

Will London's 'Big Bang' be Merrill Lynch's last?

by William Engdahl and David Goldman

"If you're looking for a 'trigger' for a global financial crash, look to the Oct. 27 'Big Bang' which comes the same day as a new system for trading UK treasury bonds," a spokesman for London's Standard & Chartered bank said recently, referring to the deregulation of the London Stock Exchange. "There's simply too much competition going after too little market. The new factor is that all the securities markets in London after Big Bang goes operational, will be fully integrated into the corporate liabilities structure of the major international banks and financial conglomerates. If a crash hits in the London equities markets, it could quickly spread. After all, Euromarkets are also based in the same institutions in London."

On the surface it sounds technically straightforward, even rational. On Oct. 27, formally, the City of London, the world's second largest financial center, will imitate the financial "revolution" spearheaded by Merrill Lynch's Donald Regan and others on Wall Street a decade ago.

Some 64 City of London brokerages have been bought up by banks, mainly international banks—the same banks that are teetering on the edge of bankruptcy: S. G. Warburg, Citibank, Chase Manhattan, Security Pacific Bank, Shearson-Lehman American Express, Merrill Lynch, Crédit Suisse-First Boston, Hongkong & Shanghai, Banque Bruxelles Lambert, and Banque Arabe et Internationale, to name only a few.

About a trillion dollars worth of financial instruments of

all kinds are traded daily on all markets; the big players are betting the store that the opening of the London exchange will trigger a rapid expansion of trading volume.

The Bank of England and the Thatcher government are opening access to a financial market, the London Stock Exchange, which last year traded stocks and U.K. treasury bonds (termed gilts for their gold-edged paper) valued at some \$540 billion. In addition, by merging this stock trading together with banks and other financial houses, some \$600 billion of assets managed in London by various banks will be merged.

London already controls the world's most active physical commodities market, and is rapidly developing a commodity futures market on the U.S. model. Further, partly because of its historic role, London today remains the center of capital raised by most West European governments, far in excess of any domestic continental market for government bonds or other capital. After "Big Bang," all this will be locked into the same, above-mentioned, multinational banks. Thus, if one or several big disasters hit, the unwinding of over-leveraged paper could be the financial equivalent of a hydrogen bomb.

Chain-reaction potential

The undercapitalized brokers are the weakest link in a global chain, comprised of \$3 trillion of financial guarantees of various sorts. These "off-balance-sheet liabilities" now

exceed the assets of the top 20 U.S. banks by 150%, and, for some months, were the subject of panicked pronouncements on the part of the bank regulators. Once the regulators realized that the problem had gone too far—that there was nothing they could do about it—the public pronouncements stopped, while the problem went on.

Available estimates of off-balance-sheet exposure of commercial banks, alarming as they are, do not take into account the expanding, quasi-bank functions of the major brokerage houses, e.g., Merrill Lynch, First Boston-Crédit Suisse, Salomon Brothers, Shearson Amex, and so forth. As underwriters of options, swaps, and similar forms of foreign-exchange or interest-rate guarantees, they have taken on a credit-creating function, and their activities are in many respects indistinguishable from those of the banks. The difference is that their market capitalization is much thinner than that of the banks, even when the banks' full liabilities (including off-balance-sheet liabilities) are taken into account.

Precisely what the real risk attached to the global brokerage firms may be, is difficult to discover from available data. Futures, forwards, and other contractual obligations, i.e., what banks call off-balance-sheet liabilities, are not even encompassed on their balance sheets.

It is not merely a question of the soundness of each brokerage house, evaluated from the standpoint of its own exposure; one house's speculation is another's hedge. The failure of a major writer of options or futures contracts to meet its obligations, would destroy the hedges of many other firms, endangering their capitalization in a volatile market. For example, if Salomon Brothers is short a bundle of German marks, and covered that short with a call option on the mark written by Merrill Lynch, and Merrill Lynch cannot make good on its option, Salomon could be in big trouble. Since the brokerage firms have taken on a bank-like function, the failure of one or many of them would destroy a volume of other firms' assets many times in excess of their own capitalization.

