Financial Meltdown and the Bailouts: The Role of Speculative Trade. Wall Street Criminality on Display

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The Role of Bailouts and Speculative trade

The elimination of the Glass-Steagall Act in November 1999 was essential to the process of dramatically cutting back the government's role as a protector of the public interest on the financial services sector. The Glass-Steagall Act was an essential measure in US President Franklin D. Roosevelt's New Deal.

Some view the New Deal as a strategy for saving capitalism by moderating ts most sharp-edged features. Instituted in 1933 in response to the onset of the Great Depression, the Glass-Steagall Act separated the operations of deposit-accepting banks from the more speculative activity of investment brokers.

The termination of the regulatory framework put in place by the Glass Steagall Act opened much new space for all kinds of experiments in the manipulation of money in financial markets. The changes began with the merger of different sorts of financial institutions including some in the insurance field. Those overseeing the reconstituted entities headquartered on Wall Street took advantage of their widened latitudes of operation. They developed all sorts of ways of elaborating their financial services and presenting them in new packages.

The word, "derivative" is often associated with many applications of the new possibilities in the reconstituted financial services sector. The word, derivative, can be applied to many kinds of transactions involving speculative bets of various sorts. As the word suggests, a derivative is *derived* from a fixed asset such as currency, bonds, stocks, and commodities. Alterations in the values of fixed assets affect the value of derivatives that often take the form of contracts between two or more parties.

One of the most famous derivatives in the era of the financial crash of 2007-2010 was described as mortgaged-backed securities. On the surface these bundles of debt-burdened properties might seem easy to understand. But that would be a delusion. The value of these products was affected, for instance, by unpredictable shifts in interest rates, liar loans extended to homebuyers who lacked the capacity to make regular mortgage payments, and significant shifts in the value of real estate.

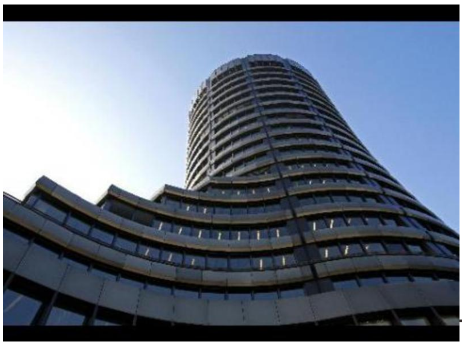
President Bill Clinton Laughs It Up as He Signs the Repeal of the Glass-Steagall Act. November 12 1999. Financial Services Modernization Act

Mortgage-backed securities were just one type of a huge array of derivatives invented on the run in the heady atmosphere of secret and unregulated transactions between counterparties. Derivatives could involve contracts formalizing bets between rivals gambling on the outcome of competitive efforts to shape the future. An array of derivative bets was built around transactions often placed behind the veil of esoteric nomenclature like “collateralized debt obligations” or “credit default swaps.”

The variables in derivative bets might include competing national security agendas involving, for instance, pipeline constructions, regime change, weapons development and sales, false flag terror events, or money laundering. Since derivative bets involve confidential transactions with secret outcomes, they can be derived from all sorts of criteria. Derivative bets can, for instance, involve all manner of computerized calculations that in some cases are constructed much like war game scenarios.

The complexity of derivatives became greater when the American Insurance Group, AIG, began selling insurance programs to protect all sides in derivative bets from suffering too drastically from the consequences of being on the losing side of transactions.

The derivative frenzy, sometimes involving bets being made by parties unable to cover potential losses, overwhelmed the scale of the day-to-day economy. The “real economy” embodies exchanges of goods, services, wages and such that supply the basic necessities for human survival with some margin for recreation, travel, cultural engagement and such.

The Swiss-based Bank of International Settlements (image right) calculated in 2008 that the size of the all forms of derivative products had a monetary value of $1.14 quadrillion. A quadrillion is a thousand trillions. By comparison, the estimated value of all the real estate in the world was $75 trillion in 2008.

[Bank for International Settlements, *Semiannual OTC derivative statistics at end-December*, 2008. See this]

As the enticements of derivative betting preoccupied the leading directors of Wall Street institutions, their more traditional way of relating to one another began to falter. It was in this atmosphere that the Repo Market became problematic in December of 2007 just as it showed similar signs of breakdown in September of 2019.

