Only Glass-Steagall bank separation can stop deadly bail-in

7 Jan.—What we have warned against for years has now become reality: as of 1 January 2016, the largest expropriation scheme in history is operational in Europe, the so-called "bail-in" system, just at the point that the entire trans-Atlantic financial system is disintegrating.

Bail-in was one of four "resolution tools" prescribed by Europe's Bank Recovery and Resolution Directive (BRRD) which came into effect one year earlier, on 1 January 2015, establishing a "single rulebook for the resolution of banks and large investment firms in all EU Member States". (European Commission press release 31 Dec. 2014.) (Individual EU member states had the option to adopt bail-in straight away, but they agreed it would apply to all members as of 1 January 2016.)

Left, Italians outside Banca Etruria in December. The sign says "We want back all the money you have stolen." Right, protests against Portugal's Novo Banco have been ongoing; here, a rally in August 2015. Photos: MediTelegraphWEB, AFP/Patricia De Melo Moreria.

Simply put, under the new Eurozone directive, in the event a bank is insolvent, its shareholders, bondholders and customers will be expropriated in order to prevent a formal bankruptcy proceeding. Only after that, can governments borrow money to bail it out (with taxpayers' money). In other words, the money you have in the bank is no longer safe.

While deposits under €100,000 are supposed to be protected under the new directive, given the dimensions of the bad assets on the banks' books, the funds available will never suffice.

Take the case of Italy. Following Cyprus in 2013, Italy was targeted in December 2015 by the bail-in regime. After 10,000 depositors of four smaller banks had been manipulated into buying bail-in bonds by their banks, which were already in receivership, their money was confiscated through a government decree which partially implemented the new EU regulation.

On 29 December, *Handelsblatt Global Edition* published a report, signed by the editorial board and thus both authoritative and anonymous, describing the Italian banking system as the most fragile of the Eurozone. When the Italian Deposit Guarantee Fund (FITD), it noted, was not able to guarantee depositors of the four failed banks, four large banks had to intervene with 3.6 billion euros.

Although the FITD—and similar institutions in the Eurozone—should be able to protect deposits under €100,000, they won't be able to in a general crisis. In the case of the four failed banks, deposits were formally untouched and therefore the FITD was not even allowed to intervene.

The *Handelsblatt* narrative seems to serve the purposes of Brussels, which is pressing to establish a single European Deposit Guarantee Fund large enough to fend off a crisis that overwhelms the national funds. That single EU fund would then be over and above any national jurisdictions, in many of which savings are constitutionally protected, and would likely be incorporated in the tax haven of Luxembourg.

So far, the German government has successfully blocked establishment of the Fund.

Time is running out: the crash of 2016 has already started, but the financial oligarchy can still be prevented from crushing the people, by implementing a Glass-Steagall reform. That means a strict separation between traditional banking and investment banks involved in high-risk activities. It also means shutting down the Wall Street- and City of London-based casino in an orderly procedure, with no safety nets, bail-outs or bail-ins.

Bail-in ... or theft by any other name

Although the Eurozone directive on bank resolution (bail-in) lays out a clear procedure to be followed, recent cases in Italy and Portugal, and knowledge of the nature of the beast, suggest that when push comes to shove, no rules will be respected and chaos will prevail.

Besides the fact that there will never be enough money to rescue the too-big-to-fail banks, the new regulation is already having a destabilising effect on the system. On 29 December, Portugal's Novo Banco—the "good bank" established after the collapse of the Banco Espiríto Santo group—expropriated €12 billion from its senior bondholders to "recapitalise" the bank. That prompted the remaining bondholders to organise a run on the bank, plunging the value of the bonds from 94 cents on the dollar in the morning, to 14 cents in the afternoon.

In the Italian Chamber of Deputies on 22 December, Carmelo Barbagallo, the head of supervision at the Bank of Italy, warned that the bail-in rules "can undermine the confidence of small savers in the banking system. The bail-in can exacerbate—rather than alleviate—the risks of systemic financial instability caused by the crisis of individual banks."

Various rules have been thrown out the window in each bail-in crisis, from Cyprus, to Spain's Bankia, to Italy and Portugal. In the Novo Banco case, the Portuguese Central Bank was directed by the European Central Bank to ignore the rule of so-called "equal treatment" for unsecured creditors.

The EU will protect derivatives, not savings

The most hideous but less known aspect of the new EU banking resolution mechanism is the potentially unlimited protection given to derivatives (gambling debts), which can be excluded from any bail-in action if they are deemed to be critical for the stability of the financial system. Section 5, Article 44, 3 of the BRRD (Bank Recovery and Resolution Directive) provides that "In exceptional circumstances, where the bail-in tool is applied, the resolution authority may exclude or partially exclude certain liabilities from the application of the write-down or conversion powers where:... c) the exclusion is strictly necessary and proportionate to avoid giving rise to widespread contagion."

This provision is then referred to later, in Article 49, 2, which concerns derivatives. "Resolution authorities shall exercise the write-down and conversion powers in relation to a liability arising from a derivative only upon or after closing-out the derivatives. Upon entry into resolution, resolution authorities shall be empowered to terminate and close out any derivative contract for that purpose. Where a derivative liability has been excluded from the application of the bail-in tool under Article 44(3) resolution authorities shall not be obliged to terminate or close out the derivative contract [page 334]."

As the experience of 2008 shows, it will be basically impossible to close a derivative contract at the point that a large bank or financial institution goes belly up. All that has been "agreed" in eight years is that counterparties (i.e., in London) will supposedly wait for all of 24 hours before closing out derivatives and seizing collateral. In the famous case of AIG, collateral-seizing by banks went on for more than a week. Economist Simon Johnson, a member of the bank resolution advisory committee of the US Federal Deposit Insurance Agency, recently said that "If you think Europe [i.e. London] will cooperate in resolving a major bank, you are wrong. There will be no cooperation from them."

