pany, Salomon Smith Barney is an investment bank) merged, thumbing their noses at Glass-Steagall.

Now, as a result of speculative activity, the banking-financial system is on the verge of a breakdown, several orders of orders of magnitude larger than anything that occurred in 1929-32. The same Wall Street firms that contributed to the 1929-32 meltdown, and ensuing depression, have built a bubble bigger than that of the late 1920s. Today, they use highly leveraged derivatives: In 1999, America is burdened by $55 trillion of derivatives outstanding, of which the financial institutions own more than 90%. In the 1920s, there weren't even $150 million of these instruments. Today, these Wall Street forces are carrying out an incredible array of corporate mergers—in 1998, mergers took place to the tune of $1.6 trillion; in 1929, less than $15 billion.

Thus, this is the worst possible time to undermine Glass-Steagall and the very principle of regulation of the financial system.

The Gramm-Leach-Bliley "Financial Modernization Act" will concentrate enormous speculative power into the hands of 15 to 20 institutions; along with the Federal Reserve Board, they will have control over every facet of financial life. This will speed up the process of looting and dissolution. A nation that tolerates such a retrogressive step, has abandoned its moral fitness to survive.

LAROUCHE ON
THE NEW BRETTON WOODS

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Deregulation: a license to steal

by John Hoefle

The irony of a wildly, dangerously out of control group of parasites proclaiming that they are being "over-regulated," suffering from a "regulatory burden" so onerous that they cannot serve the "little people" as fully as they could were the government to get off their backs, should not be lost on anyone watching the bankers and their agents running roughshod over the very people they claim they want to serve. If it hadn't happened before one's very eyes, one might have trouble believing it.

Among the loudest whiners have been the biggest commercial and investment banks in the United States, some of whom are so "over-regulated" that the notional value of their off-balance-sheet derivatives bets is more than 30 times the assets they list on their balance sheets. Think about the implications of that for a minute, both in terms of the meaninglessness of balance sheets in such circumstances, and of the nature of a regulatory system which permits such incredible activity. In many areas of the business world, a company which reported such a tiny portion of its financial activities on its balance sheets would be indicted for fraud. But, not the big commercial and investment banks. The double standard is obvious.

In case after case, Federal banking regulators, from the Federal Reserve to Congress, have bent over backwards not only to ignore, but also to actively protect, the wild speculation which has taken over modern banking. When banks break the law, as in the clearly illegal merger of the insurance and investment banking giant Travelers Group with Citicorp, the regulators jumped through hoops to promise to change the law, a promise upon which they have now delivered with the Gramm-Leach-Bliley financial modernization act. In those rare occasions when some regulatory agency does raise questions about the derivatives frenzy, as in the cases of the Federal Accounting Standards Board and the Commodity Futures Trading Commission, the knives come out quickly.

They're not banks anymore

Over the past two decades, there has been a fundamental shift in the nature of banking in the United States, namely, that the big banks have increasingly turned from banking to speculation; more and more, they've become gamblers, not bankers.

Take the case of Chase Manhattan Corp. As of June 30, 1999, it reported $357 billion in assets on its balance sheet,

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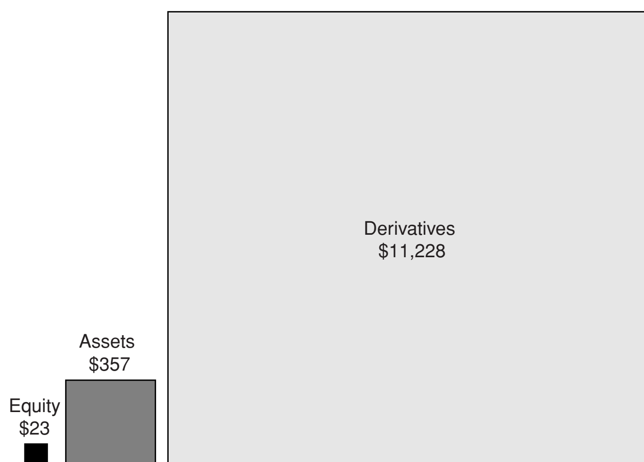
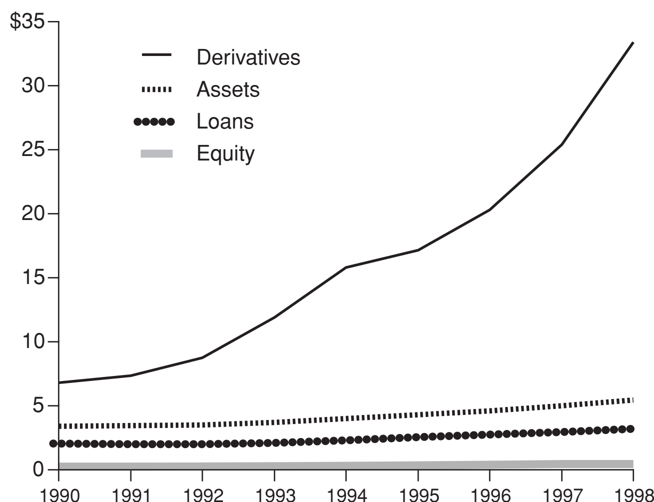
FIGURE 1
Derivatives profile, Chase Manhattan Corp.
(billions $)