In both instances the level of distrust between those in charge of financial institutions began to falter because they all had good reason to believe that their fellow bankers were overextended. All had reason to believe their counterparts were mired by too much speculative activity enabled by all sorts of novel experiments including various forms of derivative dealing.

In December of 2007 as in the autumn of 2019, the Federal Reserve Bank of New York was forced to enter the picture to keep the financial pumps on Wall Street primed. The New York Fed kept the liquidity cycles flowing by invoking its power to create new money with the interest charged to tax payers.

As the financial crisis unfolded in 2008 and 2009 the Federal Reserve, but especially the privately-owned New York Federal Reserve bank, stepped forward to bail out many financial institutions that had become insolvent or near insolvent. In the process precedents and patterns were established that are being re-enacted with some modifications in 2020.

One of the innovations that took place in 2008 was the decision by the Federal Reserve Bank of New York to hire a large Wall Street financial institution, BlackRock, to administer the bailouts. These transfers of money went through three specially created companies now being replicated as Special Purpose Vehicles in the course of the payouts of 2020.

In 2008-09 BlackRock administered the three companies named after the address of the New York Federal Reserve Bank on Maiden Lane. BlackRock emerged from an older Wall Street firm called Blackstone. Its former chair, Peter C. Peterson, was a former Chair of the Federal Reserve Bank of New York.

The original Maiden Lane company paid Bear Stearns Corp $30 billion. This amount from the New York Fed covered the debt of Bear Stearns, a condition negotiated to clear the way for the purchase of the old Wall Street institution by JP Morgan Chase. Maiden Lane II was a vehicle for payouts to companies that had purchased "mortgage-backed securities" before these derivative products turned soar.

Maiden Lane III was to pay off "multi-sector collateralized debt obligations." Among these bailouts were payoffs to the counterparties of the insurance giant, AIG. As noted, AIG had developed an insurance product to be sold to those engaged in derivative bets. When the bottom fell out of markets, AIG lacked the means to pay off the large number of insurance claims made against it. The Federal Reserve Bank of New York stepped in to bail out the counterparties of AIG, many of them deemed to be "too big to fail."

Among the counterparties of AIG was Goldman Sachs. It received of $13 billion from the Federal Reserve. Other bailouts to AIG's counterparties were $12 billion to Deutsche Bank, $6.8 billion to Merrill Lynch, $5 billion to Switzerland's UBS, $7.9 billion to Barclays, and $5.2 billion to Bank of America. Some of these banks received additional funds from other parts of the overall bailout transaction. Many dozens of other counterparties to AIG also received payouts in 2008-2009. Among them were the Bank of Montreal and Bank of Scotland.

The entire amount of the bailouts was subsequently calculated to be a whopping $29 trillion with a "t." The lion's share of these funds went to prop up US financial institutions and the many foreign banks with which they conducted business. (See this)

Much of this money went to the firms that were shareholders in the Federal Reserve Bank of New York or partners of the big Wall Street firms. Citigroup, the recipient of the largest amount, received about $2.5 trillion in the federal bailouts. Merrill Lynch received $2 trillion.

The Federal Reserve Bank was established by Congressional statute in 1913. The Federal Reserve headquarters is situated in Washington DC. The Central Bank was composed of twelve constituent regional banks. Each one of these regional banks is owned by private banks.

The private ownership of the banks that are the proprietors of the Federal Reserve system has been highly contentious from its inception. The creation of the Federal Reserve continues to be perceived by many of its critics as an unjustifiable giveaway whereby the US government ceded to private interests its vital capacity to issue its own currency and to direct monetary policy like the setting of interest rates.

Pam Martens and Russ Martens at *Wall Street on Parade* explain the controversial Federal Reserve structure as follows

> While the Federal Reserve Board of Governors in Washington, D.C. is deemed an "independent federal agency," with its Chair and Governors appointed by the President and confirmed by the Senate, the 12 regional Fed banks are private corporations owned by the member banks in their region. The settled law under John L. Lewis v. the United States confirms: "Each Federal Reserve Bank is a separate corporation owned by commercial banks in its region."
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> In the case of the New York Fed, which is located in the Wall Street area of Manhattan, its largest shareowners are behemoth multinational banks, including JPMorgan Chase, Citigroup, Goldman Sachs and Morgan Stanley.

