Click here for Full Issue of EIR Volume 33, Number 43, October 27, 2006

EIR Economics

The News Is the 'Non-News' Of the Financial Collapse

by the Economics Staff

Lyndon LaRouche warned earlier this year, that September/ October would be the likely time period for this crash phase of the collapse. Now it has come to pass, despite any pre-U.S. elections happy talk you may hear about the 12,000 level of the Dow Index, and all the polite, reserved "warnings" on hedge funds. What is evident is merely an attempt to contain the panic.

A broad pattern of attention to dangers from hedge funds is evident throughout this Fall's international financial media, and among lawmakers and banking officials from many countries. Below are items from the United States, Britain, and Germany, over the week of Oct. 16-20. But the character of all these news headlines, is a glaring generalized condition of non-news about the financial blow-out process already under way. *In fact, on the very same pages as coverage of hedge fund jitters, you will find articles equivalent to "dog bites man."*

Meantime, there are spectacular chain reaction effects of non-payment, non-saleability, and other financial and economic impacts hitting whole categories of activity, especially real estate. Locust/equity funds are swarming over what's left of industry, infrastructure, and services, furthering the economic breakdown process.

We provide the following review of the recent spate of attention to hedge funds, with a proviso: By themselves, the threats of regulation are not going anywhere. But were regulations implemented, they would only be a precursor to the thorough overhaul of the bankrupt world financial system, which, if carried out in the tradition of FDR's Bretton Woods, is the only approach that can save the system.

Officials, Media 'Tut Tut' Over Hedge Funds

Oct. 16: Sen. Chuck Grassley (R-Iowa), chairman of the Senate Finance Committee, sent a letter to Treasury Secretary Henry M. Paulson, Jr., saying he was "deeply concerned about the lack of publicly available information regarding hedge funds . . . concerned that tens of millions of Americans may be unwittingly tied to hedge fund investments through their participation in public and private pension plans, and yet would have no way of knowing it.

"Today, the hedge fund industry is comprised of over 9,000 hedge funds that manage over $1.1 trillion in asssets . . . [but they] are not subject to disclosure and transparency rules. . . ."

An Oct. 16 press release from Senator Grassley's office, providing the text of the letter, was titled, "Grassley Seeks Multi-Agency Response on Lack of Hedge Fund Transparency, Expresses Alarm at Risk to Pension-Holders." (See Grassley.Senate.gov.)

Oct. 16: the *Financial Times* of London carried no fewer than four articles on hedge funds, summarizing on its front page: "Policymakers believe fresh hedge fund regulation may be needed to avoid a catastrophic failure and it may no longer be enough to rely on banks and other counterparties to manage their exposure to the booming industry."

Two of the four *Financial Times* articles were by Jeremy Grant, based in Washington. He cited unnamed sources close to the President's Working Group on Financial Services who say that some form of regulation is being discussed. In "U.S. Rethinks on Hedge Fund Rules; Policymakers Consider Fresh Regulation to Avert Financial Crisis," Grant wrote, "The $6

© 2006 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

billion losses at hedge fund Amaranth have thrust into the spotlight concerns over the systemic risks associated with the $1,500 billion industry."

In addition, the Oct. 16 *Financial Times* editorial, "Not So Private Equity; Buy-Out Houses Need To Become More Open," cited investigations in the U.K., Germany, and the U.S.A. on collusion and bad practices that private equity companies engage in to conduct corporate buy-outs.

Oct. 16: *The Daily Telegraph* of London carried an article on how "hedge fund capitalism" is going out of favor in Europe. Titled, "Rumblings of Revolt in Europe as Sweat-Shop Capitalism Grows," the column was written by Ambrose Evans-Pritchard, a hack paid to slander LaRouche and President Clinton in the past. It reviewed the growing revulsion against hedge funds in various European nations, citing profiteering from falling wage rates and loss of jobs. For example, in Austria, the EU 24 billion merger of OMV and Verbund was cancelled by the government, because it would have axed jobs. In Italy, Telecom Italia is going back under state control, after a debacle under privatization.