Sources: Office of the Comptroller of the Currency; company reports.

FIGURE 2
U.S. banks are addicted to derivatives
(trillions $)



Source: Federal Deposit Insurance Corp.

and $11,228 billion—$11.2 trillion—in what the Federal Deposit Insurance Corp. (FDIC) terms "off-balance-sheet derivatives" (**Figure 1**). That's $31 in off-balance-sheet bets for every $1 of assets. By comparison, Chase had only $171 billion in loans, and $23 billion in equity capital. Chase's derivatives portfolio is so large, that a loss equivalent to just two-tenths of 1% of that portfolio would be sufficient to completely wipe out the bank's equity. Does this sound like a bank which is over-regulated?

The ratios are even worse at J.P. Morgan, which had $32 in off-balance-sheet derivatives for every $1 of its $269 billion in assets as of June 30, for a total derivatives portfolio of $8.7 trillion. Morgan barely bothers to make loans any more, with just $29 billion in loans. A loss equivalent to just 0.14% of its derivatives portfolio would wipe out Morgan's $12 billion in equity. Morgan is even less of a bank than Chase.

By comparison with these two high-rollers, the other big derivatives banks are paragons of virtue. BankAmerica (the new name for NationsBank) has a mere $8 in derivatives for every $1 of assets, and Bank One (which bought derivatives giant First Chicago NBD) has $5 per $1 of assets. Taunus Corp., the Deutsche Bank subsidiary formerly known as Bankers Trust Corp., had $2.2 trillion in derivatives, or $10 in derivatives for each of its $209 billion in assets.

The U.S. banking system as a whole, according to the FDIC, had $33.5 trillion in derivatives as of June 30, 1999, compared to $5.5 trillion in assets, $3.3 trillion in loans, and $466 billion in equity. With off-balance-sheet bets more than six times assets and more than ten times loans, a pathological situation which is getting worse by the minute, it's hard to call this a banking system (**Figure 2**). Even though nearly all of those derivatives are held by a handful of big institutions, the level of derivatives bets is so high at those institutions, as to jeopardize the entire system, including those banks which hold no derivatives at all.

It is precisely the systemic nature of the financial crisis, which is the real reason the restrictions on banking and other financial institutions are being swept away. The purpose of the flight-forward into deregulation, is to sweep away any and all obstacles to the banks' ability to loot as much as required from the public, in order to keep their bubble going. The Glass-Steagall and related restrictions were imposed to protect the public from dishonest banks, and the major flaw in such restrictive laws, is that they did not go far enough. Even the old pirate J.P. Morgan would cast an incredulous—and jealous—double-take at today's derivatives markets and their ability to take stealing to previously unimaginable heights.

In Bankers We Trust?

Take the case of Bankers Trust. On March 11, 1999, Bankers Trust Co., one of the world's top derivatives banks, pleaded guilty to Federal criminal charges, arising from a scheme in which it misappropriated some $19 million in funds belonging to its customers; the bank used those funds to create a slush fund, which it then used to overstate its earnings.

"Pursuant to its agreement with the U.S. Attorney's Office, Bankers Trust will plead guilty to misstating entries in the bank's books and records and will pay a $60 million fine to Federal authorities," the bank announced in a muted but remarkable March 12 press release. "Separately, Bankers Trust will pay a $3.5 million fine to the State of New York.

The agreement concludes the investigation of Bankers Trust, and the firm continues to cooperate with the government's ongoing investigation of these matters."

Paying fines is nothing new for Bankers Trust, which in 1994 was fined $10 million by the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC) for illegal activities in its derivatives trading operation. Bankers Trust's actions were so blatant that one of its derivatives victims, Procter & Gamble, accused the bank in a Federal lawsuit of violations of the civil section of the Federal Racketeer Influenced and Corrupt Organizations (RICO) Act, a law passed, at least nominally, to help law enforcement agencies battle the mob and the drug cartels.

