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More Banks versus the People

- Features -

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“As the Economist put it at year-end 2006, “having grown at an annual rate of 3.2% per head since 2000, the world economy is over halfway towards notching up its best decade ever. If it keeps going at this clip, it will beat both the supposedly idyllic 1950s and the 1960s. Market capitalism, the engine that runs most of the world economy, seems to be doing its job well.” [1]

The primary objective of the world's leaders is to avoid another banking and financial crash that could be worse than the one in September 2008. [2]

As we saw in the first three parts of this series, the big central banks (ECB, Bank of England, US Federal Reserve, and National Bank of Switzerland) have prevented the bankruptcy and collapse of many private banks by lending them massive sums. [3] Without this unlimited line of credit, a large number of banks would have had to suspend payments. Central banks have loaned more than 20 trillion dollars to private banks since 2007. In the EU alone, the loans given to private banks by public administrations go far beyond the unlimited credit doled out at very favourable interest rates. Guarantees must also be put into the balance, which amount to 1.174 trillion euros (9.3% of EU GDP) [4], for the period between October 2008 and December 2011, and bank recapitalisations to the tune of €442 billion (3.5% of EU GDP).

Also to be considered are:

- the decrease in tax revenues, because banks declared losses, which enabled them to avoid paying taxes for several years, even when they were making a profit; [5]
- the decision not to take legal action against banks for financial offences in spite of the damage they have inflicted on society; [6]
- the unwillingness to apply any binding or disciplinary measures on financial institutions in order to prevent another banking or financial crisis. [7]

What is more, the eurozone, the States, and the European commission maintain the judicial framework that gives the private financial sector a monopoly in terms of lending money to the public sector. Yet, the eurozone private banks' principal source of funding at low interest rates (between 0.75% and 1%) is the ECB and the central banks of eurozone countries (which constitute the Eurosystem). These are the funds that are lent to the peripheral EU countries (Greece, Ireland, Italy, Portugal, Spain, and the East European eurozone countries) at exorbitant rates (between 4.5% and 10% or more). From a legal and moral point of view, this is doubly condemnable: the banks are guilty of abusive practises and unjust enrichment (abusive because of the usury rates). In Part 7 of this series, we will look at other crimes and offences committed by banks, which should cancel the debts these banks are trying to collect. The people and the corporations that are responsible should be forced to pay heavy fines, perform community service, have their personal freedom restricted, or be banned from exercising a financial or banking profession.

It would be naive to imagine that banks will take advantage of public generosity to adopt careful management practices for the funds that States allocate to them or that people deposit in their accounts. This is one of the points analysed in the following pages.

Crises are part of Capitalism's metabolism

A crisis in the capitalist system is a kind of wake up call: speculative bubbles burst, the price of assets [8] moves back towards their real value; the least profitable corporations go bankrupt, and capital is destroyed [9]. Crises are in a way part of Capitalism's metabolic system.

However, interventions by public authorities, who cater to demands made by Presidents of large corporations, have made it impossible to "clean up" or purge the Capitalist system. There are millions and millions of victims among the 99%, while those responsible for the crisis have not really put things back in order. Very few major corporations have gone bankrupt, the banks have not cleaned up their accounts, and new speculative bubbles have formed or are forming.

The small number of bank failures can be attributed to the aid provided by the ECB and EU governments. Member states considered that the banks were too big to fail. In the EU, only 7 small or medium-size banks have been liquidated: 4 Danish, 1 Finnish-Luxemburgish, 1 Irish, and 1 British [10]

Unless there is a radical shift towards greater social justice, the crisis is going to continue for many more years due to the following factors: current government policy favours the interests of major private corporations and is attacking the social and economic rights of people everywhere; [11] weak government and market demand; speculative bubbles persist; unprofitable and even insolvent corporations are being kept alive.

It is for these reasons that it is important to better understand how banks function. We need to open their books, and audit the budgets of the public authorities that support them, shed light on their activities, and identify what is behind their actions. This analysis will show that the part of public debt that is the direct or indirect result of the banking crisis and bank bailouts is illegitimate. [12] This debt did not serve the general interest. It simply allowed the banks to have their cake and eat it too, while continuing the same disastrous activities. This public debt is the pretext cited by government leaders around the world for attacking the economic, social, and political rights of people.

However, a different conclusion is in order: given their importance and the devastating effect their bad management can have on the economy, banks must be redefined as public services. The work banks do (as an entity enabling people to save money and take out loans) is far too serious to be entrusted to private bankers, who by definition seek to maximise the profits of a handful of private owners (the 1%, as the Occupy Wall Street movement called them). Given that they use public funds, benefit from government guarantees, and are supposed to provide a basic fundamental service to society, banks should become a public service.

This alternative conclusion leads me to make two radical propositions. First, the cancellation/repudiation of illegitimate public debt and the launch of a new government borrowing policy promoting social justice, better living conditions, and the restoration of the major ecological balances. Second, the banking sector should be socialised, placed under citizen control, and be subjected to public service rules and regulations, [13] and the revenues generated must be used for the common good. Other measures are also necessary, such as putting an end to austerity policies. [14]

The secret mission of banks: maximum Return on Equity (ROE)

If we really want to understand how the major shareholders and Directors believe their banks should operate, where

their motivations come from, and their behaviour as capitalist corporations, it is important to take into consideration the scramble for Return on Equity.

The notion of Return on Equity (ROE) is indeed a key to understanding their mindset. From the 1990s to the beginning of the crisis in 2007-2008, there has been a mad race for maximum ROE: 15% was common, but some banks were getting 25 to 30%. In 2007, ROE stood at 15% in the eurozone, 17% in the United Kingdom, and 19% in the USA. [15] Let us take for example two major US banks: Goldman Sachs and Morgan Stanley (the 5th and 6th largest banks in the country). They both posted a 30% ROE in 1999-2000 until the internet bubble burst and Enron went bankrupt in 2001.

From 2001 to 2004, the shareholders of these two banks had to content themselves with an ROE between 12 and 16%. Thanks to the all-out support policy for banks and big business implemented by the Fed and the Bush administration (with Henry Paulson, the former CEO of Goldman Sachs, working as the Secretary of the Treasury), Goldman Sachs's ROE again reached 30% in 2006-2007, while Morgan Stanley's shot back up to 25% in 2006, before falling again in 2007. Goldman Sachs advised its clients to purchase structured subprime products (the famous CDOs – Collateral Debt Obligations), while at the same time speculating that they would drop as of 2007. That is why it could post a 30% ROE at the height of the banking crisis, while its chief competitors Bear Stearns, Merrill Lynch, and Lehman Brothers were beginning a descent into hell. The SEC (Securities and Exchange Commission, the authority controlling banks in the United States) ran an investigation into Goldman Sachs activities at that time, and gave the bank a heavy fine. Then in 2008, Goldman Sachs's ROE fell to 10% and Morgan Stanley's to 2%. In 2009, Goldman's ROE went up to 20%, and Morgan Stanley's was 10% in 2010. Finally, in 2011, the two banks' ROE dropped back to 5%. [16]

Generally speaking, a bank's equity is made up of the capital put up by its shareholders [17] 25 years ago, this equity represented 8% of the bank's assets. For example, for a bank that had assets worth 100 billion euros (broken down into household loans, corporate loans, government bonds, corporate bonds, commissions on corporate mergers, and initial public offerings (IPOs)), its capital equity would have been 8 billion euros.

In that case, to achieve a 15% ROE, net profit must be \hat{a} , -1.2 billion (15% of 8 billion). It seems easy to obtain such net profit with assets that amount to \hat{a} , -100 billion, as they represent only 1.2% of that amount.

The exponential inflation of bank assets to increase ROE

The offer of new structured financial products or derivatives developed very rapidly from the middle of the 1990s. The big banks wanted their part of this buoyant and expanding market, knowing that if they were not well placed, they would be overtaken, and eventually taken over by their competitors. The profits on these products are relatively small, usually around 1%. If the shareholders are pushing for a 'Return on Equity' between 20% and 30%, the directors are under pressure to greatly inflate their assets. In the previously mentioned example, the assets were tripled in twelve years to \hat{a} , -300 billion, while the capital remained stable at \hat{a} , -8 billion or 2.66% of the assets. This growth was funded by borrowing.

Leverage

The bank concerned had used leverage, which consists in increasing its borrowing to increase the profitability of its

own resources. [18]The leverage is 36:1 (the debt is equal to 36 times the capital). As the competition between the big banks on the derivatives markets has increased over the years, the profitability of these products has decreased: in some cases it is no more than 0.1%. To maintain the ROE at 30% while the profitability of derivatives is reduced, the banks chose to increase their assets, notably in the derivatives domain, and by creating structured high profit products very much based on sub-prime contracts. In compliance with part 6 of the Basel 2 accord, they are not allowed to have capital inferior to 2.5% of their total assets. To obtain revenues and maintain high ROE, they turn to off-balance sheet methods. They create non banking companies, consequently not subject to banking regulations and controls, specialising in the derivatives markets. In 2007, the sub-prime market crashed. The banks and their specialised offshoots suffered losses, sometimes greater than their capital. If the bank in our example that uses a 36:1 leverage effect has a 3% drop in the value of its gross assets, its net assets are swallowed up. Either it goes bankrupt, gets taken over by another bank, is 'nationalised', calls on the State for a bail-out, or tries to cover up the losses by manipulating the accounts until better times arrive and profits return.

These different cases actually occurred. In the US, 400 small and medium-size banks went bankrupt alongside Lehman Bros, which was the 4th largest commercial bank. In Belgium, Fortis, the country's largest bank was taken over by BNP-Paribas in 2008. Another US bank, Merrill Lynch, was taken over by Bank of America, and Bear Stearns was bought by JP Morgan.

