raising capital and liquidity requirements to increasing executive accountability for bank failures—none get to the root of our banking problems. Accordingly, none are likely to stop the recurring cycle of crises and bailouts. What we need is a comprehensive, structural transformation that will stabilize banking.

We propose that the best way to achieve such a transformation is to treat depository banks as public utilities. Depository banks exist to provide a basic public service: issuing and circulating money. This service is like the infrastructures provided by electricity, water, and telecommunications companies. It is distinct from other financial services like asset management and investment banking. Congress originally designed our banking laws along public utility principles, but with the deregulatory craze of the last fifty years, many provisions that ensured a stable and accessible money supply—provisions that prevented Too Big to Fail bailouts and excessive risk taking—were watered down or repealed.

It is time for Congress to modernize American banking regulation by building on what worked in the past. Under a 21st century public utilities approach, everyone who wants a bank account should be able to get one without worrying about being hit by predatory fees and without having to pay to transfer their money quickly. As the government stands behind deposit accounts, it should limit the risks depository banks take. This means restoring limits on bank powers that the Supreme Court has gutted. A public utility approach also entails separating depository banking from dealing or speculating in securities and financial derivatives. Wall Street investment firms must stand on their own feet. If they take too many risks, they must be allowed to fail and their failure must not jeopardize the rest of the financial system or the economy. And crucially, nonbank financial firms should be prohibited from financing their operations with runnable deposit substitutes.

Reconfiguring our financial infrastructure in this way would bring many benefits. It would simplify our regulatory architecture, reduce complexity, expand access and inclusion, promote economic equality, right-size the financial sector, and dramatically decrease the likelihood of future acute macroeconomic disasters like the one exacerbated by Lehman's collapse.

The Structure of Banking Law

Banks function as public utilities and America's banking laws were originally built to regulate them as such. This vision was embodied in three key enactments—the National Bank Act of 1864, the Federal Reserve Act of 1913, and the Banking Act of 1933, signed into law (respectively) by Abraham Lincoln, Woodrow Wilson, and Franklin Delano Roosevelt. All of these statutes are still on the books, even if some important provisions were subsequently repealed or degraded (see below).

These enactments included the following quintessential public utility law elements:

- **Entry Controls.** Only chartered banks were allowed to maintain "deposit"-type liabilities—that is, liabilities that function as money—and bank charters were available only where they were consistent with the convenience and needs of the public. Entry controls helped to preserve public control over the aggregate money supply.
- **Separation.** Chartered banks were separated from other financial and commercial firms and were generally limited to conducting activities consistent with their monetary mission. Separation ensured that banks served their customers without conflicts of interest and improved regulators' ability to oversee risk taking and ensure safety.
- **Local and Regional Service.** Geographic expansion by banks was constrained so that both community and regional banks were spread across the country and individual banks served their local communities.[2]
- **Safe and Public Money.** Most bank deposits were backed by the government through insurance and a government agency, the Fed. These programs rendered most deposits a government product.
- **Regulated Rates.** A government agency, the Fed, regulated the quantity of bank money in circulation and set the interest that accrued to its holders.

Once each of these elements was in place, beginning the mid-1930s, the result was an unprecedented period of overall financial stability that lasted more or less until 2008.[3] During the system's heyday from 1935 to 1980, the United States also enjoyed a golden age of economic growth.

The Erosion of Banking Law

Unfortunately, the bipartisan, American approach to banking law has been largely forgotten and the achievements of the Civil War Congress, the Wilson Administration, and the New Deal have been progressively undermined and degraded since 1980. In each of the areas described above, the system has broken down.

