Get Out of Big Banks NOW!

The next big bank failure will not be resolved with a government *Bail-Out*.

It will be resolved by a depositor *Bail-In*.

It’s now legal for a big bank to **confiscate your money**.

Randy Langel

Randy.Langel@gmail.com

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Introduction

A few months ago I discovered that US banks are not legally required to give you cash whenever you request a withdrawal\(^1\). It turns out that as soon as you deposit money in a bank, the funds become the bank's property and you become an unsecured creditor holding an IOU from the financial institution. In trying to verify this I began researching the US financial system. As I dug deeper I uncovered a complex series of federal laws, risky big bank financial maneuvers, international financial group agreements, secret G20 leader approvals, and a mysterious, relatively unknown organization which happens to be most powerful financial entity in the world. These convoluted pieces of information came together when I unearthed a document co-authored by the US Federal Deposit Insurance Corporation (FDIC) and the Bank of England outlining how the next big bank failure would be handled.

As of December 2012, federal laws, government agency approvals, international agreements, and tactical procedures are in place so the next big bank failure will trigger an entirely new resolution policy. No longer will there be a government-taxpayer funded Bail-Out, but rather a Bail-In. The big banks will be allowed to confiscate your deposits at their discretion with no prior notice. Your compensation for the bank's absconding with your money is a new issuance of stock (equity) in their bank.

In other words, you may walk into your bank one day and instead of getting cash for a withdrawal request, you will receive a stock certificate and it will be your responsibility to convert it to cash. This legal seizure of your money will most likely happen in just one night in a process called “overnight sweeps.”

Bottom line – you immediately need to move all your funds from big banks to other institutions or investments. Assets in J.P. Morgan Chase and Bank of America are especially vulnerable.

Sound unbelievable? Doubt this could actually happen? Think again – it already has. In March 2013, Cyprus became the first nation to experience this new policy formally referred to as “Resolving Globally Active, Systemically Important, Financial Institutions”\(^2\) (translation – procedure to save big banks in lieu of a government-taxpayer Bail-Out). The confiscation of depositor funds (hence the name Bail-In) in Cyprus was not only approved but mandated by the European Union, along with the European Central Bank and the International Monetary Fund. They told the Cypriots that deposits below €100,000 in two major bankrupt banks would be subject to a 6.75% levy or “haircut,” while those over €100,000 would be hit with a 9.99% “fine.” When the Cyprus national legislature overwhelming rejected the levy, the insured deposits under €100,000 were spared; but it was at the expense of the uninsured deposits, which took a much larger hit, estimated at about 60 percent of the deposited funds\(^3\).

Think your money is safe if it’s insured by the Federal Deposit Insurance Corporation (FDIC)? It’s not. First of all, the FDIC can only protect your deposits if it has the money itself. With trillions of dollars in deposits and only $33 billion in the FDIC fund (as of 12/31/12), and the Dodd-Frank mandate of no more taxpayer bail-outs, there’s nowhere to get the money except from the depositors. The FDIC was set up to ensure the safety of deposits. Now, it seems, its function will be the confiscation of deposits to save Wall Street by executing the new big bank failure resolution strategy of Bail-In.

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\(^1\) In most legal systems, funds deposited are no longer the property of the customer. The funds become the property of the bank, and the customer in turn receives an asset called a deposit account (a checking or savings account). That deposit account is a liability of the bank on the bank’s books and on its balance sheet. Because the bank is authorized by law to make loans up to a multiple of its reserves, the bank’s reserves on hand to satisfy payment of deposit liabilities amounts to only a fraction of the total which the bank is obligated to pay in satisfaction of its demand deposits. The bank gets the money. The depositor becomes only a creditor with an IOU. The bank is not required to keep the deposits available for withdrawal but can lend them out, keeping only a “fraction” on reserve, following accepted fractional reserve banking principles. When too many creditors come for their money at once, the result can be a run on the banks and bank failure.

\(^2\) This document can be obtained at the US Government FDIC website. [http://www.fdic.gov/about/srac/2012/gsifi.pdf](http://www.fdic.gov/about/srac/2012/gsifi.pdf) Paragraph 13 explicitly describes the now legal process to confiscate depositor funds. You also can get the document at my website [http://www.randylangel.com/downloads.html](http://www.randylangel.com/downloads.html)

After I had compiled this information, and even though the result was staring me in the face, I still just couldn’t believe it. I’m not a financial maven so I reasoned I must have misinterpreted something. Consequently, I contacted a friend with extensive financial acumen and asked him to refute my research. His past experience includes serving as an advisor to two administrations on banking legislation and a former bank CEO. He now assists investor groups in applying for a federal bank charter or researches the purchase an existing institution for possible acquisition. Upon completing his analysis he decided to transfer 80% of his bank deposits from Money Center Banks to smaller well-capitalized federal banking institutions and federal credit unions. That’s good enough for me. I cashed out and started researching alternatives to big banks.

This document contains:

1. A summary timeline describing the events and their ramifications leading to the Bail-In method becoming the US Government’s new official policy to resolve a big bank failure.
2. A one-page example (so far hypothetical), describing how you would be affected.
3. A step-by-step tutorial to find and rate a credit union or community bank to move your money.
4. Possible legislative and long term solutions, including references and links to additional information sources.
5. A detailed timeline describing the events and their ramifications proving that Bail-In is fact. This version substantiates the new bank failure resolution technique with comprehensive references and links throughout. Infographics are also incorporated pictorially demonstrating the magnitude of US big bank’s derivatives risk exposure that could lead to the next bank failure thus triggering Bail-In.

When I first understood that big banks had been sanctioned by the US Government to literally take our money, I immediately moved my capital from Chase to a credit union and a community bank. I also wanted to inform others of this potentially catastrophic personal financial hazard, but I wasn’t sure they would believe me. That’s the reason this document contains so much detail i.e., to prove that Bail-In and the possible confiscation of our money is real and undeniable. It is of course up to you to read and validate this material.