There was no genuine effort after the financial debacle of 2007-2010 to correct the main structural problems and weaknesses of the Wall Street-based US financial sector. The Dodd-Frank Bill signed into law by US President Barack Obama in 2010 did make some cosmetic changes. But the main features of the regulatory capture that has taken place with the elimination of the Glass-Steagall Act remained with only minor alterations. In particular the framework was held in place for speculative excess in derivative bets.

In the summer edition of the *The Atlantic,* Frank Partnoy outlined a gloomy assessment of the continuity leading from the events of 2007-2010 to the current situation. This current situation draws a strange contrast between the lockdown-shattered quality of the economy and the propped-up value of the stock market whose future value will in all probability prove unsustainable. Partnoy writes,

> It is a distasteful fact that the present situation is so dire in part because the banks fell right back into bad behavior after the last crash—taking too many risks, hiding debt in complex instruments and off-balance-sheet entities, and generally exploiting loopholes in laws intended to rein in their greed. Sparing them for a second time this century will be that much harder. (See this)

Wall Street Criminality on Display

The frauds and felonies of the Wall Street banks have continued after the future earnings of US taxpayers returned them to solvency after 2010. The record of infamy is comparable to that of the pharmaceutical industry.

The criminal behaviour in both sectors is very relevant to the overlapping crises that are underway in both the public health and financial sectors. In 2012 the crime spree in the financial sector began with astounding revelations about the role of many major banks in the LIBOR, the London Interbank Offered Rate. The LIBOR rates create the basis of interest rates involved in the borrowing and lending of money in the international arena.

When the scandal broke there were 35 different LIBOR rates involving various types of currency and various time frames for loans between banks. The rates were calculated every day based on information forwarded from 16 different banks to a panel on London. The reporting banks included Citigroup, JP Morgan Chase, Bank of America, UBS, and Deutsche Bank. The influence of the LIBOR rate extended beyond banks to affect the price of credit in many types of transactions.

The emergence of information that the banks were working together to rig the interest rate created the basis for a huge economic scandal. Fines extending from hundreds of millions into more than a billion dollars were placed on each of the offending banks. But in this instance and many others to follow, criminality was attached to the financial entities but not to top officials responsible for the decisions that put their corporations on the wrong side of the law.

One of the factors in the banking frauds comprising the LIBOR scandal was the temptation to improve the chance for financial gains in derivative bets. The biggest failure of the federal response to the financial meltdown of 2007-210 was that little was done to curb the excesses of transactions in the realm of derivatives.

Derivatives involved a form of gambling that exists in a kind of twilight zone. This twilight zone fills a space somewhere between the realm of the real economy and the realm of notional value. Notional values find expression in unrealized speculation about what might or might not come to fruition; what might or might not happen; who might win and who might lose in derivative speculations.

The addiction of Wall Street firms to derivative betting remains unchecked to this day.

The bankers' continuing fixation with unregulated gambling, often with other people's money, is deeply menacing for the future of the global economy…. indeed for the future of everyone on earth.

According to the Office of the Controller of Currency, in 2019 JP Morgan Chase had $59 trillion in derivative bets. In July of 2020 it emerged that Citigroup held $62 trillion in derivative contracts, about $30 trillion more than it held before it was bailed out in 2008. In 2019 Goldman Sachs held $47 trillion and Bank of America held $20.4 trillion in derivate bets. (See this)

A big part of the scandal embodied in these figures is embedded in the reality that all of these banks carry their most risky derivative bets in units of their corporate networks that are protected by the Federal Deposit Insurance Corporation. This peril played a significant part in deepening the crisis engendered by financial meltdown that began in 2007.