The case of Northern Rock

In the UK, Northern Rock, which was originally a building society [19], changed its legal structure in 1997, and took on an aggressive real estate strategy. Between 1997 and its downfall in 2007, it grew by 23% a year to become the 5th British mortgage bank with 90% of its loans in real estate. In order to finance its growth, Northern Rock isolated its deposits and became dependant on short-term borrowing. Leverage effects were used to the full, going beyond 90:1. On 13 September 2007, Northern appealed to the Bank of England, depositors panicked, and a bank run on Northern Rock took place. Yet, it was not the bank run that caused the bank's downfall; rather it was the decision by major private lenders, some months before, to cut off the funds from one day to the next that chimed the death knell for Northern Rock. The bank was nationalised in February 2008. [20]

Deutsche Bank charged with deceit by former employees

A much less mediatised case concerns Deutsche Bank (DB), the biggest bank in the world in terms of overall assets (see above). It illustrates a situation in which a bank covers up its losses so as to avoid the government stepping in and investors turning away, which would send share values plummeting. The events occurred in 2009. The three former employees who exposed the facts to the SEC (Security and Exchange Commission) in 2010-2011 claim that Deutsche Bank had concealed a \$12 billion loss on the US derivatives market. If Deutsche Bank had acknowledged such losses in its 2009 balance sheet, its capital would have been reduced by 25%, which would have made it compulsory for the German government to bail it out (since it required the equity of German banks to amount to 8% of their assets). Instead of acknowledging any loss, the bank launched a major campaign to boost stock market share value. It announced a 1.8 billion profit before tax for the first quarter in 2009. DB share value increased from a 16 in January 2009 to a 39 at the end of April 2009. Each of the three employees exposed the deception without knowing about the other two. Eric Ben-Artzi, who was risk manager with DB, was fired three days after he had told the SEC about the deceit. He initiated a lawsuit against DB for unfair dismissal. The second complainant, Matthew Simpson, voluntarily left DB with \$900,000 in compensation money. The third complainant wishes to remain anonymous. The SEC is most embarrassed by this scandal, because Robert Khuzami, currently Enforcement Director at the SEC, was working as General Counsel for the Americas with Deutsche Bank from 2004 to 2009 when

the cover-up occurred. Richard Walker, who is currently general counsel of corporate and investment banking at Deutsche Bank, was Enforcement director at the SEC for ten years. This shows that while Goldman Sachs has indeed a most pernicious influence, other major banks play a crucial role in the decisions made by governments and control authorities both in the US and in Europe.

Evolution in bank assets and activities since the 1990s

In the theoretical case presented above, it is claimed that the balance sheet values of banks, both their liabilities (debts) and their assets (property and bank products generating revenues), increased significantly between the 1990s and the outbreak of the crisis in 2007-2008. The IMF reports that global bank assets increased by about 140% from 2002 to 2007, rising from \$40 to \$97 trillion. They further increased from 2007 to 2011, reaching \$105 trillion. While bankers and governments keep repeating that banks have cleaned up their assets and gone on a strict diet, this is not at all true. Only very recently has the volume of assets started to decrease, and in a marginal way. The IMF reports that from the 3rd quarter of 2011 and the 2nd quarter of 2012, the reduction of assets in European banks (outside derivatives) amounted to only 2%.

The Liikanen report, named after the chairman of the group of experts appointed by the EU Commissioner for Internal Market and Services Michel Barnier to make propositions concerning structural reforms to the EU banking sector, provides extremely interesting information on EU banks.

It shows that in France the assets of Société Générale (8th largest European bank, 3rd biggest French bank) increased from €410 billion in 1999 (when the euro was launched) to nearly €1.2 trillion in 2008 (an increase of close to 300% over a decade). In 2010, assets were still close to €1.2 trillion. In Germany, the assets of Commerzbank (15th largest European bank, 2nd biggest German bank) went from €380 to €850 billion between 1999 and 2009.

If we consider the whole European banking sector, assets went from €25 trillion in 2001 to €43 trillion in 2008 (3.5 times the EU's GDP)! Banks debt followed the same trend.

The increase in bank assets has relied on more borrowing, in some cases in a steep rise in mortgages and for most major banks on a dramatic increase in trading activities that include derivatives and structured securities. The issue of Asset Backed Securities was massively monopolized by US banks, but European banks were also keen to participate. They bought those ABS thanks to short-term loans, while the products bought had much later maturity, thus using the leverage effect. To cover the risks, banks would buy credit derivatives and other kinds of derivatives meant to protect them against risks related to currency exchange, interest rates, and so on. In September 2008, the bankruptcy of Lehman Brothers and the bailout of AIG (the biggest insurance company in the world) showed that those who issued derivatives could not cope with the risks they were meant to cover. The total volume of derivatives literally exploded, from \$100 trillion in 1998 to \$750 trillion in 2007.

The growth of European banks did not rely on their clients' deposits (which increased only modestly), but on their debts on the interbank market, with the ECB, or with Money Market Funds (MMFs).

What are Money Market Funds?

MMFs are financial corporations in the United States and Europe, rarely controlled and subject to few rules. The specialized press considers them to be closely akin to shadow banking. [\[21\]](#)

The Obama administration is considering creating regulations, because if an MMF goes bankrupt, it may be necessary to bail it out with public money. A worrying situation given the vast quantities of money they handle, and the sharp drop in their profitability since 2008. In the United States, they held \$2.7 trillion in 2012, a significant drop from the \$3.8 trillion in 2008. MMFs lend on a very short-term day to day basis. Created by JP Morgan, the biggest bank in the United States, Prime Money Market Fund is among the largest, worth \$115 billion. Wells Fargo the 4th largest bank in the United States has an MMF managing \$24 billion. Goldman Sachs the 5th biggest bank controls an MMF worth \$25 billion. US banks also operate MMFs in Europe; JP Morgan (â,~18 billion euros), Black Rock (â,~11.5 billion), Goldman Sachs (â,~10 billion), alongside European banks such as BNP Paribas (â,~7.4 billion), and Deutsche Bank (â,~11.3 billion). Some MMFs also operate in British pounds. Michel Barnier (European Commissioner for the Internal Market and Services) has also announced that he would like regulations to be imposed on this activity, but this is most likely to remain nothing more than a statement of good intentions. [22]

Bank balance sheets have not been reduced since 2007 – 2008

The authors of the Liikanen report expected that because of the severity of the crisis, the banking sector would be restructured, bank balance sheets reduced, and the weaker firms closed down. This did not happen, the volume of assets have not shrunk since the crisis struck in 2008. [23] It was then â,~43 trillion and has grown to â,~45 trillion in 2011. Given that European GDP has slightly decreased, in 2011 the assets (including the debts) of the European banks were equivalent to 370% of European GDP! Between 2007 and 2011 Deutsche Bank assets increased by 12.4%, those of HSBC by 22.2%; BNP Paribas + 16%; Credit Agricole + 22%; Barclays + 12%; Santander + 37.1%; Nordea, the principal Swedish Bank + 84.1%; Commerzbank + 7.3%; Intesa + 11.6%, and BBVA + 19.1%. Of the eighteen top ranking European banks, only three have seen their assets decrease: Royal Bank of Scotland -28%; the principal Dutch bank ING -3.33%, and the principal Italian bank Unicredit -9.3%. [24]

Why have banking balance sheets not been reduced?

They have not reduced their balance sheets because no authority has forced them to do so, and they have been well furnished in cash flow by the ECB, the FED, and other institutions. They continue to play heavily on the leverage effect. What is more, in the eurozone, the ECB has been encouraging banks to purchase ever more public bonds.

The European banks are slowly trying to unload part of the toxic assets that clutter their balance sheets. When they sell off toxic products below their purchase price (as indicated in their balance sheets) they must write-down the value of their assets. Of course in doing this, they reduce the whole value of their balance sheet. What they do liquidate is very little compared to the immense volume of their assets, and they hesitate to sell them for the derisory prices they would get. They prefer to wait and see if the price rises. This price rise may never come about, and at the maturity of the contract it will be necessary to make considerable write-downs.

Meanwhile, back in the United States the Fed has purchased a huge amount of toxic assets: about \$40 billion per month in 2012. In the eurozone, since the end of 2011 the ECB has accepted toxic assets as collateral for loans. The ECB has decided, since the beginning of December 2011 to ease the eligibility criteria of for guarantees for certain assets such as 'Asset Backed Securities' and 'Credit Claims'. [25] The ECB thus accepts in its own balance sheet part of the toxic assets that private banks are having a hard time trying to unload. [26]

Some details on EU banks [27]

Each of the ten biggest European banks holds $\hat{a},\sim 1$ trillion in assets:

- 1 is German (Deutsche bank, $\hat{a},\sim 2.164$ trillion in assets which represents 84% of German GDP, 101,000 employees),
- 4 are British – (HSBC, $\hat{a},\sim 1.968$ trillion , 120% of British GDP, 288,000 employees; Barclays, $\hat{a},\sim 1.187$ trillion , 114% of British GDP, 141,000 employees; Royal Bank of Scotland (RBS), $\hat{a},\sim 1.804$ billion , 110% of GDP, 147,000 employees; Lloyds Banking group, $\hat{a},\sim 1.162$ trillion, 70.7% of GDP, 99,000 employees),
- 4 are French – (BNP Paribas, $\hat{a},\sim 1.965$ trillion, 99.8% of French GDP, 198,000 employees; Credit Agricole, $\hat{a},\sim 1.880$ trillion, 95.4% of GDP, 162,000 employees; Societe Generale, $\hat{a},\sim 1.181$ trillion, 60% of GDP, 160,000 employees; BPCE, $\hat{a},\sim 1.138$ trillion, 58% of GDP 117,000 employees),
- 1 is Spanish (Santander, $\hat{a},\sim 1.275$ trillion representing 118% of Spanish GDP, 193,000 employees)

Ten years ago, none of the big banks had a volume of assets that was greater than the GDP of their country of origin. In most EU countries, banking concentration has increased. In Belgium, between 1997 and 2010 the five biggest banks increased their market share from 52% to 75%, in France from 40% to 45%, in Greece from 55% to 70%, in Ireland from 40% to 57%, and in Germany from 17% to 33%. [28]

Of the thirty biggest banks in the world in 2011, fifteen were European. Six of these banks were bigger than JP Morgan, the biggest bank in the US. [29] In addition, three European banks are very offensive on the Wall Street Market in particular, and in the US in general: Deutsche Bank, Credit Suisse, and Barclays. They control 23% of the US debt market. On the mergers/acquisition market, Credit Suisse, DB and Barclays are in 4th, 5th, and 6th positions just behind Goldman Sachs, JP Morgan, and Morgan Stanley. [30]

The top twenty European banks eat 50% of the cake

There are 8000 banks in the EU that may be divided in three categories 1) 4000 small co-operative banks having less than one billion euros in assets; 2) those with between one and one hundred billion euros in assets: 3) major banks that have more than $\hat{a},\sim 100$ billion and up to $\hat{a},\sim 2.2$ trillion in assets.