“The unsecured debt holders can expect that their claims would be written down to reflect any losses that shareholders cannot cover, with some converted partly into equity in order to provide sufficient capital to return the sound businesses of the G-SIFI to private sector operation.”


Note 1: unsecured debt holders are ordinary bank depositors like you & me
Note 2: G-SIFI stands for Global Systemically Important Financial Institutions (this means big banks)
<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Ramifications, Must-Know Facts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>Repeal of Glass-Steagall Act</td>
<td>Banks can now use depositor’s money for their own investments</td>
</tr>
</tbody>
</table>
| April 2005 | Passage of Bankruptcy Abuse Prevention and Consumer Protection Act, also known as the Bankruptcy Reform Act | • Creates Super-Priority Status for banks holding derivatives contracts. This means that when a financial institution is close to bankruptcy, any other bank or financial institution holding derivatives claims against it are given preference over all other creditors and customers for the remaining assets of the failing institution.  
• Normally, the FDIC would have the powers as trustee in receivership to protect the failed bank’s collateral for payments made to depositors. But the FDIC’s powers are overridden by the special status of derivatives.  
• In simple language, the big banks are first in line to claim the assets of the failing institution and nothing goes to the FDIC, depositors, or state and local governments until the big banks are through getting their share.  
• Rather than banks being put into bankruptcy to salvage deposits of their customers, the customers will now be put into bankruptcy to save the banks. |
| 2008     | Great Recession                                                      | • Derivatives, specifically credit default swaps, were the reason that what would otherwise have been a contained subprime crisis, instead turned into a global financial meltdown.  
• AIG wrote billions of dollars of derivatives “insurance” against the mortgage market without having even a fraction of what it would take to pay off claims. When the whole thing collapsed, they were wiped out. And because their “insurance” was part of the balance sheet of AIG’s many counterparties (Goldman Sachs and everyone like them), Goldman Sachs would have been wiped out too by AIG’s failure.  
• That’s why the government bailed out AIG — and insisted on giving them 100 cents on the dollar — so that they could pay off Goldman et al. AIG was bailed out to bail out all their counterparties. |
| April 2009 | Financial Stability Board (FSB) created                              | • Following the fiscal turmoil of the 2007-2008 worldwide financial collapse, the G20 nations at their 2009 London summit formalized a new organization called the Financial Stability Board.  
• The G20 nations agreed to be regulated by the newly formed FSB which is a sub-committee of the relatively unknown Bank of International Settlements. This has far-reaching implications.  
• The Bank for International Settlements (BIS) is a mysterious organization formed by an international treaty signed in The Hague in 1930. Its original mission, established by bankers and diplomats of Europe and the United States, was to collect and disburse Germany’s World War I reparation payments (hence its name).  
• It is composed of unelected country representatives, is not accountable to any government or financial institution, and is immune from taxation. In both peace and war the BIS is guaranteed these privileges by the international treaty signed 80+ years ago.  
• The BIS has become the central bank of central banks and is the most powerful financial organization in the world. |
| July 2010 | Passage of the Dodd-Frank Wall Street Reform & Consumer Protection Act | • Section 716 bans taxpayer bailouts of most speculative derivatives activities.  
• On the surface this appears to be a good thing but where will the banks get the money in the next crisis? And be assured – they will get their money. |
| Oct 2011 | Financial Stability Board (FSB) releases the document; Key Attributes of Effective Resolution Regimes for Financial Institutions. | • This is the first mention of the new concept of a Bail-In to replace previous Bail-Out (i.e., taxpayer funded) resolutions of bank failures.  
• This is the basis for what latter will become the legal right for US big banks to confiscated your money and in return give you equity i.e., a share of stock, in a new recapitalized company formed because of the bank failure. |
<p>| Nov 2011 | The G20 leaders endorse the FSB’s Key Attributes document at the Cannes Summit. | • “The Key Attributes” are now the international standard for developing bank failure resolution plans. |</p>
<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Late 2011</td>
<td>Bank of America is downgraded by Moody’s. Bank of America moves a large portion of its trillions in derivatives from its Merrill Lynch unit to its banking subsidiary. JP Morgan Chase follows suit moving its trillions in derivatives to its depository arm.</td>
</tr>
<tr>
<td></td>
<td>• BoA did not get regulatory approval but just acted at the request of frightened counterparties (BoA investors with personal financial reasons to keep BoA stable &amp; profitable)</td>
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<td></td>
<td>• The FDIC opposed the move, protesting that the FDIC would be subjected to the risk of becoming insolvent if BoA were to file for bankruptcy. However, the Federal Reserve favored the move, in order to give relief to the bank holding company, so it overruled the FDIC.</td>
</tr>
<tr>
<td></td>
<td>• This puts the FDIC in a wholly untenable position. They have to do something to protect themselves from billions, maybe trillions, in liabilities.</td>
</tr>
<tr>
<td></td>
<td>• With this guidance each country is to formulate plans and submit them to the FSB for review and comparison with other country’s plans.</td>
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<tr>
<td></td>
<td>• A new phrase is created called Global Systemically Important Financial Institutions, G-SIFIs (this means big banks).</td>
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<tr>
<td></td>
<td>• The document specifically states, “Banking groups that are G-SIFIs are therefore the main focus of this consultative document.” Big banks are being given preferential treatment.</td>
</tr>
<tr>
<td></td>
<td>• This formally establishes that the next big bank failure will be resolved by the new Bail-In policy.</td>
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<td></td>
<td>• Paragraph 13, page 3, “An efficient path for returning the sound operations of the G-SIFI to the private sector would be provided by exchanging or converting a sufficient amount of the unsecured debt from the original creditors of the failed company into equity. In the U.S., the new equity would become capital in one or more newly formed operating entities…or the equity could be used to recapitalize the failing financial company itself…”.</td>
</tr>
<tr>
<td></td>
<td>• Translation. One day you may go into your big US bank and when you ask for a withdrawal they give you a share of stock in a new company instead of cash. It will be your responsibility to get that share of stock converted to cash. Of course, since the new company was formed from the failed bank in the first place, it may be difficult to sell it, much less get remuneration equal to the cash you lost when the bank absconded with your money.</td>
</tr>
<tr>
<td></td>
<td>• Since your account has been converted to equity (stock) from cash, the FDIC is no longer responsible for the deposits. Why? Because the FDIC only insures cash accounts not equity accounts. Cute trick. You can’t really blame the FDIC because they were forced into action when BoA and JP Morgan Chase moved their trillions of derivatives into their depository arms. There is no way the government could make up the money lost with one of those giants failing.</td>
</tr>
<tr>
<td>Mar 2013</td>
<td>Cypress becomes the first nation to experience this new policy of Bail-In to save failing banks by taking depositor funds.</td>
</tr>
<tr>
<td></td>
<td>• The confiscation of depositor funds in Cyprus was not only approved but mandated by the European Union, along with the European Central Bank and the International Monetary Fund. They told the Cypriots that deposits below €100,000 in two major bankrupt banks would be subject to a 6.75% levy or “haircut,” while those over €100,000 would be hit with a 9.99% “fine.” When the Cyprus national legislature overwhelmingly rejected the levy, the insured deposits under €100,000 were spared; but it was at the expense of the uninsured deposits, which took a much larger hit, estimated at about 60 percent of the deposited funds⁴</td>
</tr>
<tr>
<td></td>
<td><strong>Total Notional Derivatives US Exposure</strong></td>
</tr>
<tr>
<td></td>
<td>• JP Morgan Chase ----------- $70.3 Trillion</td>
</tr>
<tr>
<td></td>
<td>• Citibank------------------------ $58.4 Trillion</td>
</tr>
<tr>
<td></td>
<td>• Bank of America------------- $44.5 Trillion</td>
</tr>
<tr>
<td></td>
<td>• Goldman Sachs-------------- $42.2 Trillion</td>
</tr>
<tr>
<td></td>
<td>• Total US banks--------------- $232 Trillion</td>
</tr>
<tr>
<td></td>
<td>• The 4 largest US banks hold 93% of the total derivatives contracts in the US.</td>
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<tr>
<td></td>
<td>• On 12/31/12 the FDIC had $33 Billion in the depositor insurance fund and a reserve ratio of .45%. This equates to FDIC insured deposits of $7.3 Trillion. Comparing these two assets we find there are 32 times more notional derivatives ($232 Trillion) than there are total deposits ($7.3 Trillion) while the ratio of gross derivatives to deposit insurance is a disconcerting 7,030-to-1. Small wonder that the FDIC had to endorse Bail-In.</td>
</tr>
</tbody>
</table>

