

Monday October 31, 2011

[Get our new FREE iPad app now](#)

Bloomberg

Fed's Hoenig Urges Restricting Banks to Loans, Deposits

May 24, 2011, 12:25 PM EDT

[Recommend](#)

7

[Share](#) 1

0

[Business Exchange](#)[E-mail](#)[Print](#)

By Scott Lanman

(Updates with comments on restrictions in 15th paragraph.)

May 24 (Bloomberg) -- Federal Reserve Bank of Kansas City President Thomas Hoenig said banks' business should be confined to loans and deposits to avert a recurrence of the federal bailouts and near-collapse of the financial system in 2008.

"The consequence of expanding the safety net to an ever-increasing range of activities is to invite a repeat of our most recent crisis," Hoenig said today in a speech in Philadelphia. "With separation of activities, risks will remain in the financial system, but unlike the past decade, this risk will be priced more correctly and failure can be resolved more equitably."

The proposal by Hoenig, 64, the longest-serving current Fed policy maker, is in line with his previous calls for the breakup of large financial firms and for tougher bank regulations than officials such as Chairman Ben S. Bernanke have publicly supported. Hoenig, who retires Oct. 1, said last month that international capital requirements are too lax to prevent another U.S. banking crisis.

"Banking organizations that have access to the safety net should be restricted to the core activities of making loans and taking deposits and to other activities that do not significantly impede the market, bank management and bank supervisors in assessing, monitoring and controlling bank risk-taking," said Hoenig, who doesn't vote on Fed monetary policy this year.

He spoke at a conference hosted by the Global Interdependence Center and Drexel University's LeBow College of Business.

Cease Bets

Hoenig's comments represent his backing of the Volcker Rule, named for former Fed Chairman Paul Volcker, which Congress passed last year to force bank holding companies to cease bets with their own money outside of traditional lending.

"I strongly support the Volcker Rule and suggest it should be implemented with resolve and should be strengthened in its reach and impact," Hoenig said.

Hoenig also proposed two other rules to ensure that the so-called "shadow banking" system doesn't take on excessive risks as financial institutions evade regulation. Money market mutual funds should be required to have a floating net asset value instead of being allowed to maintain a fixed value of \$1, he said.

In another change, lenders financing shadow banks wouldn't be allowed to immediately liquidate mortgage debt used as short-term collateral in the event of default, rolling back a change in a 2005 bankruptcy law, Hoenig said.

Increase Stability

The changes would "increase the stability of the shadow banking system because term lending would be less dependent on 'demandable' funding and more reliant on term funding, and the pricing of risk would reflect the actual risk incurred," Hoenig said.

The Kansas City Fed chief didn't comment on the outlook for the economy or interest rates.

In a related policy paper released with the speech and co-written by Hoenig and Charles Morris, a Kansas City Fed vice president and economist, they wrote that banks would also be allowed to underwrite securities, advise on mergers and manage trusts and assets. Banks would be forbidden to "conduct broker-dealer activities, make markets in derivatives or securities, trade securities or derivatives for either their own account or customers or sponsor hedge or private equity funds."

Burst Bubble

The bursting of the U.S. housing bubble and resulting cascade throughout the world financial system resulted in \$2 trillion of writedowns and losses for financial companies from 2007 to 2009.

"The combination of securities and commercial banking activities in a single organization provides opportunities for the senior management and boards of directors to be increasingly influenced by individuals with a short-term perspective," Hoenig said. "As a result, the increased propensity of these corporate leaders to take high risks for short-term gain leads to more of a short-term-returns culture throughout the organization."

Hoenig said in his speech that restrictions wouldn't drive banks and jobs outside the U.S., as some critics say, because there are "200 years of banking success in this country" and other countries are unlikely to expand their safety net to large banks.

Hoening dissented all eight times in 2010 from decisions of the monetary policy-setting Federal Open Market Committee, preferring tighter credit.

Minority View

Asked by an audience member why his views were in the minority at the central bank, Hoening said that it's "hard to know" and that his outlook is shaped by his experiences over three decades and multiple banking crises.

The Fed is completing its \$600 billion of Treasury purchases next month, ending a second round of so-called quantitative easing that was aimed at averting deflation and boosting a sluggish recovery. Hoening opposed the program. In the first round of bond purchases, the central bank bought \$1.7 trillion of mortgage debt and Treasuries. Policy makers are debating how and when to raise interest rates and sell the debt once the economy improves enough.

--With assistance from Craig Torres in Washington. Editors: James Tyson, Kevin Costelloe

To contact the reporter on this story: Scott Lanman in Philadelphia at slnman@bloomberg.net.

To contact the editor responsible for this story: Christopher Wellisz at cwellisz@bloomberg.net

[Recommend](#)
 7
 0
[Business Exchange](#)
[E-mail](#)
[Print](#)
 READER DISCUSSION

Add New Comment

[Login](#)

 Type your comment here.

Comments without profanity or abusive language are automatically posted to the site. Bloomberg BusinessWeek reserves the right to delete comments that are off-topic or offensive. Excessively long comments may be moderated as well. Bloomberg cannot facilitate requests to remove comments or explain individual moderation decisions.

Real-time updating is **paused**. ([Resume](#))

Showing 0 comments

Sort by popular now

[M](#) [Subscribe by email](#) [S](#) [RSS](#)