The twenty biggest, that is 0.25% of the total number of banks, own 50% of the total assets: more than $\hat{a},\sim 23$ trillion.

The small banks are generally more solid and do proportionally more domestic and industrially productive lending than the big banks. Because of their smaller size they are equally less risky. Numerous studies show that small cooperative or savings banks are more efficient, reliable, and useful than the big banks. [31] They are more helpful to their clients and are more involved in useful local investments, especially true when local institutions are involved. [32] According to the Liikanen report, Austria, Finland, Germany, and the Netherlands are the European countries where co-operative and savings banks are the most conducive to public utility.

The major banks are “universal”

The “universal bank” also called “full service financial firm” or “full service investment bank” means a major financial group covering various banking sectors as different as retail banking, commercial and investment banking, and asset management. They are active all over the country and abroad through their foreign branches. The risks here are important, as failures in the hazardous finance and investment sectors of activity may have adverse effects on other sectors within the bank and put the small depositors’ savings in danger. This is the case of the biggest European banks.

The major banks have an appetite for derivatives

According to the ISDA (International Swaps and Derivatives Association), the union of private banks active in derivatives trading, 94% of the world’s 500 principal banks are present on the derivatives market (in descending order, derivatives on risks over exchange rates, interest rates, commodities, and CDS); 80% of derivatives are produced and marketed by banks: it’s their captive markets. Hedge funds (some of which are bank offshoots) weigh much less than the banks on derivative markets, their assets are worth no more than \$2 trillion, which is completely marginal compared to the \$100 trillion in the hands of the banks. The overwhelming majority of derivatives trading escapes from any control as it is conducted over the counter.

Trading is God!

Half of Deutsche Bank’s and the Royal Bank of Scotland’s assets are used for trading, while the figure is 40% for both BNP Paribas and Barclays.

What is trading?

Trading is a financial market activity in which banks and other traders take buying or selling positions in stocks and shares, interest rates, currencies, derivatives markets, futures or options on these instruments, commodity futures (including foodstuffs), real estate and others. Trading is clearly a speculative activity based on making gains through short-term price fluctuations largely brought about by traders’ actions. The purchasing or selling of the commodities or products are not done to use them, but solely to make profit from the transactions. This activity was the main cause of the food crisis in 2008 – 2009, when the banks and other high rollers suddenly and massively transferred their trading funds away from the ailing real estate markets hit by the subprimes crisis towards commodity futures, [33] especially cereals. [34] The same trading mechanisms were also at the origin of the rocketing oil prices in July 2008, and their sharp drop a few months later. Part of this trading is declared on a bank’s balance sheet, the other “often greater” is conducted off-balance sheet on the OTC (over the counter) markets.

Barclays, BNP Paribas, Deutsche Bank, Nordea, Royal Bank of Scotland, and Société Générale are the banks that do the most trading as a proportion of their total business (more than 30% of their assets).

For four of these banks (Barclays, BNP Paribas, Deutsche Bank, and Royal Bank of Scotland), the derivatives they hold represent in notional value (i.e., the risk covered) more than 20 times their assets, [35] and more than 300 times their equity stricto sensu. We must recall that the derivatives market is not regulated and so has no controls! For Royal Bank of Scotland, derivatives represent 30 times their assets, for Deutsche Bank and Barclays 28 times, for BNP Paribas 25, and 7 for BPCE.

From 1990 to 2010, the major banks took increasingly bigger risks, in particular by developing trading activities. As a result, the percentage of fixed income (from loans to clients, and government and corporate bonds) decreased in their earnings. For Barclays and Deutsche Bank, between 1993 and 1996, loans represented half of their assets, whereas in 2007-2008, they only made up one tenth of them! Deposits from clients (households, companies, government administrations, and financial institutions) represented less than 30% of the liabilities of BNP Paribas, Deutsche Bank, Barclays, and Societe Generale.

Households and non-financial companies lend more to banks than banks lend to them

In general, banks loan less money to households and non-financial companies than they receive from them in deposits. This can be seen in the following figures concerning the amount households and non-financial companies contributed to the financing of banks (i.e., their debt) in 2011: 41% for Belgium, 23% for France, 28% for the United Kingdom, and 36% for Germany. [\[36\]](#)

By comparison, in their assets, the percentage of loans given to non-financial companies (NFCs) and households was very small: for Belgium, 10% to NFCs and 9% to households; for the United Kingdom, 5% to NFCs and 15% to households; for France, 10% to NFCs and 12% to households; for Germany, 10% to NFCs and 17% to households; for Spain, 23% to NFCs and 22% to households. [\[37\]](#)

Bank loans to households and non-financial companies are a minor part of bank assets

On average, loans by all European banks to households and non-financial companies only represent 28% of their assets; the remainder is made up of other kinds of debt, ABS, and sovereign debt. [\[38\]](#) However, that does not take account of the hidden activities, their off balance sheet transactions, or the infamous shadow banking system.

The 10 biggest European banks receive the most government aid

Between 2008 and 2011, the 10 biggest European banks received more than half of the €1.620 trillion (13% of GDP in the EU) of public aid disbursed in the form of recapitalisations and guarantees.

The Big Banks work in the shadow economy

As is the case on other continents, the major European banks make their business activities as opaque as possible by setting up a large number of companies. In a significant number of cases, there are more than one thousand different legal entities for a single bank. In addition to making the work of auditors very difficult, most of these entities are based in tax havens in order to pay the least possible amount of taxes, for themselves and their wealthy clients, and to, launder money. [\[39\]](#)

Return on equity

According to the Liikanen report [\[40\]](#), in 2011, equity capital represented only 2 to 8% of the total assets of the major banks. For Deutsche Bank, they hardly exceeded 2%. For ING and Nordea (Sweden), they were a little less than 4%,

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while for BNP Paribas, Crédit Agricole, BPCE, Société Générale, and Barclays, they represented about 4%. For the Spanish banks Santander and BBVA, the Italian banks Intesa Sanpaolo and Unicredit, and also for the Belgian bank KBC, they were around 6%. [\[41\]](#)

Let's do a little practical exercise to get an approximate idea of the return on equity in 2012 of the banks in some key countries. As you do this exercise, you must keep in mind what was explained above in the section "The secret mission of banks."

The IMF issued a publication on bank profits as a percentage of total assets at the beginning of 2012. These profits were very low, and in some cases (Greece, Ireland) negative :

Greece -0.4%

Ireland -0.8%

Italy 0.4%

Portugal 0.3%

Spain 0.2%

Austria 0.4%

France 0.2%

Germany 0.2%

Netherlands 0.4%

UK 0.0%

Denmark 0.1%

Switzerland 0.2%

Sweden 0.6%

United States 0.8%.

If we limit our analysis to this table, we get the impression that the shareholders of European banks are not very well off. But let's go further, and try to understand their ROE. Let's consider Deutsche Bank, which according to the Liikanen report had $\hat{a}, -2.164$ trillion in assets, basing our analysis on the principle that its profit corresponds to the average amount reported by the IMF for Germany (0.2%). That would mean profits of $\hat{a}, -4.33$ billion. According to the Liikanen report, in 2011 Deutsche Bank's capital equity amounted to 2% of its total assets [\[42\]](#), or $\hat{a}, -43.3$ billion

euros. In this case, its ROE works out to be 10%, which is a more faithful representation of true bank profits in these hard times.

Now let's apply the same reasoning to BNP Paribas. Knowing that its assets amounted to €1.965 trillion in 2011, a profit of 0.2% (€3.93 billion) would mean ROE of 5%. Indeed, according to the Liikanen report, in 2011, the capital equity of BNP Paribas represented about 4% of its assets (around €78.6 billion).

The CADTM would be very thankful if readers who have access to data concerning the ROE of one or several European banks would send us this information at info@cadtm.org.

A final point must be emphasised: banks tend to cook their books when it comes to estimating their assets, which is also true of their estimations of their capital equity, and other items on their balance sheets, because the Basel III accords force them to have better capital ratios (see Part 6 of this series).

Conclusion

In order to achieve an alternative solution to the capitalist way of managing the crisis, it is essential to understand the role the banks play and expose their dark side. This will help strengthen the grassroots action of citizens, and in particular the citizens audit initiatives that are under way in Europe (Spain, Greece, Portugal, France, Belgium, Italy...) and elsewhere. [\[43\]](#)

The banks have lost much of their legitimacy; however, they can count on unlimited support from governments and mainstream media. The private banks and governments that promoted the radical financial deregulation that began in the 1980s and 1990s are responsible for the present debacle. The decisions that have been taken are making problems worse and longer-lasting. We are living through a new major crisis of the capitalist system, along with many others such as the food and environmental crises. [\[44\]](#)

The banking crisis alone has entailed huge costs for society and it is not over yet. Luc Laeven and Fabian Valencia, two economists at the IMF, estimate that the drop in the GDP growth attributable to the banking crises for the period 1970-2011 is 33% (23% for the eurozone, 31% for the US). In their opinion, the final cost is likely to be even larger.

The same two authors say that in the advanced economies over the period 1970-2011 the banking crises accounted for 21% of the rise in public debt (20% in the eurozone and 24% in the United States). [\[45\]](#) Even if this is not at all the conclusion reached by Laeven and Valencia, this debt is clearly illegitimate, and we must therefore refuse to pay for it. Besides the need to reject repayment of the debt caused by the crisis and the bank bailout as it is currently being carried out, bank policy has to be met with a radical response. Since banks use public monies, receive State guarantees, and have to provide society with essential basic savings and loan services, the banking sector should be socialized and become a public service.

The fifth part of this series provides an analysis of the weak points of the banks today, and the sixth part will explain why the initiatives taken by governments to regulate banking activities are completely inadequate.

Epilogue: a purely imaginary story

It is not that easy to put oneself in the shoes of a Big Banker, whether it is a major shareholder or an appointed top executive, and to try to understand the way they see their business. The vast majority of people who have a bank account [46] would struggle to even imagine how those who run the very same bank work, how they think, and how they benefit from their activities. Understanding what return on equity (ROE) is in concrete terms is particularly challenging, since many of us cannot even imagine what lies behind the answer to such a question.

Let us try to make things easier to grasp, by comparing a family, like any other family, to the leaders of big banks, who are very few in number.