The irony of Bankers Trust's latest fine, is an issue of an immorality "in the small" being punished, while a much more dangerous immorality—the international derivatives market—is not only allowed to continue in operation, but is protected. It was the equivalent of citing a murderer for jaywalking upon leaving the scene of the crime.

The timing of the action against Bankers Trust also shows the fine hand of Federal banking regulators in managing the banking crisis. In the wake of its 1994 escapade, the bank lost a number of customers; only by running off the existing management and bringing in former Deputy Treasury Secretary Frank Newman and former Federal Reserve Chairman Paul Volcker, were regulators able to stop the hemorrhaging. But even then, despite all its problems, the bank avoided admitting to felony crimes. The felony conviction would put the bank's viability into question—many of the bank's customers are prohibited from engaging in financial dealings with convicted felons—were it not for the fact that Bankers Trust is being taken over by Germany's Deutsche Bank.

'Lure 'em in and f— 'em'

The culture at Bankers Trust was eloquently expressed by an employee who stated: "Funny business, you know? Lure people into that calm and then just totally f— 'em." That comment, recorded on the bank's internal taping system, was just one of several which showed the predatory view the bank had toward its customers, and the world at large. Thanks to the lawsuits brought against Bankers Trust, and the subsequent SEC-CFTC investigation, many of Bankers Trust's dealings have entered the public record, including a highly embarrassing Form 8K filed with the SEC in December 1994, which includes details about the bank's derivatives dealings and some of the traders' comments. But Bankers Trust was hardly alone in its predatory view of the world. During the same period that Bankers Trust was running wild, so was Morgan Stanley, according to former Morgan Stanley derivatives salesman Frank Partnoy, whose 1997 book, *F.I.A.S.C.O.,* is required reading for anyone attempting to understand the nature of today's financial markets.

In April 1994, when widespread derivatives losses began to surface, Partnoy said that John Mack, the boss at Morgan Stanley, told the firm's derivatives traders: "There's blood in the water. Let's go kill someone."

Partnoy describes his former associates as "feral multimillionaires: half geek, half wolf. When they weren't performing complex computer calculations, they were screaming about how they were going to 'rip someone's face off' or 'blow someone up.'. . . We were prepared to kill someone, and we did. The battlefields of the derivatives world are littered with our victims. . . . Wall Street has made, and continues to make, huge amounts of money on derivatives by trickery and deceit."

"Like most derivatives traders," Partnoy wrote, "I was an avid gambler. . . . Salesmen and traders are wild, cunning, aboriginal creatures who advise money managers about deceiving their bosses and finding new strip bars; their favorite phrase is 'f— you.' "

Partnoy's book makes a fine companion piece to the 1989 classic *Liar's Poker,* by Michael Lewis, which chronicles the bond- and derivatives-trading activities of Salomon Brothers. Lewis's book describes a world where "blowing up" customers and "ripping their faces off" was business as usual. At Salomon, Lewis wrote, "the most revered of species" was "a Big Swinging Dick. . . . Nothing in the jungle got in the way of a Big Swinging Dick. This was the prize we coveted." To become a Big Swinging Dick, a trader or salesman had to make millions of dollars in profits for the company—and for himself, in bonuses.

Salomon eventually blew itself up, with the Treasury trading scandal of 1991, in which it was caught attempting to corner the market on Treasury bonds, in order to drive prices higher and increase its trading profits. Today, Salomon no longer exists as a separate company, but is part of the Salomon Smith Barney unit of Citigroup, the giant bank formed by the merger of Travelers and Citicorp. However, several of the Salomon alumni, including the "King of Liar's Poker" players, John Meriwether, went on to form Long Term Capital Management, the hedge fund which blew up in September 1998.

A more subdued expression of the same philosophy was provided in 1993 by Chase Manhattan's Michael G.J. Davis, who told the *New York Times* that "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. . . . The worst thing for us is a marketplace where nothing happens." At the time, Davis was the deputy head of risk management for Chase. To Chase, the risk was not that chaos and volatility would hit the markets, but that the markets would be calm and stable, an environment where customers were less susceptible to having their faces ripped off by the Big Swinging Dicks of Wall Street.

Taken together, the statements show the true nature of Wall Street and the *casino mondiale* known as the global financial system. The world of Wall Street is a predatory jungle where the strong eat the weak, and if you're not a predator, you're lunch. Does this sound like a system suffering from over-regulation?