## Bail-in Example – How Your Money will be Confiscated

Scenario: Let’s assume Bank of America is in a precarious financial situation. Given the new resolution policy of Bail-In, how would your cash accounts at big banks be affected? Can you still get cash to pay your bills?

<table>
<thead>
<tr>
<th>Event</th>
<th>Reactions, Consequences</th>
<th>How, Why, Comments</th>
</tr>
</thead>
</table>
| **JP Morgan Chase loans Bank of America money.**                       | • JP Morgan Chase notices that BofA has been making some bad moves lately and decides to hedge against the risk of BofA not repaying their debt to Chase by purchasing a credit default swap derivative on BofA debt.  
  • With BofA not looking so good, Chase also bets on a decline in value of BofA stock through a short sale. | • The credit default swap would pay Chase if BofA failed to repay their loan.  
  • When an investor goes short on an investment, it means that he or she has bought a stock believing its price will go down in the future and they can make money on that bet.                                                                                                                                                                                                                                                                 |
| **Chase lets other hedge funds know they are shorting BofA.**          | • Other hedge funds short BofA stock.                                                   | • At this point, any action that Chase might take to boost the odds that BofA would default will increase the value of their derivatives. That possibility might tempt Chase to take actions that would boost the odds of failure for BofA.                                                                                                                                                                                                                                      |
| **The hedge funds shorting BofA pull their money out of BofA.**        | • BofA starts to have Capital Requirements problems. In a snowball effect, other financial groups start pulling their money out of BofA too. | • This kind of behavior in which hedge funds pull their money out of banks whose stock they are shorting contributed to the failures of Bear Stearns and Lehman Brothers.                                                                                                                                                                                                                                                |
| **BofA is failing.**                                                  | • Chase and all the other big banks want to cash-in their derivative contracts with BofA.  
  • BofA assets are rapidly depleted.                                     | • Normally when a bank is failing the FDIC would have the powers as “trustee in receivership” to protect the bank’s collateral and bring about an orderly resolution of assets. The proceeds would then be used to pay depositors with the difference being made up by the FDIC. However, the FDIC’s powers are overridden by the special status of derivatives given to the big banks by the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act.  
  • The FDIC cannot intervene and must wait till the big banks holding derivative contracts with BofA get all their money back regardless of the assets affected. This includes individual depositor accounts and state/local government accounts. |
| **BofA cash is transferred to other banks in payment for derivative contracts.** | • BofA is drained of assets, including individual depositor accounts and state/local government accounts.  
  • All cash is gone at BofA leaving only real estate assets.             | • All this happens in one night in the “overnight sweeps” process.  
  • One day a depositor will have money in his/her account and the very next day there will only be an empty asset IOU entry.                                                                                                                                                                                                                                                                                                                                 |
| **FDIC comes into BofA to resolve the failure.**                     | • A new company is formed to manage the remaining assets of BofA.  
  • Depositor asset IOU’s are converted into stock in the new company.   | • The FDIC executes the new Bail-In policy laid out in the December 2012 document, Resolving Globally Active, Systemically Important, Financial Institutions                                                                                                                                                                                                                                                                                                                                 |
| **A BofA customer comes into the bank to get cash to pay bills.**     | • When asking for a withdrawal the person is given a share of stock in the new company but no cash. | • The FDIC is no longer responsible for your account and is not required to give you cash. Why? Because the FDIC only insures cash accounts not equity accounts and your account has been converted to equity (stock) from cash.  
  • It is the customer’s responsibility to get that share of stock converted to cash. Of course, since the new company was formed from a failed bank in the first place, it may be difficult to sell it, much less get remuneration equal to the cash lost when the bank failed and Bail-In was executed.                           |
## Short Term Fix - Where to Move Your Money – Alternatives to Big Banks

### Credit Unions Tasks

- To find a local credit union go to [http://www.asmarterchoice.org/](http://www.asmarterchoice.org/)
- Key in your zip code, select a distance and press Search.