Oct. 16: *The New York Times* ran a front-page article titled, "As Lenders, Hedge Funds Draw Insider Scrutiny; Role in Debt Market Provides Easy Access to Privileged Data." This notes that in the past, corporations had a private, privileged, confidential relationship with their banks. But today, when corporate officers speak with their hedge fund financiers, wild stock speculation ensues because of leaks about the corporation's financial condition. This amounts to illegal insider trading. But it is not uncommon.

Oct. 16: *Forbes* posted an article, "A Dangerous Game," by Daniel Fisher, which began, "Hedge funds have gotten rich from credit derivatives. Will they blow up? The downfall of Amaranth Advisers, the hedge fund that lost $6 billion in a single week by betting on natural gas was a special case. There was no domino effect taking down energy traders generally, no meltdown of an industry. But if you want to fret over the next financial catastrophes, turn your gaze away from energy futures and focus on something far more obscure: credit default swaps. Hedge funds are neck-deep in these derivatives, and if something goes wrong, the pain will be widespread. . . ."

Oct. 17: Sir John Gieve, deputy director of the Bank of England, issued a warning over aggressive risk-trading by hedge funds. According to Oct. 18 *The Times* of London, "Sir John questioned whether some funds would survive the stress of severe market turbulence. He noted that the huge growth in hedge fund activity had taken place in a largely 'benign environment', and that firms' risk management had yet to be 'tested by a severe shock.' Sir John said that 'some comfort' could be taken from the lack of wider market disruption after the collapse of Amaranth Advisors, a US hedge fund, with losses of $6.5 billion. But in a stark message, he argued that future failures could have graver repercussions."

Gieve is then quoted, saying: "We should not conclude that it will be as smooth and easy next time—and of course there will be a next time. If we face a financial crisis in the next few years, we are almost bound to find some hedge funds at or near the centre of it."

Oct. 17: Peer Steinbrueck, Finance Minister of Germany, said that the new sensitivity shown in the United States about the systemic risks of hedge funds, offers a new opportunity to discuss the issue. "The discussion in the United States is qualitatively very different from what it was four or five years ago. The case of Amaranth seems to have played a role in this. We see clear signs of rising interest in the United States about ways to boost transparency of such funds." (From the Oct. 18 *Financial Times,* see below).

Oct. 17: Edgar Meister, board member of the Bundesbank in Germany, said that what happened to Amaranth was "not a single case in the hedge fund sector in recent history." There have been other cases, but have not been made public, due to the lack of transparency. But rather than enjoying the "illusion of security," Meister said we should see what happened to Amaranth as a "warning and a call for action." (From the Oct. 18 *Financial Times,* see below).

Oct. 18: the *Financial Times* of London reported on the statements of the German officials, noting that, "Germany is putting hedge fund transparency on the agenda of next year's meeting of the Group of Eight leading industrial nations in the wake of the Amaranth debacle." After quoting from Minister Steinbrueck, the *Financial Times* reported, "G-7 finance ministers will tackle ways to improve transparency of hedge funds when Berlin takes up the presidency of the G-8 next year, according to a draft programme for today's German cabinet meeting."

The *Financial Times* stressed that neither Minister Steinbrueck nor Bundesbank Board Member Meister want regulation. Steinbrueck is quoted from Oct. 17, "We are not talking about new regulation here. The question is really one of transparency." Meister, cited as having the same view, said that increasing attention to "transparency" could mean making hedge funds a target of independent rating agencies.

Oct. 18: Derivative Fitch was announced by Fitch Ratings, to serve as a new private agency to rate offerings in the credit derivatives market, which is estimated to now be approaching the $33 trillion level in notational value. Fitch Group Inc., is a subsidiary of Fimalac S.A., headquartered in Paris.

Oct. 18: *The Times* of London, in reporting the Oct. 17 warnings by Bank of England Deputy Director Sir John Gieve, notes that the British Treasury will soon launch a new review of hedge fund regulation. "Amid growing pressure for increased regulation of hedge funds in the United States and Europe, the Treasury believes that Britain's policing of the industry will need to be re-examined rigorously. However, it is also understood that the Treasury remains sceptical over the case for a tougher regime of oversight of hedge funds."