The Gramm-Leach-Bliley Act

• Repeals the barrier between commercial banking and securities dealing, allowing bank holding companies to acquire or be acquired by non-bank financial firms such as investment banks, securities dealers, and insurance companies.

• Greatly expands the list of activities in which bank holding companies are permitted to engage, including what the American Bankers Association calls "a long laundry list of financial activities." The act also permits activities not on the list, that the Fed and the Treasury consider "financial in nature or incidental to financial activities"; and any activity the Fed determines is complementary to financial activity.

• National banks will be permitted to sell any financial product without geographic limitation, and underwrite any financial product other than insurance underwriting and real estate development.

• Ends the ability for commercial (that is, nonfinancial) companies to charter unitary thrifts, and prohibits the future sale of unitary thrifts to commercial companies.

• Reduces the ability of states to restrict the sales of insurance by commercial banks.

• Eliminates the requirement that banks must have at least 10% of their assets in housing loans to join the Federal Home Loan Bank System, and reduces the restrictions on what types of collateral are required for banks to borrow from the FHLB System.

Protection racket

Rather than move to clean up this dishonest market, Federal regulators have consistently defended the derivatives market, and attacked anyone who dared to suggest that regulation was needed.

Former House Banking Committee Chairman Henry B. Gonzalez (D-Tex.) successfully raised the issue of the danger of derivatives in 1993, holding hearings on the financial services aspects of the North American Free Trade Agreement (at which this author testified) and on derivatives, and introduced *EIR* material into the *Congressional Record*. Gonzalez's bravery forced the Office of the Comptroller of the Currency and the FDIC to begin reporting the level of derivatives held by commercial banks. The FDIC's Quarterly Banking Profile for the third quarter of 1993 contained a new entry on the banking system's balance sheet, $12 trillion in "off-balance-sheet derivatives," more than three times the $3.6 trillion in assets of the banking system as a whole. As it turns out, the FDIC had been tracking the level of derivatives since 1990, but keeping it a secret. Gonzalez publicly credited *EIR* with bringing the issue to public attention.

While Gonzalez's efforts forced the regulators to publicly report the level of derivatives at commercial banks, opposition by Wall Street, other regulators, and most of Congress prevented him from taking further action. When the Republicans took over Congress and Jim Leach (R-Iowa) took over the chairmanship of the House Banking Committee, the Gonzalez rebellion was over.

The Financial Accounting Standards Board (FASB), which sets accounting standards for U.S. companies, has also been fighting a losing battle to impose reality on the banks' balance sheets. In 1989, the FASB proposed that all companies, including banks, be required to disclose in their financial statements, the fair market value of all financial instruments held by them. The response was swift, with Treasury Secretary Nicholas Brady warning that "this proposal could have serious, unintended effects on the availability of credit as well as on the stability of the financial system."

"I strongly urge the FASB not to adopt it at this time," Brady wrote to the FASB board.

In late 1994, with derivatives losses rocking the financial system, FASB finally issued a watered-down rule.

"While the alarm bells are sounding, it appears that the financial regulators are content to let the speculative controls burn out of control while they keep the fire trucks parked at the station," Gonzalez warned, accurately characterizing the derivatives market as "rampant speculation and gambling."

FASB continued its efforts to force some honesty into derivatives reporting, announcing in August 1997, that it would implement new standards for derivatives, effective for fiscal years beginning in 1998. Again, the response was quick. Citicorp warned that the move "is not what the marketplace wants or needs," and "Contract on America" kook Sen. Phil Gramm (R-Tex.) told the FASB that it "would be making a mistake with serious consequences for the financial markets." Federal Reserve Board Chairman Alan Greenspan wrote three letters to FASB Chairman Edmund Jenkins, demanding that the disclosure rules be scuttled.

Why the objection? "They don't want the derivatives showing up on their books. They don't want people knowing how it is affecting the company," a FASB spokesman told *EIR* at the time.

Thus far, the derivatives dealers are winning. While the FASB has not abandoned its plans for disclosure, it has postponed them until next year, allegedly so as not to conflict with possible Y2K issues.

Bashing the CFTC

Perhaps the most egregious example of pressure by bankers and their regulators, is the assault on the Commodity Futures Trading Commission in 1998, when the CFTC issued a "concept release" suggesting that it might establish some regulation over the over-the-counter (OTC) derivatives.

In early 1993, under then-chairman Dr. Wendy Gramm, the CFTC exempted much of the derivatives market from regulation, on the dubious theory that market professionals could be trusted and needed little oversight. Gramm's move helped pave the way for the surge in OTC derivatives, the same bubble her husband, Sen. Phil Gramm, has defended so heartily in the Senate. Today, Wendy Gramm sits on the board of Sir George Bush's Enron, while her husband chairs the Senate Banking Committee. They have, with their deregulation fetish, been among the more destructive couples in modern American economic history.