- **From Entry Controls to Uncontrolled Entry.** Beginning in the second half of the twentieth century, government agencies permitted and in certain key cases facilitated the emergence of nonbank firms that operated like banks (i.e., shadow banks). These firms issue instruments that function like deposit money, but are formally structured in other ways. Regulators also eased access to bank charters, dropping public need analysis.
- **From Separation to Conglomeration.** Regulators also permitted banks to affiliate and engage in various non-monetary financial businesses long off limits to depository institutions. Congress, under pressure from regulators and Wall Street, eventually amended the law to permit bank holding companies to own broker dealers and insurance companies. Meanwhile, the Supreme Court signed off on regulatory interpretations of bank powers that allowed banks to enter lines of business as unrelated to deposit money as building websites for third parties.
- **From Community Service to Community Abandonment.** States and later the federal government allowed banks to branch throughout the country leading to the consolidation of the banking industry and the degradation of service in many communities and regions. Regulators also relaxed scrutiny of bank mergers, fueling a massive wave of agglomeration.
- **From Public Money to Private Money.** As the shadow banking sector grew larger and larger, more and more of the money supply became private rather than public. Deposit alternatives were not insured, nor did their issuers in most cases have access to the Fed's standing liquidity support program.
- **Rate Deregulation.** The rise of nonbank money made it all but impossible to continue rate regulation and Congress threw in the towel. The Fed's ability to manage the quantity of money in circulation also eroded.

By 2007, deposit alternatives exceeded deposits in value, and the country's once-diffuse banking system with limited powers subject to ongoing supervision had given way to top-heavy financial architecture in which a handful of complex conglomerates engaged in a broad range of nonmonetary financial activities with little meaningful government oversight. Financial panics, exorcised for three quarters of a century, returned—only now, accompanied by a federal government willing and able to use overwhelming force to backstop a sprawling financial system.

While the Dodd-Frank Act of 2010 sought to bring more stability to the financial system, it did not restore the public utility provisions enumerated above. And in recent years, instability has returned. In 2019, the Fed lent two hundred billion dollars to securities dealers to prevent another collapse on Wall Street. A few months later, while the Fed was still trying to extricate itself from this latest program, the COVID-19 pandemic triggered a fresh economic downturn. The Fed reopened the spigot, backstopping money market mutual funds, commercial paper issuers, and asset-backed securities markets. It lent $500 billion to securities dealers, $500 billion to foreign central banks, and bought $1.5 trillion of financial assets in "market functioning purchases." Then, in March 2023, the $210 billion Silicon Valley Bank (SVB) failed. Two days later, with panic spreading, the Federal Deposit Insurance Corporation took over the $100 billion Signature Bank while also overriding a $250,000 cap on deposit insurance to rescue SVB's and Signature's uninsured depositors. That same day, the Federal Reserve, with support from the Treasury Department, established an emergency lending facility to support other banks facing similar pressure. Weeks later, the FDIC closed the $230 billion First Republic Bank and sold it to JPMorgan Chase, the $3.7 trillion conglomerate that functions as America's apex bank and financial services provider. The FDIC once again made uninsured depositors whole, this time maneuvering around, rather than overriding, the ordinary rules of bank failure.

Fifteen years after the financial crash in 2008, then, the banking system remains rife with problems: rolling financial panics; ever-expanding too-big-to-fail institutions; a monetary-financial complex with the Federal Reserve at its center; loss of monetary control; rent extraction and upward redistribution; financialization of the economy; and the erosion of trust in government.

How to Fix the Banking System

With benefits of history and some distance from the 2008 financial crisis and 2010 Dodd-Frank legislation, it is now clear that reforming our banking laws is essential. We propose a New National Banking (NNB) system, which we describe in detail in a new academic paper.

The NNB aims simultaneously to renew and refine the framework that undergirded American prosperity in the twentieth century, while expanding access and inclusion and carrying through on the public utility vision where previous policymakers came up short. The NNB proposal is a structural reform, not a technocratic one; it's a comprehensive system, not an attempt to shore up our current deregulated monetary liberalism. When the components are in place, we should no longer experience the repeating crises we have seen in the past fifteen years. We believe that transitioning to the NNB system would be fairly simple—because virtually every feature of the system has a direct analogue or precedent in U.S. banking law. In the academic paper, we describe what a comprehensive reform would look like. But we recognize that Congress often works incrementally.