### Finding the Information

The “Search” will yield a screen similar to the following:

Go to the credit union’s website and see if you are eligible to become a member.
Upon identifying a possible credit union i.e., you qualify as a member, go to http://www.bankrate.com/rates/safe-sound/bank-ratings-search.aspx to see how that particular financial institution is rated.

Select “Credit Union” in “Institution Type” and key in the credit union’s name. Keep the default for the “Choose star rating” field as “All ratings” and click “See Results.”

Stick to 4 or 5 star credit unions if possible. A 3 star institution, while not as desirable, is still far better than a big bank to avoid becoming a victim of a Bail-In.

There may be many credit unions listed, find the correct one and click on “Memo” to find out more detailed information.
The resulting report gives many more details about the credit union and rates individual Component Highlights. This is only a small part of the output.

<table>
<thead>
<tr>
<th>Component Highlights</th>
</tr>
</thead>
</table>

### Capital highlights

<table>
<thead>
<tr>
<th>Key measures of Capital Adequacy</th>
<th>Ratio (%)</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Capital / Assets</td>
<td>10.82</td>
<td>Above Peer Norm</td>
</tr>
<tr>
<td>Capital (1) / Assets</td>
<td>11.82</td>
<td>Above Peer Norm</td>
</tr>
</tbody>
</table>

(1) Includes loan loss allowance.

### Asset quality highlights

<table>
<thead>
<tr>
<th>Component star rating: 5 ****</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community Bank Tasks</td>
</tr>
<tr>
<td>----------------------</td>
</tr>
</tbody>
</table>
| To find a community bank go to the locator at [http://www.icba.org/consumer/BankLocator.cfm](http://www.icba.org/consumer/BankLocator.cfm) | **Community Bank Locator**  
**Here Today, Here Tomorrow**  
Community banks are the safest, soundest and most secure financial institutions in our nation. Community banks are common sense lenders that follow responsible business practices; are risk averse; and work every day to support their customers, communities and local markets.  
Find a local community bank in your area:  
Address:  
City:  
State:  
ZIP Code:  
Display All Banks Within:  
- 25 miles  
- 50 miles  
- 75 miles  
- 100 miles  
Submit |
| Key in your zip code, select a distance and press Submit. |  
The “Submit” will yield a report similar to the one on the right. Print this screen. |
| After identifying a possible community bank to deposit your money, go to [http://www.bankrate.com/rates/safe-sound/bank-ratings-search.aspx](http://www.bankrate.com/rates/safe-sound/bank-ratings-search.aspx) to see how that particular financial institution is rated. | **SAFE & SOUND® STAR RATINGS**  
Bank Ratings for Thrift, Credit Union and National Banks.  
Search for safe financial institutions  
Ratings information for Q1 2013 now available  
* Select institution type:  
  - Banks/Thrifts  
  - Credit Unions  
* Search by name:  
  - Farmers and merchants  
* Choose star rating:  
  - All ratings  
* Search by asset size:  
  - All  
* Denotes required field  
Tips for using Safe & Sound®:  
- Ratings are for the legal entities, not by brand name or bank branch.  
- Bank holding companies and foreign institutions that do not have a federal charter number and/or are not federally insured are not rated.  
- Use more search options to narrow your results and fewer search options to broaden your results.  
- Use the Credit Union button to access the Credit Union inquiry, the Bank & Thrift button for Commercial Banks and Savings institutions.  
- Data is updated quarterly in thrifts.  
- We do not rate credit unions with less than $5 million in assets.  
If you are searching for an institution by its geographic headquarters, click here for the advanced search.  
By clicking the “See Results” button below, I agree that I have read and agree to the Terms of Use of Safe & Sound Ratings and Reports, as well as Bankrate’s Terms of Use. By clicking the “See Results” button below, I also agree that I have read and understand Bankrate’s Privacy Policy.  
See Results |
There may be many banks listed. Find the correct one and click on “Memo” to find out more detailed information.

Community banks are analyzed differently than credit unions. Only a 4 or 5 star institution should be selected but other things need to be considered.

For banks, the value for “Net Worth to Total Assets,” should be 12 or greater.

The FDIC website also needs to be searched to scrutinize the derivatives activity at the candidate bank.

Go to [http://research.fdic.gov/bankfind/](http://research.fdic.gov/bankfind/)
Key in the bank name, zip code, and click “Find”
When the results appear, select the appropriate bank from the list and a summary screen will appear.

Click on, “Latest financial information”

Click the down arrow of the “ID Report Selections” field.

In the drop down box click on the selection, “Assets and Liabilities - %Assets”

Then click on the “Generate Report” button.
This will generate a report revealing the bank’s financial health.

Page down until you find the entry “Total bank equity capital.” This number should agree with bankrate.com’s report category “Net Worth to Total Assets” and should be above 12 in order to consider the bank a viable candidate to deposit your money.

Another report field to verify is “Derivatives.” This field should be zero. If the bank has any derivatives involvement i.e., this field is greater than zero, then exclude the institution from further consideration.

As a point of comparison, I have included a portion of JP Morgan Chase’s latest FDIC report.
Notice that their Total bank equity capital is only 7.68% which is barely above legal requirements.