That danger has not gone ignored by the regulators. On Sept. 16, Robin Leigh-Pemberton, governor of the Bank of England, that country's central bank, warned a private meeting of bankers in London, convened by the Group of 30, that "globalization of international securities markets has heightened the risk that the failure of one single large securities house could endanger the health of the world financial system," according to *Financial Times* banking correspondent Peter Montagnon. Significantly, at the same seminar, Stanislas Yassukovich, the chairman of Merrill Lynch London, protested that there was no immediate likelihood of such a collapse. The voices of apprehension have been drowned out in the clamor for greater trading volume, and not surprisingly, since an attempt to cut back on the banks' riskiest operations would probably precipitate a crash in itself.

One principal of a major London brokerage characterized

the situation under the new deregulated regime. "You as a client will have to place exceeding trust in the personal integrity of your broker. The opportunities for conflict of interest in this situation are enormous. Nobody really can predict what will happen after Big Bang."

This is not entirely true. Already, one can anticipate fairly accurately, based on the players who will dominate London after Oct. 27. The world's largest securities trading and banking conglomerate, Merrill Lynch, is reportedly the house most exposed in the emerging London markets. According to New York brokerage sources, Merrill Lynch, through its London Merrill Lynch-Giles & Cresswell, has already moved in a few short months, even before Big Bang, to dominate 15-20% of the market in U.K. government bonds. It proceeded to lose over £25 million during the September shake-out in the gilts market, alarmed London sources report.

But, the same Merrill Lynch was "black-balled," according to London financial insiders, when it tried early this year to gain a seat on the London Stock Exchange and the privilege of setting policy for regulation of the market.

Global 24-hour trading

Under the new regime, London becomes, because of its position in the center of the world's time zones, the heart of a global trading market. The deregulated City will be able to start the day in trade with Asian markets still open, and end the same day with New York markets just beginning. With computerized trading, this global scale will open the doors for staggering shifts in world capital. In reality, it is the financial side to Bertrand Russell's old dream of world government. Like Russell's model, this will be every bit as dictatorial. The "free market" will dominate the credit markets of the entire non-communist world.

The new chairman of Merrill Lynch Europe Ltd. in London, Stanislas Yassukovich, one of the world's most seasoned dealers in bearer securities used to evade national tax, Eurobonds, says of the impending change, "London will be the center of development of the global market. London's services are less fragmented than those in New York and Tokyo. More can be combined here and more can be readily exploited." The last is understatement. Yassukovich will have an old friend at Merrill Lynch to conspire with: Michael Von Clemm, a flamboyant Harvard-trained American, who for the past 15 years has dominated the Eurobond market as founder of London's Crédit Suisse-First Boston, since March has been in New York on a reported \$1 million salary, to head Merrill Lynch Capital Markets, the firm's global investment banking arm. At the time Von Clemm stated, "Merrill Lynch has set the pace for the entire industry in the globalization of the capital markets."

Since Don Regan arranged the merger of White Weld into Merrill Lynch in 1978, Merrill has become increasingly dependent on illegal money flows for revenues. One Merrill

Lynch branch manager in Europe reports that the institution's current biggest earner is margin loans to offshore customers, including a high proportion of drug dealers. It appears that Merrill's salesmen discovered that high-rollers in the drug business preferred ultra-high-margin, speculative accounts, buying securities for as little as 10% down. Merrill Lynch takes an interest spread of several points on such margin loans, making this business its most profitable line.

Collapse of stock market boom?

