Financial Market Actors: The Fiction of "Regulation" of Global Banking

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"Markets have become too huge, complex, and fast-moving to be subject to twentieth-century supervision and regulation. No wonder this globalized financial behemoth stretches beyond the full comprehension of even the most sophisticated market participants. Financial regulators are required to oversee a system far more complex than what existed when the regulations still governing financial markets were originally written. " |1|

This remark by Alan Greenspan, chairman of the US Federal Reserve bank from 1987 to 2006, has been repeated by all the leaders of the highly industrialised countries. They have imagined that the banks and other financial corporations would discipline themselves whilst satisfying their own egotistical interests. Alan Greenspan adds: "Today, oversight of these transactions is essentially by means of individual-market-participant counterparty surveillance. Each lender, to protect its shareholders, keeps a tab on its customers' investment positions. Regulators can still pretend to provide oversight, but their capabilities are much diminished and declining." |2|

The supposed will of banks, and other financial market actors, to self-discipline themselves is a smokescreen allowing them to do whatever they like. Alan Greenspan, all the leaders of the industrialised countries, an army of experts and financial pundits are all unashamed liars who think they can treat the citizens like idiots, repeating 'ad nausea' the old song of self-regulated markets. "Since markets have become too complex for effective human intervention, the most promising anticrisis policies are those that maintain maximum market flexibility—freedom of action for key market participants such as hedge funds, private equity funds, and investment banks" |3|

The financial catastrophes of 2007 – 2008 and their dramatic and durable effects are a stinging denial to these incantations. Financial market actors are totally incapable of regulating themselves and have neither the desire and certainly not the will to do so. As the history of capitalism and its crises clearly shows. So the policymakers have adopted a different line "Self-discipline to reply to problems is over, laissez-faire is over, the markets are always right is over." |4|. In fact, six years after the beginning of the crisis, five years after announcing a return to controls, there has been nothing more than a captivating spin. Leaders and lawmakers, in cosy complicity with the banks, have taken very few real and restrictive measures concerning financial companies.

One serious measure in an ocean of laxity

Since the 1st November 2012, in the European Union it has become prohibited to buy *Credit Default Swaps* (CDS – see below) to hedge against sovereign debt default if one does not possess this debt |5|. The penalties for doing so have been left to the discretion of each State. This gives a lot of leeway to banks and other financial societies who would dare to brave or break this regulation. It is about the only significant measure that has been taken to introduce some order into the financial sector.

What is a CDS?

The *Credit Default Swap*(CDS) is a financial derivative product, created at the beginning of the 1990s, during an intense period of financial deregulation, which is not subjected to any public control. Its original purpose was to be a creditor's insurance, provided by the seller of the CDS, against default on obligations repayments, whether the obligations are issued by a public administration or by a private company.

However, it is possible to purchase CDS cover for this kind of risk without holding the corresponding obligation (a practice that has been prohibited in the EU since November 2012 for the minimal 5 to 7% of the CDS market concerning sovereign debt). This is like insuring your neighbours house against fire in the hope that it will burn down, so as to collect the indemnity. The other risk linked to CDSs is the lack of financial means available to indemnify all the big CDS holders.

Should there be a series of bankruptcies by private companies having issued obligations, or default by an important bond issuing country, it is quite probable that the CDS sellers will be unable to cover their promises.The disaster experienced by AIG, the biggest North American international insurance company, in August 2008 (nationalised by President George W. Bush to avoid its total collapse) and the bankruptcy of Lehman Brothers are the direct result of their important spread on the CDS markets where they were very active.

The Dodd-Franck act in the United-States and the half-hearted European measures

In the US, a new law, which is half-hearted when compared to the regulations imposed by Franklin D. Roosevelt in 1933 (see below) was adopted during the first Barack Obama term. This is the Dodd-Franck Wall street reform and consumer protection act (which includes the Volcker rules) |6|. Although this law was passed in 2010 the application is delayed. The banks and their lobbyists along with Congressmen and Senators, both Democrats and Republicans, who are under their influence, have managed to severely limit this already half-hearted legislation. |7|.