Notice the Derivatives number = 3,613.43%

Chase has leveraged derivatives to the tune of 3,613% of their assets. Think this may be a bit too much risk exposure? And remember, this is only what Chase is reporting to the FDIC. It may in fact be more!

Legislative Solutions

Legislative action espoused by Ellen Brown⁵. Makes a lot of sense to me too.

1. Protect depositor funds from derivative raids by repealing the super-priority status of derivatives.
2. Separate depository banking from investment banking by repealing the Commodity Futures Modernization Act of 2000 and reinstating the Glass-Steagall Act.
3. Protect both public and private revenues by establishing a network of publicly-owned banks, on the model of the Bank of North Dakota. See http://publicbankinginstitute.org/

Long Term Solutions

- Building local economies, http://bealocalist.org/
- Peer-to-Peer Lending, http://www.prosper.com/
- Worker Owned Cooperatives, http://www.usworker.coop/education
- Alliance of Californians for Community Empowerment, http://calorganize.org/
- Time Banks, http://timebanks.org/
- The Hour Exchange, http://www.hourexchangeportland.org/
- Earth Intelligence Network, http://www.earth-intelligence.net/
- The Public Intelligence Blog, http://www.phibetaiota.net/

Other References & Sources

Books

• “Lester Land: The Corruption of Congress and How to End It,” Lawrence Lessig, TED Conferences, April 2013. Amazon rating 5 from 34 readers. [http://www.ted.com/pages/tedbooks_library#LarryLessig]

Papers / Reports

• Public Banking, Information on public banking like that being done by the Bank of North Dakota [http://publicbankinginstitute.org/]


Websites

- Web of Debt Blog http://webofdebt.wordpress.com/
- It’s Our Economy http://itsoureconomy.us/
- Economic Infographics http://demonocracy.info/
- Eye on ALEC http://billmoyers.com/spotlight/eye-on-alec/
- Economic Inequality is real, personal, expensive, created and fixable http://inequality.is/
- TED Conference Video, “We the People, and the Republic we must reclaim,” Lawrence Lessig, 2013 http://www.ted.com/talks/lawrence_lessig_we_the_people_and_the_republic_we_must_reclaim.html
- Let’s put things that matter first http://www.actionforhappiness.org/
- “Deck of Cards,” A Salute to our troops, Justin Flom http://stg.do/91qb
- Educational outreach cards for activists http://www.occucards.com/
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<tr>
<td>1999</td>
<td>Repeal of the Glass-Steagall Act.</td>
<td>• The original law was passed in 1933 as a result of banker’s taking risky investments. The reckless behavior in the 1920’s was the prime catalyst of the Great Depression in the 1930’s.</td>
<td>• Glass-Steagall prevented banks from using insured FDIC deposits to underwrite private securities and then dumping them on their own customers. With repeal, the banks were now free to use depositor’s money for the bank’s own investments.</td>
<td>• The post-repeal years were almost an exact replay of the Roaring Twenties. Once again, banks originated fraudulent loans and once again they sold them to their customers in the form of securities. The bubble peaked in 2007 and collapsed in 2008. The hard-earned knowledge of 1933 had been lost in the arrogance of 1999.</td>
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<tr>
<td>1999</td>
<td>Financial Stability Forum founded.</td>
<td>• G7’s country’s financial authorities such as finance ministries, central bankers, securities regulators, and other international financial bodies create a working group to promote global financial stability.</td>
<td></td>
<td>• The BIS was originally established in May 1930 by bankers and diplomats of Europe and the United States to collect and disburse Germany’s World War I reparation payments (hence its name).</td>
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<td>• The Bank for International Settlements (BIS) was chosen as the organization to house the newly created forum.</td>
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<td>• It is composed of unelected, member country, financial representatives and other elites.</td>
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<td>• It is not accountable to any government or financial institution.</td>
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<td></td>
<td>• It has immunity from any government interference and is free from any taxation. In both peace and war the BIS is guaranteed these privilege by an international treaty signed in The Hague in 1930.</td>
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<td>• It is the central bank of central banks and is, consequently, the central bank of the world.</td>
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<td>April 2005</td>
<td>Passage of Bankruptcy Abuse Prevention and Consumer Protection Act, also known as the Bankruptcy Reform Act.</td>
<td>• Creates Super-Priority Status for derivatives holders. This means that when a financial institution is close to bankruptcy, any other bank or financial institution holding derivatives claims against it are given preference over all other creditors and customers for the remaining assets of the failing institution.</td>
<td>• Normally, the FDIC would have the powers as trustee in receivership to protect the failed bank’s collateral for payments made to depositors. But the FDIC’s powers are overridden by the special status of derivatives.</td>
<td>• The phrase “derivative counter-parties” is the actual wording the law uses to describe banks or financial institutions. Counterparty is a term commonly used in the financial services industry to describe a legal entity, unincorporated entity or collection of entities to which an exposure to financial risk might exist.</td>
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<td>• Rather than banks being put into bankruptcy to salvage deposits of their customers, the customers will now be put into bankruptcy to save the banks.</td>
<td>• Hailed at the time of the bill’s passage as the banking lobby’s greatest all-time victory. <a href="http://en.wikipedia.org/wiki/Bankruptcy_Abuse_Prevention_and_Consumer_Protection_Act">http://en.wikipedia.org/wiki/Bankruptcy_Abuse_Prevention_and_Consumer_Protection_Act</a></td>
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<td>• This super-priority status not only supersedes individuals and companies but also state and local governments. If the city of Newport Beach had its money in bank A and it was failing, and if bank B</td>
<td>• Remember MF Global and its missing $600 million? The reason its customers lost their supposedly segregated customer funds to the derivatives claimants was that</td>
</tr>
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</table>

6 The G7 is a group consisting of the finance ministers of seven industrialized nations: the U.S., U.K., France, Germany, Italy, Canada and Japan. They are seven of the eight (China excluded) wealthiest nations on Earth, not by GDP but by global net wealth. The G7 represents more than the 66% of net global wealth ($223 trillion), according to Credit Suisse Global Wealth Report September 2012.
had derivatives claims against bank A, bank B could take the cash from bank A accounts (assets) before the city could. Operating and pension funds could be wiped out.


