

# The bigger they get, the harder they'll fall

by John Hoefle

The \$25 billion merger between Swiss Bank Corp. and the Union Bank of Switzerland, announced on Dec. 8, is part of an ongoing, global banking consolidation, in which banks are racing to become giants, in the vain hope that they will somehow become too big to fail. The mergers occur against the backdrop of an Asian financial meltdown, which itself is but a reflection of a global, systemic financial crisis. The idea that grabbing a larger piece of a doomed bubble will somehow result in success, is the sort of logic that only a banker could grasp.

The Swiss merger will create a new bank, the United Bank of Switzerland, which will have assets of some \$640 billion, making it second in size only to Japan's Bank of Tokyo-Mitsubishi, which itself was created by the 1996 merger between Mitsubishi Bank and the Bank of Tokyo, and had assets of \$648 billion as of March 31, 1997. Rounding out the top five, with assets as of Dec. 31, 1996, are Deutsche Bank of Germany (\$575 billion), Cr dit Agricole Mutuel of France (\$479 billion), and Dai-Ichi Kangyo of Japan (\$434 billion). Given the turmoil in world currency markets, the dollar value of these assets has shifted significantly during the year.

"It is in the general interest that two strong and solid Swiss banks should join forces," Swiss Bank Corp. (SBC) Chairman Georges Blum said, announcing the merger. "Individually, they might otherwise find themselves in partnerships where Swiss interests could no longer be safeguarded to the same extent."

## Blood in the water

Such comments reflect the "blood in the water" nature of today's financial system, where "eat or be eaten" is a dominant theme, and today's champion is tomorrow's lunch.

There was clearly blood in the water around Union Bank of Switzerland (UBS), which reportedly lost in the vicinity of \$400 million from its derivatives activities during the first nine months of 1997; in November, a number of UBS equity derivatives officials resigned, including the vice-chairman of UBS London, who headed the bank's equity derivatives business, and three New York-based employees.

The merger may temporarily shore up UBS's financial position, but the new bank will have a huge derivatives exposure. According to the Bank for International Settlements,

SBC had \$3.3 trillion in derivatives at the end of 1996, putting it third in the world behind Chase Manhattan, with \$5.6 trillion, and J.P. Morgan, with \$4.7 trillion. Adding UBS's \$1.9 trillion would give the new United Bank of Switzerland a combined \$5.3 trillion as of the end of 1996. For a bank to be a leader in the \$135 trillion-or-so global derivatives market, thereby placing itself at ground zero of the coming disintegration, is not exactly ensuring its survival.

There is other blood in the water, as well.

Chase Manhattan Corp. recently announced that it had lost \$160 million in October, as a result of what it termed "unusually volatile and adverse trading markets." Chase lost more than just money: Going into Black October, Chase had issued a report claiming that the "Thai contagion" would be contained, and would have little impact on Japan or South Korea, making the bank look quite silly, if not duplicitous. The event is replete with irony, as well, since it was a Chase executive who confided to the *New York Times* several years ago, that what the bank feared the most was periods of calm and stability in international markets.<sup>1</sup>

J.P. Morgan also got hit by the lack of calm, admitting on Dec. 10 that its revenues would be "adversely affected by unsettled market conditions globally, which resulted in lower levels of client activity and lower trading revenues."

Morgan has more egg on its face, in the form of a stock manipulation scandal in London. On Dec. 1, the bank announced that it had suspended two of its vice presidents in London, for what appeared to be a blatant manipulation of the FTSE 100 stock index, deliberately driving the FTSE down in order to generate big profits on stock-linked derivatives. The executives reportedly sold a large block of one of the FTSE index stocks, at a price significantly below its market price, taking a substantial loss on the stock, in order to obtain a much bigger payoff on a derivatives contract. Morgan, which says it is cooperating with the authorities, is now in the process of restructuring its senior management worldwide.