The separation of deposit banks and investment banks during the Roosevelt administration

One of the important measures taken by the Roosevelt administration and the European governments (notably under pressure from the European popular movements after the Second World War) was to limit and to strictly regulate the way banks could use public money.

This principle of protecting deposits resulted in the separation of deposit banks from merchant banks. The Glass Steagall Act is the best known example of this measure. It was applied for decades, with local variations, in European countries.After this separation the peoples deposits that had a State guarantee could only be handled by deposit banks. At the same time their field of action was restricted to household and business loans, excluding bond issues, stock exchange activities and all other financial instruments, these activities were the domain of merchant banks that had to find their resources on the financial market.

In the UK, the Vickers commission presented its recommendations to the authorities in 2011, but their response is still awaited. The governor of the Bank of Finland, Errki Liikanen, presented his report commissioned by the EU in October 2012. These two reports go in the same direction as the Dodd-Franck act and the Volcker regulations: |8| starting to ring-fence different banking activities. Neither of them suggest returning to the Glass-Steagall act or to the similar regulations that were in force in Europe at the same time. Nobody suggests a frank separation between deposit and investment bank activities, or the dismantlement of what is known as universal banks, also called full-service financial firms. These banks are active in all the banking sectors from retail banking to commercial and investment banking, including underwriting and asset management. They intervene within their national territories and outside their countries through their different branch offices and subsidiaries. The great danger here are losses in one of the high risk related activities having to be supported by the deposits in the other, base activities, so putting savers funds in danger. This was the primary concern of Roosevelt and the European governments in the 1930s and 1940s, which resulted in banking regulations that made watertight sectors of these different activities. The Dodd-Franck act, the propositions of the Vickers and Liikanen commissions, the French banking reform law project put before the National Assembly in December 2012 |9|, are half-hearted; creating uncertain separations which will prove to be inefficient and limited (if they are ever applied). The commercial and investment sectors within banks do not hesitate to divert savers' funds towards their riskier activities and they will continue to do so because no serious and restrictive measures have been taken against them. |10| In addition, since deposit banks and commercial and investment banks belong to the same general banking structure, any losses of the commercial and investment sectors will be supported by the retail section (e.g. in France the losses of Natixis bank were paid for by 'Banque Populaire' and 'Caisse d'Epargne' within the BPCE group).

The banks put on the pressure to continue as they see fit

Although the Vickers and Liikanen recommendations are very conciliatory towards the bankers, as is the case in the US, the heads of private banks in the EU are organising intense lobbying so that these propositions remain on the shelf. *Challenges*, a French financial weekly magazine, reports the reaction of the French banking sector to the Liikanen report. "Most of these kind of reports have ended up in the waste paper basket" said one banker who accepted to speak to Challenges, "Liikanen hardly knows what a bank is" quipped another. "Finland only has subsidiaries or branches of foreign banks". Challenges goes on to present a differing opinion from Martin Wolf, editorialist at the Financial Times: "This is a step forward. But the next ones must be further forward, not backward.". |11| The *Financial Times* has also investigated the banking system. In its columns, Christian Clausen, CEO of the Swedish bank Nordea and president of the European Banking Federation, said that the Liikanen report was completely wrong to propose separation between retail banking and trading activities. |12|. Members of the different elected bodies and high ranking civil servants on both sides of the Atlantic, are facing intense pressures. Banks are able to count on the solid support of their highly placed allies, starting with Mario Draghi, President of the European Central Bank and ex-director of Goldman Sachs.

The voices of a few oversight authorities are starting to rise against laxity

Among the oversight authorities a few voices are rising to criticise the absence of effective banking regulations. Andrew Haldane, director of the department of financial stability at the

Bank of England, spoke out, at a financial directors meeting, in London in October 2012, criticising the fact that the 29 SIFIs (Systemically Important Financial Institutions – see below) take advantage of the dangers their crashes would produce in order to obtain,, cash flow from, among others, the BCE, the Federal Reserve and the Bank of England in favourable conditions. He considers that the credits advanced to them by the public institutions amount to an annual subvention of $700 billion.