The financial crisis has enough blame to go around. Borrowers were reckless, brokers were greedy, rating agencies were negligent, customers were naive, and government encouraged the fiasco with unrealistic housing goals and unlimited lines of credit at Fannie Mae and Freddie Mac.

The fact that there were so many parties to blame should not be used to deflect blame from the most responsible parties of all—the big banks. Without the banks providing financing to the mortgage brokers and Wall Street while underwriting their own issues of toxic securities, the entire pyramid scheme would never have got off the ground.

Derivatives, specifically credit default swaps, were the reason that what would otherwise have been a contained crisis became a global disaster.

AIG wrote billions of dollars of derivatives “insurance” against the mortgage market without having even a fraction of what it would take to pay off claims in the naked belief that they could collect fees forever and never have to pay out once. When the whole thing collapsed, they were wiped out. And because their “insurance” was part of the balance sheet of AIG’s many counterparties (Goldman Sachs and everyone like them), Goldman Sachs would have been wiped out too by AIG’s failure.

That’s why the government bailed out AIG — and insisted on giving them 100 cents on the dollar — so that they could pay off Goldman et al. AIG was bailed out to bail out all their counterparties.

Derivatives are contracts between parties who want to trade risks, but they aren’t market-traded, standardized or vetted by any controlling institution.

In derivatives trading, the counterparties know each other, the contracts are one-off between the parties directly, and the only guarantee that either party will get paid is trust or the naked belief that they just can’t lose on this one.

The vast majority of US derivatives are Credit Default Swaps (CDS). The Office of the Comptroller of the Currency document, “OCC’s Quarterly Report on Bank Trading and Derivatives Activities First Quarter 2013,” page 9, puts the CDS’s percent of the US derivatives market at 97.2%. Credit default swaps are pure casino bets. They were originally designed as a form of insurance against bond and other credit defaults (“I’ll pay you a monthly fee and you pay me my losses if these bonds default.”). It’s a simple concept, but CDSs soon evolved. Turns out you don’t have to actually hold the bonds to insure them. This means that


8 A derivative is a financial product derived from another financial product (for example, a futures contract tied to a stock index). In practice, the term applies to a whole world of financial products that are written on a one-off basis between two entities called “counterparties,” as opposed to products that are traded on a broad, well-regulated market. Standard futures contracts are bought and sold on large exchanges, for example, the Chicago Board of Trade (CBOT). If I buy a futures contract — for example, I go long (contract or agree to buy) in the future — a million bushels of wheat, or barrels of oil, in the expectation that the future price will rise within the time limit of the contract — there will be a counterparty on the short, or selling side, but I have no idea who that is. In fact, in a well-regulated market, the contracts are all standardized; there are millions of identical contracts in pairs (one on the long or buy side, and one on the short or sell side); and as long as there are the same number of identical contracts on each side, it makes no difference who’s on the other side of my personal contract. The exchange just matches up longs with shorts when they liquidate. The contracts, as you can see, are created by the exchanges themselves (for example, by the CBOT); they keep the operation orderly; and there are rules, both by the exchanges and by the government, that prevent things (mostly) from running out of control. For example, I can indeed buy futures contracts on millions and millions of barrels of oil for delivery next July (say), and I can put up a tenth of the cost of these contracts, but if the market moves against me, I have to increase my margin (add to my escrow if you will) to protect my counterparties from my inability to pay. The exchange requires that, and if I don’t comply, I’m liquidated (at my expense) and kicked out. Futures contracts are gambling — I can bet on the Dow to go down or up, for example — but trading in futures contracts is regulated gambling, in which winners are protected from losers, and in many cases, losers protected from themselves. Not so, derivatives, in the usual meaning of the word. Derivatives in that sense are contracts between parties who want to trade risks, but they aren’t market-traded. They aren’t standardized. And counterparties aren’t vetted by any controlling institution. In derivatives trading, the counterparties know each other, the contracts are one-off between the parties directly, and the only guarantee that either party will get paid is trust or the naked belief that they just can’t lose on this one.

9 Derivatives example. Suppose Bank 1 (B1) decides to hedge against the risk that Bank 2 (B2) might fail to repay their debt to B1. To guard against that, B1 might hedge the risk through derivatives. In so doing, B1 might buy a credit default swap (CDS) on B2 debt. The CDS would pay B1 if B2 failed to repay their loan. B1 might also bet on the decline in shares of B2 through a short sale. At that point, any action that B1 might take to boost the odds that B2 might default would increase the value of their derivatives. That possibility might tempt B1 to take actions that would boost the odds of failure for B2. This kind of behavior -- in which hedge funds pulled their money out of banks whose stock they were shorting — contributed to the failures of Bear Stearns and Lehman Brothers.

10 A good set of product descriptions, definitions and frequently asked questions about derivatives is at http://www.isda.org/educat/faqs.html#1
<table>
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<tr>
<th>Date</th>
<th>Event</th>
<th>Description</th>
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<tbody>
<tr>
<td>April 2009</td>
<td>Financial Stability Board (FSB) created</td>
<td>Following the fiscal turmoil of the 2007-2008 worldwide financial collapse, the G20 nations at their 2009 London summit formalized a new organization called the Financial Stability Board. It was the successor of the Financial Stability Forum (created in 1999 – see above) and was to become a sub-committee of the Bank of International Settlements (BIS). The FSB's stated goal was to identify key weaknesses underlying the current financial instability and recommend actions to improve market and institutional resilience.</td>
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<td>July 2010</td>
<td>Passage of the Dodd-Frank Wall Street Reform &amp; Consumer Protection Act.</td>
<td>Section 716 bans taxpayer bailouts of most speculative derivatives activities. It does not in any way limit the swaps activities which banks or other financial institutions may engage in. There will be no more $700 billion taxpayer bailouts. On the surface this appears to be a good thing but where will the banks get the money in the next crisis? And be assured – they will get their money.</td>
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</table>