Gramm's replacement at the CFTC, Mary Schapiro, took office in October 1994, and promised tougher policing of the derivatives market, noting that the rash of losses by municipalities across the nation showed the need for greater regulation.

"I'm clearly more of a regulator than Wendy Gramm was," Schapiro stated.

The CFTC got even bolder under Chairman Brooksley Born, who took office in August 1996. During her nomination hearings, Born raised the issue of further regulation of the derivatives markets, noting that some derivatives contracts appeared to be illegal.

In Congressional hearings in April 1997, Born warned that the "professional markets exemption" issued by Dr. Gramm "could lead to widespread deregulation," which "would greatly restrict Federal power to protect against manipulation, fraud, financial instability, and other dangers." This, she added, would "pose grave dangers to the public interest."

"It is the large institutions which have the greatest power to hurt us all by their attempts at manipulation," Born warned.

The fact that certain derivatives were illegal was all but admitted by others who testified, including Mark Haedicke of Enron, representing the International Swaps and Derivatives Association. Haedicke complained that "legal uncertainties continue to exist" in the OTC derivatives market, because the Commodities Exchange Act "flatly prohibits off-exchange futures contracts."

"If certain swaps transactions were ever classified as 'futures contracts,' " Haedicke continued, "they would be illegal and unenforceable as a matter of law." That, Haedicke arrogantly asserted, "is obviously unacceptable in the global marketplace."

In July 1997, Chase Manhattan managing director Dennis Oakley explained the question of legality as follows: "The Commodity Exchange Act requires that all commodity futures contracts be traded on a board of trade, and that since 1974, financial products have been considered commodity futures, unless they fall within the exception of the Treasury Amendment. If a product is deemed to be a future, and is not traded on a board of trade, it is null and void."

The problem, Oakley said, "is that some of our fastest-growing products, such as equity and credit derivatives, are not covered by the exemption."

"We have no way to manage this new legal risk," he continued, adding that unless the CFTC were stopped, "Chase will be forced to move this business to another location, probably London."

The issue of legality was also addressed by a Group of 30 study released in 1993, which admitted that in many countries, derivatives could be considered gambling, and as such not enforceable by law. The G-30 also demanded changes to the law, to force the derivatives suckers to pay up.

The issue came to a head in May 1998, when the CFTC issued a "concept release" announcing that it was "reexamining its approach to the OTC derivatives market." It was, given the derivatives mania which pervades Wall Street and its pets in Washington, a declaration of war.

The response, again, was immediate and forceful. On May 7, the day the CFTC issued the release, Fed Chairman Greenspan, Treasury Secretary Robert Rubin, and SEC Chairman Arthur Levitt issued a joint statement denouncing the CFTC's action.

"We have grave concerns about this action and its possible consequences," the statement said. "The OTC derivatives market is a large and important global market. We seriously question the scope of the CFTC's jurisdiction in this area, and we are very concerned about reports that the CFTC's actions may increase the legal uncertainty concerning certain types of OTC derivatives."

On June 5, Greenspan, Rubin, and Levitt sent a joint letter to House and Senate leaders, demanding legislation to prohibit the CFTC from reexamining the OTC derivatives market; attached to the letter was a legislative proposal which, they said, "seeks to protect this market from unnecessary, and potentially damaging, legal uncertainty."

The letter said that the President's Working Group on Financial Markets, created after the 1987 stock market crash, would conduct a year-long study of the OTC market, to see if any changes were needed. That study, released in November 1999, not surprisingly concluded that the CFTC should keep its hands off the OTC derivatives markets, and urged Congress to "clarify" the OTC's lack of authority in the area.

Faced with such opposition, and the threat that the CFTC would be forcibly neutered through revisions to the Commodity Exchange Act, the CFTC decided to wield the knife itself. Brooksley Born was forced to resign, replaced by former Kidder Peabody banker and money manager William Rainer. (Kidder Peabody was driven bankrupt by derivatives losses in 1994.)

In a speech to a Chicago commodities conference on Oct. 28, 1999, Rainer signalled to all that the CFTC had been brought to heel. "The CFTC must embark on a process that may result in a major deregulation of financial futures markets," he said, promising to shift the agency "from being a front-line regulator to an oversight regulator. While the financial futures markets are most in need of regulatory reform, all of our contract markets would benefit from a lighter regulatory hand."