The G20's list of SIFIs (*Systemically Important Financial Institutions*)In November 2011 the G20 established a list of *Systemically Important Financial Institutions (SIFIs)*. Just like 'Lehman Brothers' these banks are considered to be too important for their governments to let them to go bankrupt, they are *too big to fail*. By their size, and the effects that would result if one of them failed, they have become preponderant in the international financial system. In 2011, among the 29 banks listed eight were of US origin (JP Morgan, Bank of America, Morgan Stanley, Goldman Sachs, Citigroup, Bank of New York Mellon, Wells Fargo, State Street), four British banks (HSBC, Lloyds, Barclays and Royal Bank of Scotland), four French (Societe Generale, Credit Agricole, BNP Paribas and BPCE), three were Japanese (Sumitomo, Mitsubishi UFJ FG, Mizuho FG), two German banks (Deutsche Bank and Commerzbank), two Swiss (UBS, Crédit suisse), one each from Italy (Unicredit), Spain (Santander), the Netherlands (ING), Sweden (Nordea), and China (Bank of China) and one Franco-Belgian (Dexia). In 2012, the G20 withdrew three banks from the list (Dexia, Commerzbank and Lloyds), and added two (the Spanish 'BBVA', and the British 'Standard Chartered').

Andrew Haldane claims that the higher ratio of assets to equity which will be generalised in 2018 – 2019 is totally insufficient and will, in no way, reduce the effects of a bankruptcy. He recommends the drastic reduction of the size of banks. Thomas Hoenig, at the US Federal Deposit Insurance Corporation, an institution created during F. D. Roosevelt's presidency of the United States to regulate the banking system, states that the separations put into place between the different banking activities are in fact porous. He supports the adoption of 'Glass-Steagall' type regulations to radically ring-fence merchant banking from retail banking. He also estimates that the levels of equity required as from 2018 – 2019 should be increased by at least threefold. |13|

Epilogue: Victory of the bankers thanks to the oversight authorities

In January 2013, the Basel committee |14| postponed the application of one of its principal measures, the *liquidity coverage ratio* (LCR) regulation, requiring banks to constitute reserves capable of affronting a crisis for thirty days. The measure was to have applied as of 2015, but it has been postponed until 2019! The financial press clearly announced this decision on its front pages as a victory for the banks and a step backwards for the authorities. A *Financial Times* title on 8 January 2013 said, "European banks gain after Basel rules eased" |15| *The Economist* headlined: "Bank liquidity. Go with the Flow. Global regulators soften their stance on liquidity" |16|. Not only has the application of these rules been postponed to 2019, in other words 'put off indefinitely', but the banks may include in the LCR; structured and other toxic products. It's all poppycock.

More news to please the bankers came a few weeks later. Michel Barnier, European Commissioner in charge of financial affairs announced that he will not follow the principal recommendation of the Liikanen report concerning the separation of deposit banking and trading activities. Headlines in the the *Financial Times* on 30 January 2013 read: "Brussels retreat on key bank reform" |17|. The paper explains that the European commission has retreated in its proposition to protect deposit banking activities from the undesirable effects that may arise from highly speculative and risky trading activities.

Conclusion: It is necessary to break away from the dictatorship of the banking system. Through a radical shift in policies, it would be possible to protect the deposits of ordinary people, to finance socially useful production and guarantee employment and the working conditions in the sector. These changes would require a public service for savings, loans and investment. Banking (the service that protects savings and supplies loans for social uses such as productive development) is too important to be left in the hands of a small number of private bankers (the 1% as the 'Occupy Wall Streets now call them), who, by definition seek only to maximise their profits. Speculation and all activities that support it must be prohibited, and so must all transactions related to tax havens. Since banks use our money, enjoy state guarantees, and must provide the fundamental services society needs they must be socialised and placed under citizen's control. |18|