Let us imagine Mr. and Mrs. Fernandez in Spain in 2007. They are close to their fifties and during 30 years of activity have saved up €100,000 (which they consider to be their capital). They decide to buy a house worth €500,000, which is made up of three apartments. They make a €100,000 down payment (20% of the total price). They plan to live in one of the three apartments, and rent out the other two. They borrow €400,000 to be repaid over 20 years at 5% interest, that is €18,780 a year (the average amount for the first four years of the loan) plus an annual €12,898 to repay the capital (the average amount for the first four years of the loan), that is €31,678 to repay each year. Here is what they plan to do: "If we rent out each apartment for €1,000 a month, we will get an annual €10,000 per apartment, i.e., €20,000 in all, allowing for maintenance and other costs. We will have to finance €11,678, which is 117% of the rent we previously had to pay. That means we will have to dedicate a greater share of our income to repay the loan, but in the end, when we are 70, we will be the owners of this house, which will be a source of income, and one day we will leave it to our 3 children."

On the other hand, let us imagine that the same year the Big Bucks Bank also decides to buy the same kind of real estate as the Fernandez couple. The bank buys hundreds of them so as to increase its real estate-related assets in a context of soaring prices. Real property worth €500,000 may be worth €600,000 two years later. It is therefore a good deal. How is the bank going to finance this purchase? Here is the plan: they make a 4% down payment with the bank's own funds, i.e. €20,000. For the remaining €480,000, they take €180,000 from the current accounts of their clients who deposit their salaries and other income there (which represents a kind of interest-free loan by these clients to their banks). To finance the rest (€300,000), they borrow on the interbank market at a 3.26% rate (the average European interbank rate or "Euribor" from 2007 to 2010). In addition to the €20,000 of its own funds that the Big Bucks Bank spends just once, the annual cost of the purchase amounts to €9,780 in interest paid to the other banks. If, like the Fernandezes, the bank rents out the three apartments €1,000 each, allowing for all maintenance costs, it will get about €30,000 every year €9,780 of which will go to paying the interest. The net income comes to €20,220, which is a 101% return on the capital initially invested. As for the return on total investment, i.e., €20,220 on €500,000, it is 4.04% per year.

The difference between these two situations is blindingly obvious. What the banks do to finance the purchase of real estate is very far from the options available to anybody else. In the small and closed world of the big banks (let us not forget that out of the 8,000 banks operating in the EU, the 20 largest own half of the €46,000 billion in assets!), somehow they do not pay back what they borrow, they just pay interest. In fact, for each instalment, they take out a new loan to pay back the previous one. This option is simply unimaginable for the vast majority of people. In addition, as we have observed, they pay little or no interest on the deposits made on current accounts even though they use the money deposited there. This situation will last as long as the major banks have continuous and cheap access to credit (preferably at a rate below the inflation rate). Of course, if depositors withdraw their money and/or if the different lenders lose confidence and turn off the credit tap; the bank is left in default, since its little game is over. In this case, it is very likely that the public authorities will intervene to bail out the bank if they consider it to be too big to fail.

The imaginary situation described above was set in 2007. Let us take a step forward in time: it is 2013, the real estate bubble has burst in Spain (as well as in Ireland and the United States), which has had devastating consequences. Hundreds of thousands workers in the construction industry have lost their jobs, economic activity has slowed down, all the other economic sectors have been impacted, the number of unemployed people has soared

[47]. The Fernandezes are unemployed and cannot continue paying the mortgage on their €400,000 loan. The Miserly Bank repossesses their house; [48] the Fernandezes end up homeless, and must ask their children to put them up. The bank sells the house, and receives €300,000, since prices have plummeted. The Fernandezes had paid €75,120 in interest over four years, and paid off €51,591 of the capital borrowed [49], bringing the outstanding capital to €348,409. According to the Spanish law, the Miserly Bank demands that the Fernandezes, who are jobless and homeless, pay back €48,409 (i.e., the outstanding capital after a payment of €300,000 coming from the sale of the property).

Let us now have a look at what is going on for the Big Bucks Bank, which had bought similar real estate. In 2013, it can carry on its purchases with a change in its funding profile since the other banks won't lend it money (the banks distrust each other because of the bad debt that many of them have). Fortunately, the public authorities are ready to help the Big Bucks Bank and the other banks. The ECB lends them money at a rate well below the inflation rate. A real blessing for bankers.

What does the Big Bucks Bank do? It buys the Fernandez's house from Miserly Bank for €300,000. To do that, it invests €18,000 of its equity capital (that is 6% of the price of the house), withdraws €132,000 from its clients' deposits, and borrows €100,000 short term from the ECB at 0.75%. The annual interest to be paid by the bank is €1,375. The bank rents out the three apartments at the same price, which means an income of €30,000 minus €1,375 of interest (€28,625). The return on equity (ROE) is 159%, the profit on the total investment, 9.5%.

All of this is of course pure fantasy. But is it really that far from reality?

Part 5: The Banks, Fragile Giants

"In order to facilitate the financing, insuring, and timeliness of all that trade, the volume of cross-border transactions in financial instruments has had to rise even faster than the trade itself. Wholly new forms of finance had to be invented or developed, credit derivatives, asset-backed securities, oil futures, and the like all make the world's trading system function far more efficiently.

In many respects, the apparent stability of our global trade and financial system is a reaffirmation of the simple, time-tested principle promulgated by Adam Smith in 1776: Individuals trading freely with one another, following their own self-interest leads to a growing, stable economy." Alan Greenspan [50]

The financial innovations presented as a panacea by Alan Greenspan have been a big flop, causing very serious economic and social damage. At the same time, the dictatorship of the markets and the ukases of the European troika have been infringing on the democratic rights of citizens everywhere. European treaties and the policies applied by successive governments have progressively chipped away at the peoples' hard-won democratic rights: the legislative power has been increasingly dominated by the executive, the European parliament is a front piece for the European Commission, and there is less and less respect for what the electors try to say. Meanwhile, leaders hide behind the European treaties and repeat the old Thatcherite refrain: TINA (there is no alternative), to justify austerity and debt repayment. At the same time, they have been doing as much as possible to defy the economic and social rights conquered during the 20th century, on the one hand (see Part 3 of this series); and, on the other hand, to prevent a new banking crisis from erupting. However, no seriously restrictive measures have been taken to impose a new discipline on banks and other financial institutions. The banks have not cleaned up their accounts since 2007-2008. Worse yet, they have been very active in creating new bubbles and new structured financial products.

In this fifth part of the series, [51] we look at how the banks have been bending over backwards to fund their activities, their almost total dependence on public assistance, the speculative bubbles that are in gestation,

speculative financial innovations, the disastrous effects of the present banking system particularly in creating food crises, as well as the new risks that the modus operandi of banks has been creating for people. [52]

Medium- and long-term financing problems

We will first have a look at the financing side of bank operations, (i.e., bank liabilities), where banks are encountering big problems. Institutional investors (insurance companies, pension funds, other banks, and sovereign wealth funds among others) no longer have confidence in banks, and hesitate to buy their covered bonds issued in the hope of finding stable long-term financing. Even if some banks like France's two biggest, BNP Paribas and Societe Generale or Spain's second biggest bank BBVA, have found buyers for their bonds, the volumes issued in 2012 remain as low as in the previous years. According to the Financial Times, this might even be the worst year since 2002. [53]

As the banks cannot find sufficient long-term funding on the financial markets, they are vitally dependant on the 3-year ECB loans totalling $\hat{a},-1$ trillion at 1%, [54] and generally the liquidities made available by the central banks of the industrialised countries (particularly by the US Federal Reserve Bank, the ECB, Bank of England, National Bank of Switzerland, and the BoJ (Japanese Central Bank)).

Short-term financing problems

Much of their financing, other than deposit and savings accounts, which show no growth because of the crisis, must be found on the short-term market. According to the Liikanen report, the big European banks need $\hat{a},-7$ trillion from day to day. [55] The volume of banks' short term debt increased significantly between 1998 and 2007, from $\hat{a},-1.5$ to $\hat{a},-6$ trillion, while from 2010 to 2012, it remained at $\hat{a},-7$ trillion! Where do banks find this short-term money? It is no longer, or hardly, available on the interbank markets, because the banks are too wary to lend each other money. They are thus dependent on Money Market Funds (MMFs) which have up to \$2.7 trillion available for day-to-day trading depending on how the winds of crisis are blowing in Europe. [56] MMFs shut off the flow in June 2011, and reopen it when the ECB lent $\hat{a},-1$ trillion. [57] At any moment, they may close or restrict the flow again. The surest supply of funding is once again the central banks. The ECB has made massive loans at 0.75% (the current rate since May 2012).

The conclusion is clear: without the $\hat{a},-1$ trillion over three years and the day-to-day loans of the ECB and the national central banks linked into the Eurosystem (to which must be added the Bank of England and the National Bank of Switzerland), many big European banks would be menaced with suffocation and bankruptcy. This is more evidence that the banks have not cleaned up their accounts. They must find massive short-term funding, whereas they hold long-term assets of doubtful value. In many cases, the value of the assets on their balance sheets will not be realised when they come to maturity, and the losses suffered may absorb their whole capital.

The stock exchanges are blocked

Funding from the stock exchanges is also blocked The price of bank shares has dropped, on average, to a fifth of their 2007 level [58] (see charts in appendices). The institutional investors (insurance companies, pension funds, investment funds, banks, and others) are not inclined to buying shares of companies that are in bad shape. This is additional proof of the abysmal distance that exists between the theoretical functioning of capitalism as announced by its supporters and reality. In theory, the stock exchange is supposed to help listed companies gain access to

long-term investment capital (shares are considered to be investments that must be kept for at least eight years). However, this scenario just doesn't work, because the stock exchange is no longer a place where companies can find funding for a long time, but a place of pure speculation. That is why banks must be recapitalised with public money.

On other hand, according to the same theory, the stock exchange, by the price of its shares, is the real representation of a company's value. From this point of view, the average 80% drop in the capitalisation value of banks suggests a very embarrassing revelation for their directors and for the pundits of the capitalist system.