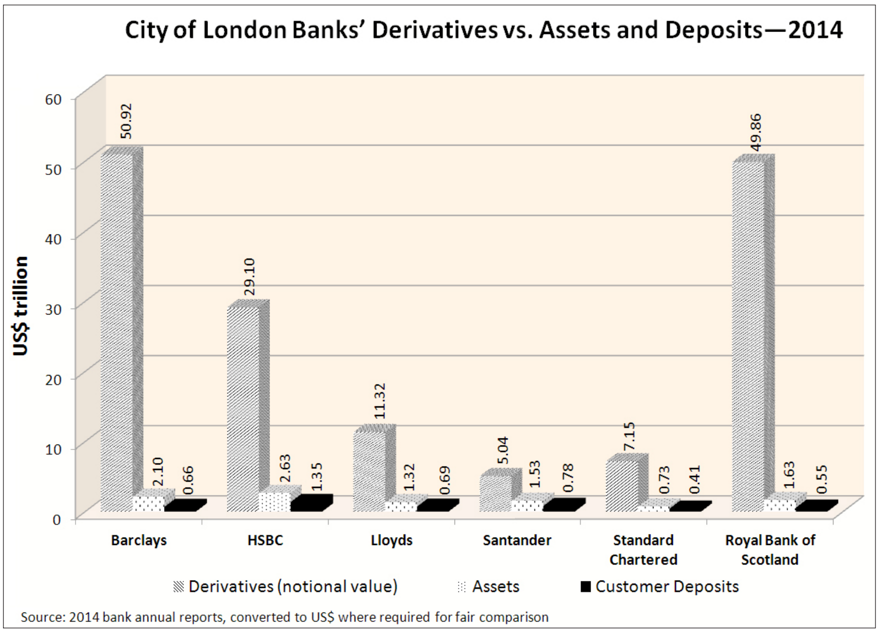
Faced with the impossibility of carrying out the orderly procedure so nicely laid out, resolution authorities (i.e. the European Banking Authority and the European Central Bank) are provided with the power to exclude derivatives from the bail-in in order to prevent "contagion".

But what about "contagion" to the real economy, families and business? Irrelevant, for the EU bureaucrats.

—*EIR Strategic Alert*

EU's bail-in props up City of London derivatives casino

The bail-in regime of the European Union's Bank Recovery and Resolution Directive (BRRD) that came into effect in EU member states as of 1 January also applies to the UK. In fact, the UK had complied with the BRRD bail-in a full year earlier on 1 January 2015. The UK's enthusiasm can be explained by the fact that the BRRD's bail-in, in conjunction with the US *Dodd-Frank Act*, explicitly protects the more than $2 quadrillion global derivatives market, the centre of which is the City of London.



The *AAS* this week compiled the latest available figures, from annual reports for 2014, for the derivatives obligations of the UK's Big Six banks, compared with their assets and deposits (see chart). They show that in all cases, derivatives dwarf assets and deposits, especially for Barclays, RBS and HSBC, the derivatives obligations of which count in the tens of trillions of dollars equivalent. RBS's total derivatives are 91 times its deposits!

This derivatives-to-deposits ratio is especially important in a bail-in, because both are obligations of the bank—deposits being straight liabilities, and derivatives being contracts which bind the bank to a certain obligation to a counterparty which may, depending on the success of the underlying "bet", become a liability or an asset. As the 7 January *EIR Strategic Alert* reported ("Only Glass-Steagall bank separation can stop deadly bail-in", p.3), under the BRRD bail-in rules, a bank's derivatives obligations are excluded from bail-in unless they have been "closed out". The deadly logic behind this rule is that as "financial stability" is the priority, a bank must honour its derivatives bets so as not to trigger a chain-reaction collapse of its derivatives counterparties, i.e. other banks. When banks such as the three named above have tens of trillions of dollars of derivatives obligations, the collapse of any one of them would implode the entire global derivatives bubble.

A UK Treasury notification of the intention to comply with the BRRD, last updated 12 December 2014, explained that, in contrast to derivatives, only "protected" deposits will be excluded from a bail-in. In the UK, protected deposits are those up to £85,000. However, the sheer size of the UK banks' derivatives exposure means that in the event of a bank failure, not only will deposits above £85,000 be automatically bailed in, but because shoring up the derivatives bubble is the intention of the bail-in regime, there is a real danger that, in an "emergency", banking regulators—who in London are usually bankers too—will grab whatever they can, including protected deposits, to plug the derivatives black hole. And remember, the scenario of bank failures isn't theoretical—in 2008 many of the UK banks did fail, and had to be nationalised to keep them afloat.

The UK Parliament legislated bail-in through its *Financial Services (Banking Reform) Act 2013*. Ironically, this is the same legislation which almost imposed a full Glass-Steagall separation of British banks, before the Glass-Steagall amendment was narrowly defeated following a memorable debate in November 2013. Instead, the Act introduced so-called "ring-fencing": the requirement that banks internally separate their deposits business from their speculative investment banking divisions. Not only is this a fake Glass-Steagall—it doesn't even come into effect until 2019! With bail-in operational now, the crisis in the global financial system that has already escalated sharply in 2016 means that there's unlikely to be any UK deposits left to ring fence by 2019. If UK residents want secure deposits, they must demand their Parliamentarians revisit the Glass-Steagall debate of 2013, and this time pass it.