To start the transition to the NNB, Congress can and should adopt the following ten reforms. These measures would produce a workable version of the NNB system, that would achieve the goals of stability and access, even if it does not have every feature that could come with a total transformation of the banking system:

1. **Require All Depository Institutions to be Insured Member Banks.** Amend the Federal Reserve Act to require that (1) all U.S. depository institutions join the Federal Reserve System as member banks and (2) all member banks maintain federal deposit insurance.[4] All U.S. depository institutions should be subject to a relatively uniform regulatory framework.
2. **Reinstate the Utility-Style Chartering Standard for Banks.** Amend the National Bank Act to reinstate the "public convenience and necessity" chartering standard that Congress excised in 1991.[5] Require the FDIC to apply the same standard, in consultation with the other federal banking regulators, in approving deposit insurance applications.
3. **Close the Unauthorized Banking Loophole.** Replace the existing unauthorized banking provision of federal law,[6] which relies on a formalistic definition of "deposit" and lacks a civil enforcement mechanism, with a new unauthorized banking law, which prohibits financial institutions that are not member banks from issuing money-like instruments in substantial quantities. Money creation will then be confined to member banks and the federal government.
4. **Cap the Amount of Money Banks Create.** Amend the reserve requirement provisions of the Federal Reserve Act[7] to apply them to all "bank money" (e.g., deposit balances and cash equivalents) issued by Fed member banks, thereby placing a cap on the supply of bank money, which the Fed can adjust in the conduct of monetary policy. In conjunction with the above-mentioned changes, this reform will restore public sector control of the quantity of money.

5. **Insure All Deposits.** Amend the insurance coverage provisions of the Federal Deposit Insurance Act[8] to fully insure, with no coverage caps, all member banks' outstanding bank money liabilities (and only their bank money liabilities—which means terminating insurance of long-term certificates of deposit). All money will then be sound and nondefaultable.
6. **Require Banks to Fully Pay for Deposit Insurance.** Amend the risk-based deposit insurance assessment provisions of the Federal Deposit Insurance Act[9] to require the FDIC to keep charging such assessments even if the FDIC's insurance fund is fully funded, converting surplus fees into a fiscal revenue item. Instruct the relevant bank regulatory agencies to calibrate the fees so as to cause member banks to earn no more than a fair return on capital. Member banks should not earn supracompetitive profits, and the federal government should earn "seigniorage"—fiscal revenue from money creation—not just from the central bank but also from member banks, in return for their receiving special privileges.
7. **Reinstate Controls on Deposit Interest Rates.** Reinstate administrative controls over interest on bank money, which Congress eliminated in 1980.[10] The Fed will then be able to administer bank money rates and thus improve the conduct of monetary policy.
8. **Close the Bank Powers Loophole.** Amend the corporate powers provisions of the National Bank Act[11] to tighten existing bank portfolio constraints—including implementing a swaps push-out rule, like the one that was included in the Dodd-Frank Act but later repealed.[12] Require, as a condition of eligibility for deposit insurance, that member banks that are not national banks abide by these corporate powers limits. Override the Supreme Court's decision in Nationsbank of N.C. v. VALIC[13] to clarify that national banks' corporate powers are to be strictly construed. Member banks' investments must consist of diversified portfolios of loans and bonds representing claims on domestic U.S. borrowers, supporting the real economy.
9. **Prohibit Foreign Countries from Issuing Dollar-Denominated Money.** Supplement the existing Basel capital and liquidity accords[14] with an international accord in which each country agrees to prohibit its domestic financial institutions from issuing bank money denominated in nondomestic currencies. Also, empower the Federal Reserve to deny dollar clearing to foreign banks that are known issuers of dollar-denominated bank money. Foreign financial institutions would no longer be able to create dollar substitutes without oversight; the United States would control the supply of dollars.
10. **Restore Structural Separations.** Reinstate the Glass-Steagall provision,[15] repealed by Congress in 1999,[16] that prohibited conglomeration between commercial banks and investment banks. This would restore the separation of banking (member banks) and commerce.

These changes would not require hundreds or thousands of pages of statutory text and implementing rules. These ten legal changes would bring the public utility vision that undergirds the National Bank Act, the Federal Reserve Act, and the Banking Act of 1933 reasonably close to full realization. If members of Congress want to go further and achieve a complete version of the system, we describe how to do so in the paper.