We should also remember that banks use part of the cash supplied to them by the central banks to buy back their own shares. There are two reasons for this: to try to stop the value of their shares from falling, and to pay their shareholders for their shares. [\[59\]](#)

Banks funded by money coming from drug trafficking

Drug trafficking money is another source used to fund banks. On 26 January, 2009, Antonio Maria Costa, Executive Director of the United Nations Office on Drugs and Crime (UNODC), declared to the on-line Austrian magazine *profil.at* [\[60\]](#) that some interbank loans were recently funded "by money from drug trafficking and other illegal activities." Very recently, in December 2012, HSBC (UK, the second largest bank in the world in terms of assets) accepted to pay a record fine of \$1.92 billion [\[61\]](#) to US authorities to put an end to the lawsuits being brought against it, in particular for charges of laundering money for the Mexican drug cartels. [\[62\]](#)

Time bombs in European and US bank assets

As seen above, banks assets are in reality, large financial time bombs that are already ticking.

In Europe, 70% of the structured financial products backed by commercial mortgages (CMBS – Commercial Mortgage-Backed Securities) that matured in 2012 were not paid! [\[63\]](#) These products were sold between 2004 and 2006, just before the subprime bubble burst, and they come to maturity from 2012 to 2014. According to the Fitch rating agency, only 24 of the 122 CMBS that matured in the first 11 months of 2012 were paid. In 2013-2014, the contracts that arrive at their term amount to €31.9 billion. In 2012, JP Morgan, the biggest US bank lost \$5.8 billion on the European CMBS market through its London office because of the bad management by one of its agents nicknamed "the Whale". [\[64\]](#) This did not stop Deutsche bank or the Royal Bank of Scotland creating new CMBS for the European market! Why do these banks get involved in these operations? Because the high risk level is compensated by the expectation of higher returns than those on other products. Keep watch!

European and US banks still have several trillion dollars of residential mortgage-backed securities (MBS) on their balance sheets, notably subprime MBS and other categories of asset-backed securities (ABS). Banks have a hard time trying to unload these securities unless they accept important losses. At the end of December 2011, MBS could be sold for no more than 43% of their nominal value, but there were very few buyers. [\[65\]](#) Banks are very discrete about the exact volumes of MBS they hold on their balance sheets, and even more so concerning their off-balance sheet holdings.

Collateral loan obligations (CLO) are another structured product created during the period leading up to the subprime

crisis, which raises concern while at the same time enticing the most aggressive European banks, such as the Royal Bank of Scotland into the fairy circle of high risk – high profits. CLOs were sold to gain funds for investors who wanted to buy companies by taking on more debt, playing on leverage to the maximum, which is known as a leveraged buy-out (LBO). These CLOs are now reaching maturity, and their owners are wondering how they will be paid. The European market is totally flat, but the US market has come back to life, selling \$39 billion in 2012. Some European banks are also purchasing them because the possible gains are high given the risks involved. [66] Fragile, handle with care.

New bombs are being set

JP Morgan and other big banks have proposed to create structured products comparable to the subprime mortgages CDOs, for credit linked to international trade. Remember that Collateral Debt Obligations (CDOs) were created out of different types of mortgages, which the banks wanted to unload by securitising them (that is by transforming mortgages into a more easily tradable security). [67] JP Morgan wants to do it all over again with export credits instead of mortgages. It was this same bank that in 1994 created the ancestor of CDOs. [68] The export credit market is \$10 trillion per year. JP Morgan is trying to persuade banks that are active in this market, to structure the credits into CDOs so as to render them more liquid. The official line is that this approach will reduce assets thereby reducing the leverage effect in accordance with the new Basel III regulations on the need to increase capital ratios (see Part 6 and the Basel III accords). In fact, for JP Morgan and the other big banks that are always seeking to achieve profitable financial innovation, this is a new mine to open and exploit on a major market. [69] Here again, if the JP Morgan strategy works well there are high prospects of more damage from a new bubble.

The frantic scramble for profit causes losses

A few examples illustrate the magnitude of the risks that banks continue to take. There was the blow to Societe Generale in France (â, -4.9 billion) resulting from the continual mishaps of its trader, Jerome Kerviel. This affair goes back to January 2008 and we might imagine that the banks would have since taken the lesson. Not at all! In September 2011, the Swiss bank UBS announced losses of \$2.3 billion through unauthorised transactions by Kweku Adoboli, manager at Global Synthetic Equities Trading in London. Again in London, as mentioned above, JP Morgan's "whale" lost \$5.5 billion for "his" bank. These affairs are only the tip of the iceberg.

A speculative bubble has developed in Corporate Bonds

Many financial market observers and many fund managers consider that a speculative bubble has developed in the Corporate Bonds sector, bonds issued by big companies. There is thus, a new bubble forming on the debt of major corporations. Why has this \$9.2 trillion market been creating a bubble? The return that banks and other institutional investors get from the United States treasury and the sovereign bonds of the main EU powers is at a historical low. The investors search around for a better sector, in which there is no apparent risk: corporate bonds of non financial companies gave a more attractive return of about 4.5%. Another reason that banks prefer to purchase obligations rather than take on loans is that obligations can be easily converted into cash on the secondary market if need be. [70] This rush on bonds caused a serious drop in their yield, which fell from 4.5% at the beginning of 2012 to 2.7% in September of that same year.

A major corporation like Nestle was able to issue €500 million in 4-year obligations offering no more than 0.75% p.a. This case is exceptional, but it shows that the rush on corporate bonds does exist. According to JP Morgan, the call for bonds is such that the yield on junk bonds was in free fall during the summer of 2012, dropping from 6.9% to 5.4%. If the trend continues, institutional investors may look elsewhere for better returns. [71]

The craving for profit is such that companies succeed in issuing PIK (Pay in Kind) bonds, which were trendy before 2006-2007 then found no new buyers until 2012. These bonds receive no interest until the capital is fully paid off. Of course, the promised final repayment is high, but there is a great risk that the company borrowing will not be in a position to either pay back interest or capital when the loan matures! It would in fact be prudent of a lender to ask why a company that is unable to pay regular interest over the duration of the loan will be able to repay the full amount at the end. [72] Once again the craving for profit and the availability of liquidity (because of central bank loans) has led to a keen interest for these high risk products.

The shortage of collateral [73]

Up to 2007-2008, the financial markets experienced a period of growth and exuberance. The Bankers and other institutional investors cross lent capital and structured products to each other in a joyful asset-go-round without any verification as to the credit worthiness or the capacities of those signing a contract to assume their responsibilities when it came to maturity. For example, bankers paid insurance premiums to Lehman Brothers and AIG to cover against the risk of payment defaults without first verifying whether they had the means to pay the indemnity if need be.

In most transactions, the borrower must put up an asset as a guarantee. This is called collateral. What often happened and still does is that the same collateral is used to guarantee several different transactions. A borrows from B and puts up collateral as a guarantee. B borrows from C and uses the same collateral as a guarantee, and so on. If the chain is broken anywhere, there is the risk of not finding the collateral. As long as the markets were euphoric and nobody asked embarrassing questions about collateral, business went on as usual. Since 2008, things have not quite been the same and the co-contractor who wants collateral may insist on having assurances that it is really available if need be, that its value is authentic and of that it is of good quality. Collateral circulates less and doubtful collateral is refused. [74]

It is reasonable not to accept toxic assets such as subprime CDOs as collateral. This has led to the beginning of a shortage of collateral. In 2011 and 2012, the Franco-Belgian financial company Dexia suffered from insufficiently good collateral, and was unable to cover its financial needs. In 2012, Dexia borrowed close to €35 billion from the ECB at 1% within the LTRO framework. The enormous loans from the ECB were insufficient, so Dexia, once again, turned to the French and Belgian States, in October-November 2012 for a €5 billion recapitalisation.

According to the Financial Times, Spanish banks have become experts in the creation of collateral. They create structured ABS products from doubtful mortgage credits and other equally doubtful products, and push them on the ECB as collateral for treasury needs. [75] So the ECB accepts this custom-made low quality collateral. This example offers more evidence of how the ECB bows down to the bankers.

In the context of collateral, we must also denounce the lies concerning government bonds that are supposedly giving the banks a headache. Government bonds are a much surer form of collateral than most private financial instruments. Banks do not hesitate to offer them as prime quality collateral for ECB loans.

Sovereign debts

Indeed, let us have another look at sovereign debt. Until now, it has not caused any banking catastrophes. Nevertheless, it is evident that in countries like Spain and Italy, the banks are making important purchases of the bonds issued by their own governments. They have two good reasons for acting in this way: on the one hand, they hold large amounts of liquidities lent by their central banks at very low interest rates (0.75 to 1%); on the other hand, their own country's bonds are remunerated at much higher rates (4 to 7%). However, the austerity policies are so brutal that it is uncertain whether these governments will always be to pay them back. This problem is not an immediate threat, but the possibility of future difficulties must be considered. [76]

Sovereign debt is not the Achilles' heel of private banks

The mainstream media permanently repeats the story told by bankers and politicians according to which sovereign debt represents a real danger. In order to clear up this issue and take away this old sovereign debt argument from those in power, who are using it to impose antisocial policies, we must develop convincing counter-arguments, which could be based on the data provided in this series. In a recent IMF report, [77] there is a chart on the percentage of sovereign debt in the assets of private banks in 6 key countries. According to this chart, government debt represents only 2% of the assets of British banks, [78] 5% for French banks, 6% for US and German banks, and 12% of the assets of Italian banks. Japan is the only country, among the 6 mentioned, in which government debt represents an important proportion of bank assets (25%). It is not every day that the IMF agrees with our arguments. However, the conclusion we draw from this data, and the one the IMF would clearly hesitate to make, is that it would be much easier to cancel illegitimate public debt than most people could imagine!

Shadow banking

One of the main causes of bank fragility is their off-balance sheet activities, which in some cases may be greater than their officially declared activities. The major banks continue creating ad hoc companies (Special Purpose Vehicles, MMFs) that are not considered as banks and do not have to comply with banking regulations. [79] Until now these companies could operate without control or, in the case of MMFs, with little control, lending to banks and conducting many kinds of speculative actions on a multitude of derivatives or raw materials (including foodstuffs) on futures markets or the over the counter (OTC) market, which is not regulated. The opacity is total or nearly so. Banks are not obliged to declare, in their accounts, the activities of the non-banking companies they create. The most dangerous activities are the ones conducted by Special Purpose Vehicles. If the losses of one of these companies causes their bankruptcy, the bank that created it is forced by its creditors to record this loss on its balance sheet, which may absorb the bank's capital and cause it to go bankrupt (or perhaps be taken over by another bank or the government, or be given a public bailout). This is what has happened to Lehman Brothers, Merrill Lynch, Bear Stearns, the Royal Bank of Scotland, Dexia, Fortis, and several others since 2008.