One of the most redeeming feature of the Dodd-Frank Act as originally drafted was a provision preventing financial institutions from keeping their derivative portfolios in banks whose deposits and depositors were backed up by federal insurance. (See this)

Citigroup led the push in Congress in 2014 to allow Wall Street institutions to revert back to a more deregulated and danger-prone economic environment. The notoriously inept decisions and actions of Citigroup had played a significant role in the lead up to the financial debacle of 2007 to 2010. Since 2016 Citigroup has become once again the biggest risk taker by loading itself up with more derivative speculations than any other financial institution in the world.

By returning derivative speculations to the protections of federal financial backstops, taxpayers are once again forced to assume responsibility for the most outlandish risks of Wall Street's high rollers. It is taxpayers who are the backers of the federal government when it comes to their commitment to compensate banks for losses, even when these losses come about from derivative bets.

How much more Wall Street risk and public debt can be loaded onto taxpayers and even onto generations of taxpayers yet unborn? How is national debt to be understood when it plunders working people to guarantee and augment the wealth of the most privileged branches of society? Why should those most responsible for creating the most excessive risks to the financial wellbeing of our societies be protected from bearing the consequences of the very risks they themselves created?

Along with Citigroup, JP Morgan Chase stands out among a group of financial sector reprobates most deeply involved in sketchy activities that extend deep into the realm of criminality. In a simmering scandal six of JP Morgan Chase's traders have been accused of breaking laws in conducting the bank's futures trading in the value of precious metals. They have been accused of violating the RICO statute, a law meant for people suspected of being part of organized crime. (See this)

In the charges pressed by the Justice Department on JP Morgan Chase's traders it is alleged that they "conducted the affairs of the [minerals] desk through a pattern of racketeering activity, specifically, wire fraud affecting a financial institution and bank fraud." (See this)

In 2012 JP Morgan Chase faced a $1 billion fine for its role in the "London Wale" series of derivative bets described as follows by the Chair of the US Senate's Permanent Subcommittee on Investigation. Senator Carl Levin explained,"Our findings open a window into the hidden world of high stakes derivatives trading by big banks. It exposes a derivatives trading culture at JPMorgan that piled on risk, hid losses, disregarded risk limits, manipulated risk models, dodged oversight, and misinformed the public." (See this)

Traders at Goldman Sachs appear to have been part of the Wall Street crime spree. The tentacles of corruption in the Goldman Sachs case apparently extend deep into the US Justice Department. The case involves allegations of embezzlement, money laundering and missing billions. These manifestations of malfeasance all spin out of a scandal-prone Malaysian sovereign wealth fund administered by Goldman Sachs.

A big part of the scandal reported in *Wall Street on Parade* in July of 2020 involves the fact that the Justice Department's prosecutors seem to be dragging their feet in this possible criminal felony case against Goldman Sachs. The prosecutors, including the US Attorney-General, William Barr, worked previously for the law firm, Kirkland and Ellis. Kirkland and Ellis was retained to defend Goldman Sachs in this matter. (See this)

Pam Martens and Russ Martens express dismay at the failure of US officialdom to hold Wall Street institutions accountable for the crime spree of some of its biggest firms. They write, "Congress and the executive branch of the government seem determined to protect Wall Street criminals, which simply assures their proliferation." (See this)

Even racketeering charges against officials at JP Morgan Chase, where Jamie Dimon presides as CEO, failed to receive any attention from the professional deceivers that these days dominate MSM. The star reporters of *Wall Street on Parade*write, "Crime and fraud are so *de rigueur*at the bank led by Dimon that not one major newspaper ran the headline [of the racketeering charge] on the front page or anywhere else in the paper. (See this)

While federal charges that JP Morgan Chase's Wall Street operation engaged in criminal racketeering was not of interest to the press, Jamie Dimon's surprise visit in early June to a Chase branch in Mt. Kisco New York aroused considerable media attention. Dimon was photographed with staff wearing a mask and taking the knee. By participating in this ritual Dimon signalled that his Wall Street operation is in league with the sometimes violent cancel culture pushed into prominence by the Democratic Party in partnership with Black Lives Matter and Antifa. (See this)

In an article on 21 July marking ten years since the Dodd-Frank Act of 2010, the Martens duo conclude, "So here we are today, watching the Fed conduct another secret multi-trillion dollar bailout of Wall Street while the voices of Congress and mainstream media are nowhere to be heard." (See this)

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