



Still Broken After All These Years

By Martin Weil
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“Though the principles of the banking trade may appear somewhat abstruse, the practice is capable of being reduced to strict rules. To depart upon any occasion from those rules, in consequence of some flattering speculation of extraordinary gain, is almost always extremely dangerous and frequently fatal to the banking company which attempts it.”

Adam Smith, *The Wealth of Nations*

“I think we will look back in ten years’ time and say we should not have done this, but we did because we forgot the lessons of the past.”

U.S. Senator Byron L. Dorgan in 1999 on the repeal of the Glass-Steagall Act.

Four years ago this week, the financial crisis took the world’s economies to the brink of collapse. September 15, 2008, the day Lehman Brothers failed and sent global financial markets into cardiac arrest, was my wedding anniversary. My wife and I were celebrating at the time on the Mediterranean coast of Turkey – a memorable trip, to be sure. Reflecting back on that moment now, I’m struck by how little distance our nation has traveled since.

Though we survived the tidal shock waves in 2008, our capital markets remain in a precarious condition. Public trust, severely undermined by revelations of reckless behavior, lax oversight, and the ensuing instability of our major financial institutions, has yet to be restored. This state of affairs is not good for investors or the country as a whole.

The causes of the financial crisis, both here and abroad, will remain a matter of debate, with the conclusions drawn often depending on one’s politics. But there can be no doubt that banks, insurance companies, and other major financial players became shockingly over-leveraged in the years leading up to 2008. This dramatic increase in leverage (and the inevitable corresponding reduction in the systemic “safety net”) was intentionally obscured, invisible to both regulators and the public. In some cases, it was invisible even to the financial institutions themselves.

The outrageous expansion of financial-sector leverage took place concurrent with efforts on Capitol Hill to weaken and dismantle regulations that had protected the industry from exactly this sort of crisis for more than 60 years. It was a bold policy experiment – to allow a critical industry, one with tentacles in every facet of our economy, to essentially regulate itself – and it failed in spectacular and costly fashion.



Take away the traffic cop and some drivers will take liberties. Dismantle the entire the police force, and the world quickly becomes very unsafe for the average citizen.

Practices that were once outlawed or at least highly supervised – such as excessive leverage, negligent lending standards, self-dealing, and proprietary trading, especially proprietary trading *against one's own customers* – became, and largely remain, the norm. If you are a taxpayer, saver, borrower, or investor, whether Republican or Democrat, you have every right to be appalled. While the egregious abuses that occurred are beyond remediation, we can once again take steps to ensure that such excesses do not reoccur.

Yet the bankers and financial institutions have fought tooth-and-nail against the slightest attempt to re-regulate their broken industry. Simple regulations (and simple is the most effective) such as the Volcker Rule, proposed as a palatable alternative to a full restoration of the Glass-Steagall Act, were first muddied and then beaten back by the banking lobby's pervasive influence in Washington. Glass-Steagall, which mandated a separation between commercial and investment banking, was part of a sweeping legislative response to the parallel excesses of the banks during the 1920s, excesses that led to the Great Depression. Its framework successfully safeguarded the integrity of US banking and our markets until those regulations were gutted during the 1990s and 2000s.

For most of the 20th century, the US capital marketplace stood as the undisputed center of global finance. This was an envied position and one that provided exceptional benefits to our nation. The foundation of this outsized stature was a hard-earned trust, built on the qualities of transparency, fairness and the rule of law throughout our markets – qualities now impaired by our failed experiment in financial sector deregulation. To regain that leadership, we must re-earn that trust. And to accomplish that, some basic "rules of the road" need to be restored such that investors and other participants will not fear they are at a disadvantage in every transaction.

"Caveat Emptor" should not have to be the motto of the US Stock Exchange.

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