Speculation on commodities [80]

Through their trading activities, banks are the biggest speculators on the over the counter and commodities futures markets. They have much greater means available than the other protagonists. See the website Commodity business awards (<http://www.commoditybusinessawards....>), where a list of important bankers and brokers on the commodities markets is available (whether on the commodities market where they are bought and sold, or on the underlying derivatives market). Among these banks, the ones most often mentioned are BNP Paribas, Morgan Stanley, Credit Suisse, Deutsche Bank, and Societe Generale.

What is more, the banks are trying to take direct control of the stocks of raw materials. This is the case of Credit Suisse which is associated with Glencore, [81]

These are the leading performers in the development of speculative bubbles formed on the commodities markets. [82]] When the bubble bursts, the repercussions on the state of the banks will cause new damage. Not to mention, and much more seriously, the consequences on the people in the developing countries that export raw materials.

A look back at the fundamental role played by speculation in the dramatic increase in food and energy prices in 2007-2008

Speculation on the principal markets in the United States on which world commodity prices are negotiated (farm products and raw materials) played a crucial role in the dramatic increase in food prices in 2007-2008. [83] These rising prices resulted in a big increase in the number of people suffering from hunger: more than 140 million additional people in one year, for a grand total of more than 1 billion (1 in 7 of the world's population). Those involved in this speculation were not mavericks, they were institutional investors (or high rollers), including banks, [84] pension funds, investment funds, and insurance companies. Hedge funds [85] also played a role, even if they had much less impact than institutional investors. [86]

Michael W. Masters, who had been managing a Wall Street hedge fund for twelve years, provided evidence of this in his testimony before a Congressional commission in Washington on 20 May 2008. [87] He made the following declaration to this commission, which was making an official investigation into the possible role played by speculation in rising commodity prices: "You have asked the question 'Are Institutional Investors contributing to food and energy price inflation?' And my unequivocal answer is 'YES'". In his authoritative testimony, he explains that the increasing price of food and energy was not due to an inadequate supply but rather to a "demand shock" caused by the arrival of new participants in the commodities future market. On the futures market, participants buy the future production: the wheat that will be harvested in 1 or 2 years, or the oil that will be produced in 3 or 6 months. In "normal" times, the main participants in those markets are for example airline companies that buy kerosene, or food companies that buy grain. Michael W. Masters shows that in the United States, the capital allocated by institutional investors to the commodity index trading in futures markets rose from \$13 billion dollars at the end of 2003 to \$260 billion in March 2008. [88] During the same period of time, the prices of the 25 commodities that make up these market indices rose by 183%. He explains that it is a small market, [89] and if institutional investors such as pension funds and banks allocate 2% of their assets to it, this will change the situation drastically. The price of commodities on the futures market has an immediate repercussion on the actual price paid for these basic goods. He shows that institutional investors bought huge quantities of corn and wheat in 2007-2008, which produced a price spike.

It is worth noting that in 2008 the Commodity Futures Trading Commission (CFTC) considered that institutional investors should not be considered as speculators. The CFTC stated that institutional investors are commercial market participants, which enabled it to argue that speculation did not play a significant role in the dramatic rise in prices. Michael W. Masters is very critical of the CFTC, but Michael Greenberger, a Law professor at the University of Maryland, was even more adamant in his testimony before the Senate commission on 3 June 2008. Michael Greenberger, who was Head of the CFTC's Division of Trading & Markets from 1997 to 1999, criticised the laxity of other CFTC Directors, who looked the other way when they saw manipulation of energy prices by institutional investors. He cites a series of declarations by CFTC Directors worth publishing in an anthology of hypocrisy and stupidity. Michael Greenberger considers that 80 to 90% of the stock market transactions in the US energy sector are speculative. [90]

On 22 September 2008, as financial turmoil was rocking the United States, and President Bush was proposing a

\$700 billion bank bailout plan, the price of soy beans shot up by 61.5% driven by speculation!

Jacques Berthelot also shows the crucial role played by bank speculation in the rising prices. [91] He gives the example of a Belgian bank, KBC, which ran an advertising campaign to market a new investment product offering customers the possibility to invest in six food raw materials. To convince its clients to put their money into its “KBC-Life MI Security Food Prices 3” investment fund, KBC’s advertisement encourages them to: “Take advantage of rising food commodity prices!” It presents the “shortage of water and farm land” as an “opportunity” since there is now a “shortage of food products, leading to rising food commodity prices.” [92]

Meanwhile, the US judicial system has ruled in favour of the speculators. This is what Paul Jorion denounces in an editorial published in Le Monde. He questions the decision made by a court in Washington on 29 September 2012, which rejected a proposal made by the CFTC “that aimed to limit the volume of positions a single participant can take on commodities futures market, so that he or she alone would not be able destabilise it.” [93]

Currency speculation

Banks are also the main participants on the currency markets, which they maintain in a permanent state of instability. Approximately 98% of foreign exchange activity is speculative. Only 2% is associated with the really productive economy, Foreign Direct Investments, effective international trade of goods and services, remittances by emigrants, and credit or debt repayment). Between $\hat{a},-3$ to $\hat{a},-4$ trillion transit daily through the foreign exchange markets! Banks also trade heavily on foreign exchange derivatives, which may cause considerable damage, not to mention the damage to society because of the instability of the currencies.

Over thirty years ago, James Tobin, long time advisor to US President J.F. Kennedy, suggested throwing sand into the wheels of international speculation. In spite of all the fine talk by some heads of States, the plague of foreign exchange rate speculation has worsened. Bank and other lobbies have so far averted having the smallest grain of sand disrupt their wheels from spinning or profits from accumulating. The decision taken in January 2013 by 11 eurozone governments to impose a tax of 0.1% on financial transactions is totally insufficient.

High–frequency trading

High-frequency trading enables orders to be passed on the markets in 0.1 milliseconds (one ten thousandth of a second). The “Regulations and banking activities separation act” put before the French national assembly by Pierre Moscovici, French finance and economy minister, on 19 December 2012 contains an interesting description of high-frequency trading: “High-frequency trading is a market activity entrusted to computers running on algorithms that combine observation and analysis of the market, and the placing of orders at ever higher frequencies. They may place several thousand orders per second on the same exchange platform, sometimes causing saturation. The risks are high in case of coding errors, these may cause absurd financial movements (the quasi-bankruptcy of the ‘Knight Capital Group’ in August 2012 is an example). In 2011, high-frequency trading accounted for more than 60% of the orders on the Paris stock exchange, only 33% of which created a real transaction”. [94]

High-frequency trading is clearly linked to speculative operating: manipulate the financial markets in order to influence prices and extract a profit. Specialists are well aware of the most popular methods:

Quote Stuffing: “A tactic of quickly entering and withdrawing large orders in an attempt to flood the market with quotes that competitors have to process, thus causing them to lose their competitive edge in high frequency trading”.

[\[95\]](#) [\[96\]](#)

Layering, high-frequency traders may use this method to sell a block of values at the highest possible price, they place a series of buying orders at price offers up to a ceiling price, and in this way create layers of orders, once the ceiling is reached they sell massively before the price has time to go down, and at the same time cancel the invalid orders. This process relies on the filling of their competitors sales ledger with offers to buy, and then surprising the market by inverting the movement. [\[97\]](#)

On 6 May 2010, Wall Street experienced a “flash crash” [\[98\]](#) typically caused by high-frequency trading including a ‘quote stuffing’ operation. The Dow lost about 998.52 points (before recovering 600) between 2.42pm and 2.52pm. A fall of 9.2% in ten minutes, unprecedented in stock exchange history. This incident spotlights the involvement of high-frequency trading that corresponds to about two-thirds of transactions on Wall Street.

Such accidents will certainly happen again. The big banks that actively use high-frequency trading are opposed to banning the system or introducing any strict controls under the pretext of maintaining the greatest possible liquidity on the financial markets.

Proprietary trading

Proprietary trading: when banks trade for themselves, is an important banking activity, producing a great amount of revenue and profit, but carrying very heavy risks. Banks engage their own resources (equity, customer deposits, borrowings) to take positions (buy or sell) on the different financial markets: stocks and shares, interest rates, foreign currency, raw materials, derivatives, futures, forwards, commodities (including foodstuffs), and their futures and real estate. Trading is definitely a speculative venture, because it is based on short-term market movements greatly influenced by their own actions. One illustration of the speculative nature of trading is Societe Generale’s €4.9 billion loss in 2008 because of the positions, taken by one of its traders Jerome Kerviel, which engaged close to €50 billion. JP Morgan allowed \$100 billion dollars to be engaged by a person on its London proprietary trading department staff known as the “Whale”. The sums involved by the banks in propriety trading action are so huge that the losses can menace the survival of the bank itself.

Short selling: another speculative activity

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. For the Banque de France: “there are two kinds of short selling”:

• Covered short-selling: in this case, the seller has borrowed (or made a borrowing agreement for) the stock that he must eventually sell at the end of the operation. In fact, the stock that this person borrows will be sold, and he promises to return the same kind of stock to the lender;

• Naked or uncovered short selling: in this case, there is no borrowed stock or borrowing agreement before the sale of the stock. The seller must buy identical stock to be able to pass it on to the buyer”. [\[99\]](#)

According to the French banking federation, ‘short “short selling is good for market vitality (...) it increases market cash flow.” [\[100\]](#) Who do they think they are kidding?

Who sells short and why?