One of the prime attractions of the London Eurobond market which Michael Von Clemm and Yassukovich have created has been the fact that it deals in "bearer bonds," meaning unregistered securities. This is important for anyone in the "underground economy," as there is no transaction record. Crédit Suisse, Merrill Lynch and other large international houses with access to Swiss banking secrecy, have made a killing in this market in recent years. Now, under the deregulated City of London, these same actors will set the rules for the "self-policing" regulation of the City of London after Big Bang. In a scenario a little like placing the fox to guard the henhouse, the London Stock Exchange in September agreed to merge with the Eurobond regulatory agency, the International Securities Regulatory Organization. Under the terms of the merger, the new "regulatory" body, to be known simply as the Stock Exchange, will be controlled 50% by the Merrill Lynch, Crédit Suisse Eurobond houses. This means that the body which decides penalties for a firm dealing in illegal trading practices will be made up of those firms which have become notorious in recent years with the very abuses themselves.

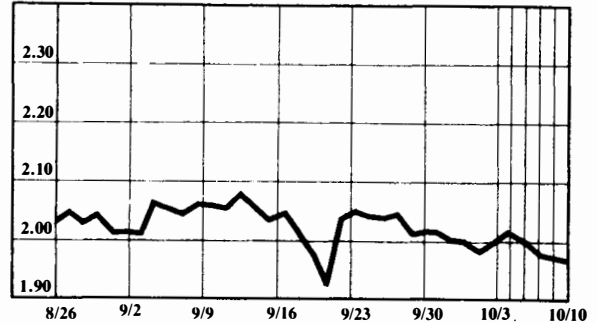
Whether Oct. 27 is an immediate trigger for a global Black Friday, it opens the way for the bankrupt financial houses to expand their cannibalism of the world's real assets massively. With an estimated \$2.2 trillion of publicly traded stock shares held outside the United States, London is a prize target for the international giants like Merrill Lynch. The U.S. firms such as Merrill Lynch, Salomon Brothers, and Chase have already sunk a reported \$4.5 to \$6 billion into merger acquisitions and office and computer facilities in London in advance of Big Bang.

The risk of triggering a global crash from this Big Bang process is enormous, by all estimates. Even *Business Week International* last May 12 admitted, "The risk, of course, is that if the sizzling debt and equity markets cool, investment bankers' grand global dreams could collapse. . . ." One London merchant banking insider was more explicit. "There are very real fears that we are at the end of a global bull [rising prices] market. For the last year, we have seen huge volumes on the stock exchanges of Europe. But this is a one-shot adjustment of undervalued stock prices. If we were now to see a sustained U.S. bear [falling prices] market, under Big Bang integration of markets, this would turn a process of competitive bloodletting into an absolute massacre."

Currency Rates

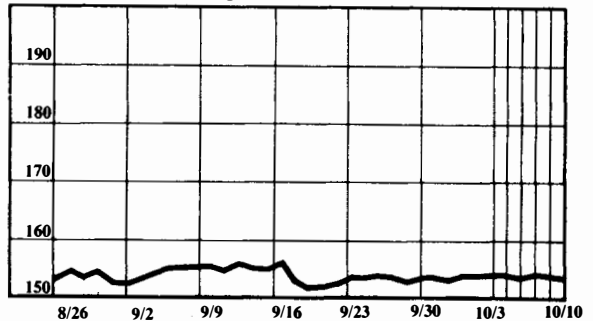
The dollar in deutschemarks

New York late afternoon fixing



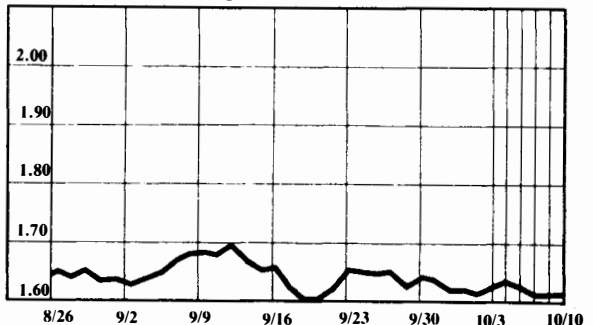
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The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

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