11 The Group of Twenty Finance Ministers and Central Bank Governors (also known as the G20) is a group of finance ministers and central bank governors from 20 major economies: 19 countries plus the European Union, which is represented by the President of the European Council and by the European Central Bank. Collectively, the G20 economies account for approximately 80% of the gross world product (GWP), 80% of world trade, and two-thirds of the world population.
**Oct 2011**  
Financial Stability Board (FSB) releases the document, *Key Attributes of Effective Resolution Regimes for Financial Institutions*[^12]  
- Details the core elements the FSB considers necessary for an effective resolution of a future bank failure.  
- To quote the document, the FSB believes that the “implementation should allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of the bank’s vital economic functions.”[^12]  
- This is the first mention of the concept of a Bail-In to replace previous Bail-Out resolutions of bank failures.  
- Key Attribute 3.2 section ix, “Carry out bail-in within resolution as a means to achieve or help achieve continuity of essential functions either (i) by recapitalising the entity hitherto providing these functions that is no longer viable, or, alternatively, (ii) by capitalising a newly established entity or bridge institution to which these functions have been transferred following closure of the non-viable firm (the residual business of which would then be wound up and the firm liquidated).”[^12]  
- This is the basis for what latter will become the legal right for US big banks to confiscated your money and in return give you equity i.e., a share of stock, in a new recapitalized company formed because of a bank failure.

**Nov 2011**  
The G20 leaders endorse the *Key Attributes of Effective Resolution Regimes for Financial Institutions* at the Cannes Summit.  
- “The Key Attributes” are now the international standard for developing bank failure resolution plans.

**Late 2011**  
Bank of America is downgraded by Moody’s.  
Bank of America moves a large portion of its trillions in derivatives from its Merrill Lynch unit to its banking subsidiary.  
JP Morgan Chase follows suit moving its trillions in derivatives to its depository arm.  
- BoF did not get regulatory approval but just acted at the request of frightened counterparties (BoF investors and other groups with personal financial reasons to keep BoF stable and profitable i.e., stable and profitable at least as far as the public is concerned).  
- The FDIC opposed the move, protesting that the FDIC would be subjected to the risk of becoming insolvent if BoF were to file for bankruptcy. However, the Federal Reserve favored the move, in order to give relief to the bank holding company, so it overruled the FDIC.  
- *Remember that the FDIC is a federal government agency acting according to existing federal law. The Federal Reserve is not a federal government.*  
- Moving derivatives contracts to the bank’s deposit arm commingles the cash you and I have in the bank with highly-leveraged, extremely risky derivative investments.  
- If a bank needs to pay off on a derivative (it is after all a contract and some contracts are winners and some losers), the pooled money pot (the bank’s derivative gains and our cash) is used to pay the debt. As long as profits from derivatives are greater than losses, our deposits are not affected.  
- If lots of derivatives go bad such that derivatives profits are less than losses, then using the pooled pot of money to pay off the bank’s obligation will result in our deposits (our cash) being eroded. We will not know this is happening since individual deposit accounts will not reflect the decrease in value as long as the bank is solvent.  
- Here’s how it would work. Let’s assume there is a major derivatives bust at BoF. As of 12/31/12 BoF had derivatives with notional values exceeding $42 trillion (see US Comptroller of Currency entry below). A number this large indicates that there would be many financial institutions liens against BoF. As BoF is failing (not after it has failed but while it is failing), all the financial institutions holding BoF derivative contracts call them and take whatever BoF assets are still remaining. After all the banks get done taking their slice of BoF assets the collateral is likely to be gone. With nothing left for the FDIC to take into receivership to pay secured depositors (including state and local governments), the FDIC is now on the hook for it all. This is why the FDIC is so annoyed by this big bank financial maneuver.  
- *This puts the FDIC in a wholly untenable position. They have to do something to protect themselves from billions, maybe trillions, in liabilities.* In December 2012 the FDIC, in

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[^13]: The Federal Reserve System has both private and public components, and was designed to serve the interests of both the general public and private bankers. However, the good intentions of its 1913 formation have been overshadowed so that today the Federal Reserve works almost exclusively for private banking interests. The Fed’s structure is considered unique among central banks. It is unusual in that an entity outside of the Fed, namely the United States Department of the Treasury, creates the currency used. According to the Board of Governors, the Federal Reserve System “is considered an independent central bank because its monetary policy...”
agency yet it reversed the legal and fiduciarily proper actions of a government agency because the bank’s investors, not depositors, might be harmed. This is not acting in the public interest.\footnote{Proof positive, says former regulator Bill Black that the Fed is working for the banks and not for us. “Any competent regulator would have said: ‘No, Hell NO!’” \url{http://dailybail.com/home/william-black-not-with-a-bang-but-a-whimper-bank-of-americas.html}}

If lots of derivatives go bad such that the bank is in danger of failing, then the super-priority status granted to derivatives claimants by the 2005 Bankruptcy Reform Act comes into play. Normally, the FDIC would have the powers as trustee in receivership to protect the failed bank’s collateral for payments to make to depositors. But the FDIC’s powers are overridden by the special status of derivatives claimants.

In simple language, the big banks are first in line to claim the assets of the failing institution and nothing goes to the FDIC, depositors and state or local governments until the big banks are through getting their share.

The lunacy of giving big banks super-priority status in derivatives by the 2005 Bankruptcy Reform Act was actively supported in an article by Mark J. Roe in 2011. Mr. Roe is a professor at Harvard Law School where he teaches bankruptcy and corporate law. The article was so well received it was published by

4. European Corporate Governance Institute.

The article’s abstract\footnote{A copy of the document can be obtained from \url{http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1567075} or my website at \url{http://www.randylangel.com/downloads.html}} (see right) provides a concise overview of the ongoing risk brought about by this new law. Two years after the publication of this paper nothing has changed to alleviate the risk exposure. This means that the possibility of a big bank failure and consequently the initiation of a Bail-In and the confiscation of your funds are more probable than ever.