National Westminster Bank, the large City of London "high street" bank, is liquidating its NatWest Markets investment bank subsidiary, selling portions of its equity and equity derivatives business to Bankers Trust and Deutsche Morgan Grenfell. In February, NatWest announced that it had lost some \$50 million on interest rate options derivatives, and that loss has grown to as high as \$500 million, according to unconfirmed reports. National Westminster will receive some \$260 million from Deutsche Morgan Grenfell and

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1. "The bank's biggest fear would be a long period of calm and stability in the markets, which would lull companies and investors into slowing their trading activities," Michael G.J. Davis, the deputy head of Chase's risk management department, told the Aug. 4, 1995 *New York Times*. "The worst thing for us is a marketplace where nothing happens."

Bankers Trust, and expects the cost of restructuring NatWest markets to be around \$160 million.

### Gobble, gobble, gobble

Meanwhile, a restructuring is also under way among U.S. banks, both through ongoing mergers between commercial banks, and purchases by commercial banks of investment banks (the fact that such combinations of commercial and investment banks violate U.S. law, has proven to be a surmountable obstacle to the banks and their regulators). Among the most active U.S. banks in this expansion are the two Charlotte, North Carolina-based "superregionals," NationsBank and First Union. NationsBank has completed the purchase of Montgomery Securities, and is buying the \$44 billion in assets Barnett Banks of Florida, after which the bank will have some \$290 billion in assets, leapfrogging into third place behind Chase Manhattan and Citicorp. First Union, which bought First Fidelity of New Jersey in 1995 and Signet Banking of Virginia earlier this year, is now buying both CoreStates Financial, the Philadelphia-based commercial bank, and the Richmond, Virginia-based Wheat First Butcher Singer brokerage, deals which, when complete, will give First Union \$204 billion in assets. Besides buying portions of NatWest Markets, Bankers Trust has bought Alex. Brown & Co., the Baltimore-based investment bank; while Fleet Financial is buying discount brokerage Quick & Reilly, and BankAmerica is buying the San Francisco-based Robertson Stephens. Merrill Lynch, which announced in November that it is buying London-based Mercury Asset Management for \$5.3 billion, is also negotiating a possible takeover of Hambrecht & Quist. In September, Travelers Group announced that it was buying Salomon, Inc., and in February, Morgan Stanley merged with Dean Witter Discover. The Canadian Imperial Bank of Commerce recently announced that it is buying the New York-based Oppenheimer & Co.

In other international deals, Allianz AG Holding has announced the acquisition of AGF; Internationale Nederlanden is buying Banque Bruxelles Lambert and the Equitable Cos. of Iowa; Zurich Insurance is buying the financial services arm of Britain's BAT Industries; Cr dit Suisse Group is buying Winterthur Schweizerische and some of the operations of Barclay's BZW investment banking arm; Bayerische Vereinsbank is buying Bayerische Hypotheken; and Britain's Abbey National is buying Scottish Amicable Finance.

The restructuring is far from complete, however. Mellon Bank, which made unsuccessful bids to acquire both CoreStates and the Bank of Boston, is widely considered fair game, as are Wells Fargo, Banc One, and the Bank of New York. Among the more interesting rumors, is speculation of a possible merger between the \$360 billion Chase Manhattan and the \$213 billion (as of December 1996) Merrill Lynch, and talk of a merger between Wells Fargo and London-based HSBC (HSBC is the notorious Hongkong & Shanghai Bank-

ing Corp., the premier drug bank of the British Empire). Chase and Merrill Lynch are also rumored to be interested in Donaldson Lufkin & Jenrette.

It is gospel among U.S. bankers that the Federal Reserve would like to see the U.S. banking system streamlined to about 20 major banks, which means that merger activity will not only continue, but increase, especially while stock prices are high and stock swaps are considered attractive. Rumors about particular combinations often prove unfounded, but the feeding frenzy is assured.

Those bankers who think size will be their salvation, however, would do well to study the actions of their British cousins. The British have sold off important chunks of their banking system over the last few years, in addition to that reported above: Barings to ING, Warburg to Swiss Bank Corp., Kleinwort Benson to Dresdner, Smith New Court to Merrill Lynch, and earlier, Morgan Grenfell to Deutsche Bank. The Brits, knowing the crash is coming, are selling their soon-to-be-annihilated financial assets to foreign suckers, while putting their money in hard assets such as gold and other precious metals, strategic minerals, and other commodities. They are slipping quietly away to the lifeboats, leaving the suckers to enjoy—for the moment—their prize deck chairs on this *Titanic*.

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