Translation : Mike Krolikowski and Charles La Via

Part 1
Part 2
Part 3
Part 4
Part 5
Part 6

notes articles:

|1| Alan Greenspan, *The Age of Turbulences*, Penguin press, New York, 2007, 2007, p. 529.

|2| Idem

|3| Idem, p. 530.

|4| Speech by Nicolas Sarkozy, le 25 September 2008 in Toulon (mentioned by Eric Toussaint et Damien Millet, *AAA. Audit Annulation Autre politique*, Seuil, 2012, p. 34).

|5| Source: Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps Text with EEA relevance http://eur-lex.europa.eu/LexUriServ...
As the title indicates short selling is also considered. Short selling is the sale of a stock that we do not hold at the moment, but intend to buy later to balance the end of the account. The regulations contain numerous exceptions that will permit the practise to continue.
See also:http://www.lemonde.fr/economie/arti...

|6| See Daniel Munevar, "Un pequeño recordatorio de parte de JP : La importancia de la Volcker Rule", 25 May 2012 (in Spanish only), http://cadtm.org/Un-pequeno-recorda...

|7| See Matt Taïbbi, "How Wall Street Killed Financial Reform", *Rolling Stone*, 10 May 2012, http://www.rollingstone.com/politic.... See also *Les Echos*, "La réforme de Wall Street reste aux deux tiers inachevée" (in French), 12 December 2012, p. 28.

|8| See Erkki Liikanen (chairperson), *High-level Expert Group on reforming the structure of the EU*

banking sector, October 2012, Brussels. Erkki Liikanen is governor of the Finnish central Bank. At the initiative of Michel Barnier, eleven experts formed a work group to diagnose the situation of European banks and to propose reforms to the European banking sector. One of the interesting points of the Liikanen report is its official confirmation of the depravity of the banks, the staggering risks taken to make maximum profit. The group was created in February 2012, and delivered its report in October 2012. See: http://ec.europa.eu/internal_market... The data concerning the day-to-day financing needs is found in chart 2.5.1, p.27. This document will hereafter be called the Liikanen report.

|9| See complete text: http://www.assemblee-nationale.fr/1...

|10| See the excellent critic by Gaël Giraud of the proposed banking reform act in France and on the Dodd Franck, Vickers et Liikanen reports: http://www.lavie.fr/www/files/media... Gaël Giraud shows that the propositions are more favourable to the status quo and so to the banks than the recommendations made by the commissions. See also: ATTAC, "Les 20 propositions d'Attac pour une véritable réforme bancaire", 14 February 2013, http://www.france.attac.org/article (these articles are in French)

|11| *Challenges*, «La cloison bancaire est bien fragile», 11 October 2012, p. 28 See also : "I fear that under the pressure of the bankers too much trading will become exempted from separation measures. Martin Wolf in Financial Times "Liikanen is at least a step forward for EU banks", 4 October 2012.

|12| *Financial Times*, "Nordea chief takes a swipe at Liikanen", 30 October 2012.

|13| Remarks taken from Andrew Haldane and Thomas Hoenig in: *Financial Times*, "Warnings over steps to reform biggest banks", 28-29 October 2012, p. 3.

|14| The Basel committee unites the central bankers of the G20 countries under the auspices of the Bank for International Settlements at Basel (BIS). It has four principal missions: the reinforcement of the security and reliability of the financial system, the establishment of minimum standards in the prudential control of banks, the promotion and development of better banking practices and the promotion and cooperation in matters of international prudential control.

|15| *Financial Times*, "European banks gain after Basel rules eased", 8 January 2013.

|16| *The Economist*, "Bank liquidity. Go with the Flow. Global regulators soften their stance on liquidity", 12 January 2013, p. 60.

|17| *Financial Times*, "Brussels retreat on key bank reform", 30 January 2013.

|18| See Patrick Saurin, "Socialiser le système bancaire" (in French), 2 February 2013, http://cadtm.org/Socialiser-le-syst...

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