Sen. Folmer: 'Banning Swaps and Bail-Ins'

Pennsylvania State Senator Mike Folmer (R-48th District), Central Pennsylvania (Lebanon, Berks, Dauphin, Chester, and Lancaster Counties), issued this statement July 22, 2013.

The recent City of Detroit bankruptcy filing highlights my call to ban swaps: contracts where a municipality and a financial institution agree to exchange—swap—cash-flow payments. Most swaps involve a municipality issuing a variable rate debt and then entering into a swap with a bank, which makes a variable rate payment to the municipality while the municipality makes a fixed-rate payment to the bank. However, if interest rates fall, the municipality could see losses—sometimes multi-million dollar losses.

Debt sales cost Detroit $474 million, including underwriting expenses, bond-insurance premiums and fees for wrong-way bets on swaps that almost equals Detroit's 2013 budget for police and fire protection. The largest part is $350 million owed for swaps meant to lower borrowing costs on variable-rate debt.

I believe swaps represent gambling with other people's money and state government needs to protect taxpayers by banning swaps as called for by my Senate Bill 903. At the same time, I believe the federal government needs to protect consumers by abandoning the Dodd-Frank Wall Street Reform and Consumer Protection Act and reinstating the protections of the Glass-Steagall Act. After the stock market crash of 1929, Congress passed the 1933 Banking Act, Glass-Steagall, which regulated commercial banks separately from investment banks. For 60 years, the United States had relative financial stability.

Then, in 1999, Congress passed the Gramm-Leach-Bliley Act, which allowed commercial and investment banks to come together again. Less than a decade later, we had the financial crisis of 2008, and passage of Dodd-Frank.

According to Bloomberg: Some of the key provisions of the Dodd-Frank Act of 2010, advertised as crucial to preventing a new financial crisis, won't live up to the claims of its sponsors. As with most things in Dodd-Frank, the public knows little about the liquidation authority, although it has been touted by the Obama administration and others as solving the problem of bailouts for firms seen as too big to fail. But it does nothing of the kind; instead it makes the problem worse.

Dodd-Frank worsens the problem by replacing taxpayer-funded bank bailouts with consumer-funded bail-ins. A bail-in can force shareholders, bondholders and some depositors to contribute to the costs of bank failure. Cyprus used a "bail-in" to seize people's savings to keep banks in that country from failing.

Recently, *The Wall Street Journal* reported that several bigger banks have presented plans to the Federal Reserve to shield depositors and taxpayers from losses in the event a bank subsidiary fails: a bail-in. While US regulators have yet to weigh in on this plan, Europe is reportedly writing rules to impose bail-ins for struggling banks.

My fear is that we too will soon begin to see bail-ins, which is why I'm introducing a Resolution calling upon Congress to again separate commercial and investment banking by repealing Dodd-Frank and getting back to Glass-Steagall. Like my call for banning swaps, we need to protect taxpayers and consumers for risks they did not make.

While some may argue bail-ins beat the alternative—bailouts, I believe both should be banned. Those who take risks need to shoulder the burdens of those risks should they fail.