Short selling is done by a large number of market participants, such as banks, hedge funds, and financial institutions such as pension funds and insurance companies among others. It is a purely speculative activity. A speculator gambles that the price of the share concerned will fall, and if his guess is right he purchases it at a lower price than that at which he sold it, and so makes a profit. This kind of practice undermines market stability. The sharp fall in the price of bank shares during the summer of 2011 was aggravated by short selling. It is easy to understand why this kind of activity should be quite simply prohibited. [\[101\]](#)

Leverage

As they systematically use leverage, their equity is small compared to the risks they take. From their point of view this is the desired situation: have the least possible amount of equity in proportion to their assets. A low general profit / assets ratio can produce a high profit/equity ratio, if the equity is as low as possible. Imagine a profit of $\hat{a},-1.2$ billion with assets of $\hat{a},-100$ billion, which means a profit of level of 1.2%. However, if compared to equity of $\hat{a},-8$ billion, this becomes 15% profit. If the bank using leverage, then borrows $\hat{a},-200$ billion on the financial markets to purchase further assets. the volume of assets becomes $\hat{a},-300$ billion, the equity has remained the same at $\hat{a},-8$ billion, while the liabilities have also risen by $\hat{a},-200$ billion. If the bank continues to make a profit of 1.2% that becomes $\hat{a},-3.6$ billion. With equity still at $\hat{a},-8$ billion that means a Return on Equity (ROE) of 45%. This is the fundamental reason to increase leverage by borrowing.

As we saw in Parts 2 and 4 of this series, apparently minimal losses may be quickly followed by disastrous effects and the need for a bailout. In this example, a loss of $\hat{a},-8$ billion on total assets of $\hat{a},-300$ billion (a loss of 2.66%) would wipe out the equity and result in bankruptcy. This happened to Lehman Brothers, Merrill Lynch, and the Royal Bank of Scotland, among others. The IMF's Global Financial Stability Report published in October 2012, considers that the leverage of European banks is 23:1 without taking derivatives into account. A ratio of 23:1 considering only tangible assets (without derivatives) is very high! [\[102\]](#) The real leverage effect is even more important, because banks have debts and assets that are off-balance sheet (notably a significant amount of derivatives).

Conclusion: The big banks continue playing with fire, because they are persuaded that governments will save them whenever necessary. They do not encounter any serious opposition from the authorities as they continue to trade (this question will be discussed in Part 6). At the same time, they are playing an ongoing game of brinkmanship. In spite of their continual marketing efforts to regain public confidence, they have no desire to change their objectives from seeking maximum and immediate profit, and gaining as much power as they can to influence government decisions. Their force corresponds to current government leaders' decisions to give them total freedom of action. The leaders' moralistic tones, insisting that banks should be more restrained in their bonuses and remunerations, are only for Public consumption.

Karl Marx writes in Capital that "At their birth the great banks, decorated with national titles, were only associations of private speculators, who placed themselves by the side of governments, and, thanks to the privileges they received, were in a position to advance money to the State'. This is just as applicable to today's banks. [\[103\]](#)

Banks have a colossal capacity to wreak havoc. Those who believe that a humane capitalist bank is possible must wake up and realise this is pure fantasy. The entire banking system must be withdrawn from capitalist control, and without any compensation, in order to create a public service under the control of citizens, users, and banking sector workers. [\[104\]](#) This is the only way to guarantee the total respect of public service precepts concerning savings and credit that are in the interest of the community.

In Part 6, the new banking regulations will be analysed.

Annexe : Share price movements of 17 banks

[https://internationalviewpoint.org/IMG/png/Cours_banques-1_eng-b0604.png]

[https://internationalviewpoint.org/IMG/png/Cours_banques-2_eng-04586.png]

[https://internationalviewpoint.org/IMG/png/Cours_banques-3_eng-38208.png]

Charts by Yvette Krolikowski (CADTM) - Sources Les échos and abcbourse

Translated by Stephanie Jacquemont, Christine Pagnouille, Mike Krolikowski and Charles La Via.

[1] [<http://www.ft.com/cms/s/2/4ff4c5f0-...> Alan Greenspan was the President of the US Federal Reserve from 1987 to 2006, and a great adept of the self-regulation of market forces and the absence of controls. The Economist, one of the principal financial weeklies, published in London since 1843, has always been a frank supporter of free-trade. The blind faith shared by The Economist and Alan Greenspan is worth pointing out at the beginning of this study. On The Economist see <http://www.monde-diplomatique.fr/20...>

[2] The author would like to thank Patrick Saurin and Virginie de Romanet for proofreading certain sections, as well as Damien Millet, Danielle Sabai, and Brigitte Ponet, who proofread all of Part 4.

[3] see [Banks versus the People: The Underside of a Rigged Game!](#)

[4] European Commission, "State aid: performance indicators confirm the trend toward a decrease and better targeting of aid not linked to the crisis", Brussels, 21 December 2012.

[5] Theoretical case: If banks declared losses of \hat{a} , -250 million for 2008 and 2009, they would not pay tax during those years. Meanwhile, if they make a \hat{a} , -100 million profit in 2010 and 2011, they will still not have absorbed their original losses (from 2008 and 2009), so they will not have to pay taxes on the profits made in either of those years.

[6] Neither European authorities nor governments in eurozone countries have as yet pursued any bank in criminal or civil proceedings. In the UK and US, these matters are settled out of court

[7] Part 6 of this series will show that the Basel 3 agreements and the annexes by the European authorities (Commission, EBA, and ESMA (European Securities and Markets Authority)) are totally inadequate.

[8] In general, the term "asset" refers to a commodity that has a realisable value, or can generate revenues. Meanwhile, "liabilities" are the part of the balance sheet made up of the resources a company owns (the capital equity contributed by the partners, provisions for liabilities, and debt).

In the concrete case considered here, assets are principally commodities and securities that are subject to financial speculation (mainly by banks), including raw materials and farm products, corporate bonds and government bonds (sovereign debt), currencies, and real estate.

[9] | Which causes a decrease in the organic composition of capital, to use the Marxist terminology.

[10] The banks liquidated include Fiona Bank (DK), Roskilde Bank (DK), EIK (DK), Amagerbanken (DK), Kaupthing Bank (FI, LU), Anglo Irish (Ireland), Bradford & Bingley (UK).

[11] An important aspect of this policy was analysed in Part 3 of this series, "The greatest offensive against European social rights since the Second World War" see [Banks versus the People: The Underside of a Rigged Game!](#)

[12] There are, of course, other illegitimate debts that must be identified and repudiated

[13] The banking sector should be entirely public, except for a small cooperative sector with which it could live and collaborate

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- [14] Damien Millet, Eric Toussaint, Europe: What emergency programme for the crisis? 10 June 2012 <http://cadtm.org/Europe-What-emerge...>
- [15] Patrick Artus, Marie-Paule Virard, La liquidité incontrôlable (Uncontrollable liquidity), Pearson, 2010, p.45.
- [16] See: Tom Braithwaite, "Leaner and meaner", Financial Times, 1 October 2012, p.9. <http://www.ft.com/cms/s/2/9cd35082-...>
- [17] Refers to the capital available to a company other than what it has borrowed. Equity is accounted in the liabilities column of a company's balance sheet. Source: <http://www.lesclesdelabanque.fr/Web> Capital also includes reserves and retained earnings.
- [18] The definition of leverage by the Banque de France: "Leverage measures the effect, on financial profitability and for a given economic profitability, of greater or lesser borrowing. In taking on debt the shareholders of a company or financial institution expect a better ROE to compensate the extra risk" <http://www.banque-france.fr/fileadm...>
- [19] "Building Societies" are a traditional British mutual banking structure based on the promotion of home ownership loans.
- [20] See Erkki Liikanen (chairperson), High-level Expert Group on reforming the structure of the EU banking sector, October 2012, Brussels, p. 59.
- [21] Shadow banking: off-balance sheet activities conducted by banks. According to the Financial Stability Board (FSB), the body created by the G20 to oversee worldwide financial stability, the volume of shadow banking activities is more than \$67 trillion (the equivalent of worldwide GNP). See Richard Hiault, "Le monde bancaire 'parallèle' pèse 67.000 milliards de dollars" (The shadow banking world weighs in at \$67 trillion), Les Échos, 18 November 2012, <http://www.lesechos.fr/18/11/2012/l...>
- [22] Source: Financial Times, "EU shadow banking plan rapped", 26 March 2012; "MMF lose worth in low interest rate world", 10 September 2012.
- [23] The situation varies from one country to another. Some have seen a reduction in their banks' assets while others have seen increases
- [24] Liikanen report, chart 3.4.1., p. 39.
- [25] This is what the Banque de France says about the measures applied as from December 2011 by the ECB: "The wide range of assets accepted as collateral has once again been enlarged with a concurrent reduction of the worth of the assets considered. First, the rating of asset backed securities has been lowered. Other than ABS already recognised in the eurosystem, the ABS that contain underlying assets in mortgages and loans to small and medium size companies become acceptable on the minimum condition of two simple A ratings at the moment of their offer, and throughout the whole of their period to maturity. Then, national central banks will be temporarily authorised to accept private supplementary credit claims (such as bank loans) as guarantees, if they respect specific eligibility conditions".
- [26] According to the Financial Times the list of guarantees accepted by the ECB in 2012 contains 40,000 different products! See FT, "Collateral damage", 25 October 2012.
- [27] These details are taken from the Liikanen report.
- [28] Liikanen, report, Chart 2.3.14 for European banks. The US banks have taken advantage of the crisis to consolidate. In 2012, the 5 principal banks held 43.7% of deposits up from 37.1% in 2007. The assets of the 4 principal banks (JP Morgan, Bank of America, Citigroup, and Wells Fargo) have increased by 56% since 2007, they now stand at \$7.7 trillion. See: The Wall Street Journal, 12 December 2012.
- [29] US authorities do not account for assets in the same way as their European counterparts. US authorities tend to undervalue them. Therefore, the European banks are even more oversized than the US banks.
- [30] See FT, "New York is a tall order for Europeans", 4 October 2012, p. 20.
- [31] Liikanen report p. 58

[32] There are of course many exceptions, very often public management has abandoned the original purpose of public banking. This is the case of most of the Spanish 'Cajas' that took part in the real estate bubble, or of different Landesbanken in Germany.

[33] Raw materials such as agricultural products, minerals, ores, precious metals, and petroleum products are collectively grouped under the designation 'commodities'. Like other assets, they may be permanently negotiated and their prices continually adjusted in real time on the markets, including the derivatives markets.

[34] See Damien Millet, Eric Toussaint, Why a food Crisis? September 23 2008 <http://cadtm.org/Why-a-World-Food-Crisis>. The work of two UN experts on the right to food, Jean Ziegler and Olivier de Schutter, confirmed the role of speculation in the food crisis.

[35] Liikanen report, p.45, Chart 3.4.8.

[36] Liikanen report, Chart 2.3.8.

[37] Liikanen report, Chart 2.3.9.

[38] Liikanen report, Chart 2.3.7.