Conclusion

The panic and associated government response in March 2023, with the collapse of Silicon Valley Bank, should have come as no surprise. We've seen a similar dance three other times since 2008. Changing economic conditions trigger a run on defaultable money instruments. Public officials pursue extraordinary measures to backstop money instruments that would otherwise default. The run is halted. With each iteration, however, the pattern becomes further entrenched and expectations for future government intervention become ever greater. We believe that the way forward must be to rewire our banking laws and treat banks as public utilities. But we are under no illusions that such a significant transformation will be easy or that it can be enacted overnight. The ten policies we describe here would be an important step in getting from here to there. Indeed, the reforms we propose would be far less disruptive than the initial passage of the National Bank Act of 1864. They would be a more modest rebalancing than the Federal Reserve Act of 1913. And in their reparative ambition, they would be no more challenging to implement than the Banking Act of 1933. Often the most salutary legislation has been passed in the midst of or wake of a crisis. But we need not wait until economic and financial conditions deteriorate further to start pressing forward.

About the Authors

Lev Menand is an Associate Professor of Law at Columbia Law School, Affiliated Faculty at the Institute of Global Politics at the Columbia School of International and Public Affairs, and a Fellow at the Roosevelt Institute. He served as senior adviser to the deputy secretary of the Treasury from 2015 to 2016 and as senior adviser to the assistant secretary for financial institutions from 2014 to 2015. Menand was previously an economist at the Federal Reserve Bank of New York in the Supervision Group and the Research and Statistics Group. While at the New York Fed, he was seconded to the Financial Stability Oversight Council. He is the author of *The Fed Unbound: Central Banking in a Time of Crisis* (2022) and a coauthor of *Networks, Platforms, and Utilities: Law and Policy* (2022).

Morgan Ricks is the Herman O. Loewenstein Chair in Law at Vanderbilt Law School. He previously served as a senior policy adviser and financial restructuring expert at the U.S. Treasury Department. He is the author of *The Money Problem: Rethinking Financial Regulation* (2016) and a coauthor of *Networks, Platforms, and Utilities: Law and Policy* (2022).

Endnotes

1 The 2007-09 financial crisis, the 2019 repo market meltdown, the 2020 pandemic panic, and the 2023 runs on Silicon Valley Bank, Signature Bank, and First Republic.

2 In the 1970s, Congress added critical antidiscrimination and consumer protection provisions in an effort to extend to more people the benefits of this critical infrastructure. *See, e.g.,* Community Reinvestment Act, Pub. L. No. 95–128 91 Stat. 1147 (1977) (codified at 12 U.S.C. § 2901 et seq). These measures were unsuccessful along many dimensions and the problems of access and rent extraction remain.

3 The primary exception was an episode from the mid-to-late 1980s known as the Savings and Loan Crisis. This crisis was in part a product of severe economic conditions between 1974 and 1984 and in part a product of deregulation and desupervision of banks over that same time period. The crisis, however, never gave rise to widespread contagion, disorderly monetary contraction, or acute economic recession as the New Deal legal framework, which worked to prevent these outcomes, was still largely in place.

4 *Cf.* 12 U.S.C. § 222.

5 *See* Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 115(b), 105 Stat. 1126, 2249.

6 *See* 12 U.S.C. § 238(a)(2)

7 *Cf.* 12 U.S.C. § 461 (reserve requirements).

8 *See* 12 U.S.C. § 1821(a) (deposit insurance).

9 *See* 12 U.S.C. § 1817(b).

10 *See* Depository Institution Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132.

11 *See* 12 U.S.C. § 24 (Seventh).

12 *See* Dodd- Frank Act § 716, 124 Stat. at 1648– 51, repealed by Consolidated and Further Continuing Appropriations Act, 2015, H.R. 83, 113th Cong. § 630 (2014).

13 531 U.S. 251 (1995).

14 Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems,* December 2010 (revised June 2011).

15 *See* Banking Act of 1933, Pub. L. No. 73-66, §§ 20–21, 48 Stat. 162, 188–89.

16 *See* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 101, 113 Stat. 1338, 1341 (1999).