LIBOR: The Largest Insider Trading Scandal Ever

Big Banks Are Rotten to the Core

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Among other things, the Libor scandal is the largest insider trading scandal of all time.

It also shows that the big banks are literally rotten to the core. And see this.

UC Berkeley economics professor and former Secretary of Labor – Robert Reich – explains today:

> What's the most basic service banks provide? Borrow money and lend it out. You put your savings in a bank to hold in trust, and the bank agrees to pay you interest on it. Or you borrow money from the bank and you agree to pay the bank interest.
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> How is this interest rate determined? We trust that the banking system is setting today's rate based on its best guess about the future worth of the money. And we assume that guess is based, in turn, on the cumulative market predictions of countless lenders and borrowers all over the world about the future supply and demand for the dough.
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> But suppose our assumption is wrong. Suppose the bankers are manipulating the interest rate so they can place bets with the money you lend or repay them – bets that will pay off big for them because they have inside information on what the market is really predicting, which they're not sharing with you.
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> That would be a mammoth violation of public trust. And it would amount to a rip-off of almost cosmic proportion – trillions of dollars that you and I and other average people would otherwise have received or saved on our lending and borrowing that have been going instead to the bankers. It would make the other abuses of trust we've witnessed look like child's play by comparison.
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> Sad to say, there's reason to believe this has been going on, or something very much like it. This is what the emerging scandal over "Libor" (short for "London interbank offered rate") is all about.
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> This is insider trading on a gigantic scale. It makes the bankers winners and the rest of us – whose money they've used for to make their bets – losers and chumps.

The fact that the big banks have committed insider trading on their core function – setting rates based upon market demand for loans – is particularly damning given that traditional deposits and loans have become such a small part of their business. As we noted last week:

- The big banks no longer do very much traditional banking. Most of their business is from financial speculation. For example, less than 10% of Bank of America's assets come from traditional banking deposits. Instead, they are mainly engaged in financial speculation and derivatives. (and see this)

- The big banks have slashed lending since they were bailed out by taxpayers … while smaller banks have increased lending. See this, this and this

- A huge portion of the banks' profits comes from taxpayer bailouts. For example, 77% of JP Morgan's net income comes from taxpayer subsidies

And Libor isn't the only way in which the banks trade on inside information. As Robert D. Auerbach – an economist with the U.S. House of Representatives Financial Services Committee for eleven years, assisting with oversight of the Federal Reserve, and nowy Professor of Public Affairs at the Lyndon B. Johnson School of Public Affairs at the University of Texas at Austin – provided points out:

> Billions of dollars can be made from inside information leaks from the Fed's monetary policy operations. One necessary step to stop leaks is to severely limit inside information on future Fed policy to a few Fed employees.
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> This has not happened. Congress received information in 1997 that non-Federal Reserve employees attended Federal Reserve meetings where inside information was discussed. Banking Committee Chairman/Ranking Member Henry B. Gonzalez (D, Texas) and Congressmen Maurice Hinchey (D, New York) asked Fed Chairman Alan Greenspan about the apparent leak of discount rate information. Greenspan admitted that non-Fed people including "central bankers from Bulgaria, China, the Czech Republic, Hungary, Poland, Romania and Russia" had attended Federal Reserve meetings where the Fed's future interest rate policy was discussed. Greenspan's letter (4/25/1997) contained a 23-page enclosure listing hundreds of employees at the Board of Governors in Washington, D.C. and in the Federal Reserve Banks around the country who have access to at least some inside Fed policy information.

Senator Sanders also noted last October:

> A new audit of the Federal Reserve released today detailed widespread conflicts of interest involving directors of its regional banks.
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> "The most powerful entity in the United States is riddled with conflicts of interest," Sen. Bernie Sanders (I-Vt.) said after reviewing the Government Accountability Office report. The study required by a Sanders Amendment to last year's Wall Street reform law examined Fed practices never before subjected to such independent, expert scrutiny.
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> The GAO detailed instance after instance of top executives of corporations and financial institutions using their influence as Federal Reserve directors to financially benefit their firms, and, in at least one instance, themselves. "Clearly it is unacceptable for so few people to wield so much unchecked power," Sanders said. "Not only do they run the banks, they run the institutions that regulate the banks."
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> The corporate affiliations of Fed directors from such banking and industry giants as General Electric, JP Morgan Chase, and Lehman Brothers pose "reputational risks" to the Federal Reserve System, the report said. Giving the banking industry the power to both elect and serve as Fed directors creates "an appearance of a conflict of interest," the report added.
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> The 108-page report found that at least 18 specific current and former Fed board members were affiliated with banks and companies that received emergency loans from the Federal Reserve during the financial crisis.
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> [T]here are no restrictions in Fed rules on directors communicating concerns about their respective banks to the staff of the Federal Reserve. It also said many directors own stock or work directly for banks that are supervised and regulated by the Federal Reserve. The rules, which the Fed has kept secret, let directors tied to banks participate in decisions involving how much interest to charge financial institutions and how much credit to provide healthy banks and institutions in "hazardous" condition. Even when situations arise that run afoul of Fed's conflict rules and waivers are granted, the GAO said the waivers are kept hidden from the public.

Whether you want to call it crony capitalism, socialism or fascism, one thing is for sure … this ain't capitalism.

Postscript: Reich says that the only solution is to break up the big banks and reinstate the laws which separate traditional banking from speculation.