[39] Liikanen report, p. 52.

[40] Liikanen report, p.47, Chart 3.4.13.

[41] NB: the paragraph presents the ratio between capital equity and assets. If we compare capital equity to liabilities, we get basically the same result. For Barclays and Deutsche Bank see the Liikanen report, charts 3.4.18 and 3.4.19.

[42] Deutsche Bank (DB) and 26 other major European banks were supposed to attain a higher ratio of pure equity capital (4.5%, in June 2012), but we will not get into this issue here, because the way of calculating the Tier One capital ratio (see below) is completely arbitrary. In any case, the calculation we have given here is just to give a general idea. To calculate DB's ROE, we would need to know the exact amount of its profit, and the exact amount of its equity capital.

[43] In Brazil, a citizens audit initiative has been active for the past 12 years; citizens audit initiatives are currently being started in Tunisia, Egypt, and Mali.

[44] See Damien Millet and Eric Toussaint, La crise, quelles crises ? (The Crisis: Which Crises?), Aden-CADTM, Brussels, 2009.

[45] Luc Laeven and Fabian Valencia, "Systemic banking crisis database: an update", IMF Working Paper 12/16, Washington, 2012.

[46] We must remember that more than 1 billion people do not have a bank account, and that in rich countries, hundreds of thousands of households are not allowed to open a bank account or have their bank accounts forcefully closed.

[47] In Spain, the number of families in which everyone is unemployed has reached 1.7 million (10% of all Spanish families). The official unemployment rate stands at 25%, and even 50% for the youth

[48] In Spain, between 2008 and 2012, 350,000 families were expelled from their home by the creditors.

[49] To make this calculation (which is plausible), the usual conditions offered with mortgage loans have been taken into account.

[50] Alan Greenspan, The Age of Turbulences, Penguin press, New York, 2007, p. 408.

[51] see [Banks versus the People: The Underside of a Rigged Game!](#) for parts 1-3

[52] The author would like to thank Olivier Chantry, Brigitte Ponet, Patrick Saurin, and Damien Millet for their advice.

[53] Financial Times, 27-28 October 2012.

[54] This loan that the ECB advanced to 800 European banks for a total of $\text{\textasciitilde}1$ trillion at 1% over 3 years was analysed in Part 2 of this series. At

[55] 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.

[56] MMFs were described in Part 4 of this series.

[57] See Part 2 "The ECB and the Fed at the service of the major private banks at

[58] Liikanen report, chart 2.4.1.

[59] The shareholders who sell their shares to their bank transform their paper certificates into cash. From the fiscal point of view, it is more advantageous to receive income on a regular basis by selling some shares than to receive a dividend.

[60] <http://www.profil.at/articles/0905/...>

[61] This fine is high compared to the fines usually paid by banks, but compared to its assets HSBC has paid a pittance. The amount paid by HSBC to US authorities ($\$1,920,000,000$ or $\text{\textasciitilde}1,443,000,000$) represents less than 1/1000 of its assets ($\text{\textasciitilde}1,967,796,000,000$).

[62] We will come back to this question in Part 7 of this series.

[63] Financial Times, "« Europe's property loans unpaid »", 4 December 2012, p. 23 <http://www.ft.com/cms/s/2183f122-3d...>

[64] Financial Times, "Mortgage-backed securities make a comeback", 15 October 2012, <http://www.ft.com/cms/s/ee87a148-16...>

[65] Financial Times, 21 December 2011, p. 24

[66] Financial Times, "Traders warn of sting in tail for crisis-era securities", 15 November 2012, p. 24

[67] Another objective was to reduce the amount of certain products in the total volume of assets, and replace them with more profitable ones.

[68] See Gillian Tett, Fool's Gold, Little Brown and Co. 2009.

[69] Financial Times, "Banks test CDO-style finance for trade", 9 April 2012.

[70] Besides, consumer or business loans are reducing or rising only marginally. This is the result of the banks applying stricter conditions to making loans. They prefer to buy securities (even high risk). Medium and small companies cannot float bonds on the financial markets and so are encountering difficulties in finding finance.

[71] See Financial Times, "« Fears grow bond rush will turn to price rout »", 22 November 2012 and Financial Times, "Funds warn of stretched European debt rally", 17 October 2012.

[72] James Mackintosh, "Change would pop the corporate bond bubble", Financial Times, 25 November 2012. See also the article mentioned above.

[73] Collateral: Assets that may be transferred or considered to be a guarantee in case of the incapacity to pay back a debt or cover an engagement. Source: Banque de France.

[74] See Manmohan Singh, "Beware effects of weakening collateral chains", Financial Times, 28 June 2012.

[75] Financial Times, "Collateral damage", 25 October 2012

[76] The central theme of this series is the necessity to repudiate the public debts and socialise the banks. In doing so (with other important measures) a positive outcome to this crisis is perfectly possible.

[77] IMF, Global Financial Stability Report, Restoring Confidence and Progressing on Reforms, October 2012

<http://www.imf.org/External/Pubs/FT...> p52

[78] The debt figures here concern British public debt held by British banks. Ditto for the other countries.

[79] Liikanen Report, p. 77.

[80] What is briefly called "commodities" is the raw materials market. (Foodstuffs, minerals, metals and precious metals, petroleum and natural gas products among others). Like other assets, commodity prices are in permanent negotiation whether that be on the spot market or in derivatives.

[81] Glencore was founded by Marc Rich. It is a trading and brokerage company based in Baar, Switzerland in the canton of Zug well known to high level frauders. Marc Rich has been prosecuted several times for corruption and tax evasion. In 2011, the group claims to employ more than 2 700 persons in marketing and 54 800 persons (in 30 countries) directly or indirectly in its industrial activities. According to available data, in 2011 Glencore controlled about 60% of the world zinc market, 50% of copper, 30% of aluminium, 25% of coal, 10% of cereals and 3% of petroleum. This highly controversial society was awarded the 2008 Public Eye award as the most irresponsible of the multinationals See: <http://en.wikipedia.org/wiki/Glencore>. Glencore has been considering merger with the Swiss Xstrata company, also brokerage specialists See <http://affaires.lapresse.ca/economi...> the world's biggest raw materials brokerage company. Meanwhile, JP Morgan is seeking to purchase 61,800 tons of copper in order to influence copper market prices. [Financial Times, "JPMorgan copper ETF plan would 'wreak havoc'", 24 May 2012, p. 15

[82] Of course among the powerful actors on the commodities markets are the big companies specialising in mining, production and commercialisation such as Rio Tinto, BHP Billiton, Vale do Rio Doce; in petroleum, ExxonMobil, BP, Shell, Chevron, Total... ; and in foodstuffs, Cargill, Nestlé... and many others.

[83] Much of this text has already been published in: Eric Toussaint, "Getting to the root causes of the food crisis", 21 November 2008

<http://cadtm.org/Getting-to-the-roo...>

[84] In particular, BNP Paribas, JP Morgan, Goldman Sachs, and Morgan Stanley, and until they disappeared or were taken over, Bear Stearns, Lehman Brothers, and Merrill Lynch.

[85] Sovereign wealth funds are public institutions that in the vast majority of cases belong to emerging countries like China or oil exporting countries. The first sovereign wealth funds were created in the first half of the 20th century by governments that wanted to save some of their export revenues coming from oil or manufactured goods.

[86] World wide, at the beginning of 2008, institutional investors held \$130 trillion, sovereign wealth funds \$3 trillion, and hedge funds \$1 trillion.

[87] Testimony of Michael W.Masters, Managing Member/Portfolio Manager Masters Capital Management, LLC, before the Committee on

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Homeland Security and Governmental Affairs United States Senate <http://www.hsgac.senate.gov/imo/me...>

[88] "Assets allocated to commodity index trading strategies have risen from \$13 billion at the end of 2003 to \$260 billion as of March 2008."

[89] "In 2004, the total value of futures contracts outstanding for all 25 indexed commodities amounted to no more than \$180 billion. Compare that with worldwide equity markets which totalled \$44 trillion, over 240 times bigger." Michael W. Masters points out that during that year, institutional investors invested \$25 billion dollars in futures markets, which was equivalent to 14% of the market. He shows that during the first quarter of 2008, institutional investors greatly increased their investments in this market: \$55 billion in the first 52 trading days of the year. Clearly enough to make commodity prices explode!

[90] See Testimony of Michael Greenberger, Law School Professor, University of Maryland, before the US Senate Committee regarding "Energy Market Manipulation and Federal Enforcement Regimes," 3 June 2008, p. 22.

[91] Jacques Berthelot, "Démêler le vrai du faux dans la flambée des prix agricoles mondiaux" (Distinguishing what is true from what is false in skyrocketing world food prices), 15 July 2008, p. 51 to 56. On line: <http://cadtm.org/Demeler-le-vrai-du...>

[92] <http://www.lalibre.be/index.php?vie...>

[93] Paul Jorion, "Le suicide de la finance" (The suicide of finance), Le Monde, 9 October 2012.

[94] "Loi de régulation et de séparation des activités bancaires", December 2012, <http://www.gouvernement.fr/gouverne...> and <http://www.economie.gouv.fr/files/p...>

[95] Read more at: <http://www.investopedia.com/terms/q...>

[96] See: <http://www.nanex.net/20100506/Flash...>

[97] See: <http://en.wikipedia.org/wiki/High-f...>

[98] The US FDIC and the SEC have produced a detailed report on the 6 May 2010 "Flash Crash" "Findings Regarding the Market Events of May 6, 2010" <http://www.sec.gov/news/studies/201...>

[99] See p. 42 <http://www.banque-france.fr/fileadm...>

[100] French Banking Federation activities report 2010 (Fédération bancaire française (FBF), Rapport d'activités 2010, Paris, 2011).

[101] The question of Credit Default Swaps (CDS) will be discussed in Part 6. For more information, see CDS and rating agencies: factors of risk and destabilization by Eric Toussaint, 23 September 2011 <http://cadtm.org/CDS-and-rating-age...>

[102] IMF, Global Financial Stability Report, Restoring Confidence and Progressing on Reforms, October 2012 p.31 <http://www.imf.org/External/Pubs/FT...>

[103] Karl Marx, 1867, Capital, volume I, chapter 31. <http://www.marxists.org/archive/mar...>

[104] As mentioned in Part 4 above, a small cooperative banking sector must co-exist alongside the public sector.