“Chapter 11 bars bankrupt debtors from immediately repaying their creditors, so that the bankrupt firm can reorganize without creditors shredding the bankrupt’s business. Not so for the bankrupt’s derivatives counterparties, who unlike most creditors, even most other secured creditors, can seize and immediately liquidate collateral, net out gains and losses, terminate their contracts with the bankrupt, and keep both preferential eve-of-bankruptcy payments and fraudulent conveyances they obtained from the debtor in ways that favor them over other creditors. Their right to jump to the head of the bankruptcy re-payment line, in ways that even ordinary secured creditors cannot, weakens their incentives for market discipline in managing their credits to the debtor; it reduces their concern for the risk of counterparty failure and bankruptcy, since they do well in any resulting bankruptcy. If they were made to account better for counterparty risk, they would be more likely to insist that there be stronger counterparties than otherwise on the other side of their derivatives bets, thereby insisting for their own good on strengthening the financial system. True, because they bear less risk, nonprioritized creditors bear more and thus have more incentive to monitor the debtor or to assure themselves that the debtor is a safe bet. But the repo and derivatives market’s other creditors - such as the United States of America - are poorly positioned contractually either to consistently monitor the derivatives debtors’ well or to fully replicate the needed market discipline. Bankruptcy policy should harness private incentives for counterparty market discipline by cutting back the extensive de facto priorities for these investment channels now embedded in chapter 11 and related laws. More generally, when we subsidize derivatives and repos activity via bankruptcy benefits not open to other creditors, we get more of the activity than we otherwise would. Repeal would induce the derivatives market to better recognize the risks of counterparty financial failure, which in turn should dampen the possibility of another AIG/Bear/Lehman financial meltdown, thereby helping to maintain financial stability. Re-peal would lift the de facto bankruptcy subsidy.
• Remember that the FDIC can only insure your deposits if it has the money to pay you. Once you realize the amount of deposits in the big banks and the relative pittance in the FDIC coffers, you will understand that Too Big To Fail banks are classified that way because a failure of any one of these institutions will bankrupt the FDIC fund. AND if the fund has no more money and the laws are not changed regarding repaying depositors in a bank failure, then the federal government has to make up the difference. This then becomes another version of a taxpayer Bail-Out of a big bank. (note: I said, “if the laws are not changed regarding repaying depositors,” but this has in fact happened with the new Bail-In policies of the FDIC – see below)

• The infographic\(^\text{16}\) on the right pictorially shows how the $25 billion FDIC Insurance Fund stacks up to the $9,294 Billion size of deposits at US banks\(^\text{17}\). This means the fund has only 27 cents of insurance for every $100 of deposits.

• The infographic also shows that given there is only $1,102 billion in total US currency in circulation; there aren’t physically enough dollars to go around anyway.

\(^{16}\) This infographic is part of a larger graphic depicting the US debt starting with a picture of a single $100 bill and then building it up through stacks and stacks of currency. It’s easier to understand just how much a trillion dollars is if you can see a picture comparing it to something a normal person would understand. The complete infographic is at http://demonocracy.info/infographics/usa/fdic/fdic.html this website is dedicated to pictorially envisioning the huge amount of money being spent by the US.

| Financial Stability Board (FSB) releases the document, *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational*¹⁸ | Countries must develop a plan that;  
1. Reduces the potential for bank failure  
2. Promotes resolvability of failure  
3. Creates a resolution process  
4. Follows the Key Attributes  
The document provides guidance to country regulators and resolution authorities in the areas of;  
1. Recovery triggers & stress scenarios  
2. Resolution strategies & operational resolution plans  
3. Identification of critical functions & critical shared services  
   - With this guidance each country is to formulate plans and submit them to the FSB for review and comparison with other country’s plans.  
   - A new phrase is created called Global Systemically Important Financial Institutions, G-SIFIs (this means big banks).  
   - The document specifically states, “Banking groups that are G-SIFIs are therefore the main focus of this consultative document.”  
   - Big Banks are being given preferential treatment. |
| --- | --- |
| FDIC & Bank of England jointly publish, *Resolving Globally Active, Systemically Important, Financial Institutions*¹⁹ | Following the guidelines set out by the FSB’s *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational*, document (see directly above), the two countries develop a resolution strategy for future bank failures involving G-SIFIs (big banks).  
   - “These strategies have been designed to enable large and complex cross-border firms to be resolved without threatening financial stability and without using public funds.” Page ii.  
   - “The unsecured debt holders can expect that their claims would be written down to reflect any losses that shareholders cannot cover, with some converted partly into equity in order to provide sufficient capital to return the sound businesses of the G-SIFI to private sector operation.” Page ii.  
   - “An efficient path for returning the sound operations of the G-SIFI to the private | At first blush, the statement that the resolution process will not involve public funds sounds good but further down the document we discover that the bank’s customers will be taking the hit to their own accounts.  
   - A person depositing money in a bank is an unsecured creditor of the bank. That means this new Bail-In procedure applies to the deposits of you and me. The big banks can now confiscate our money and it’s perfectly legal. In a process called “overnight sweeps” depositors will have their savings shaved by the amount needed to keep the bank afloat.  
   - One day you go into your big US bank and when you ask for a withdrawal they will give you a share of stock in a new company instead of cash. It will be your responsibility to get that share of stock converted to cash. Of course, since the new company was formed from the failed bank in the first place, it may be difficult to sell it, much less get remuneration equal to the cash you lost when the bank absconded with your money.  
   - US banks are not legally required to give you cash whenever you request a withdrawal²⁰. As soon as you deposit money the funds become the bank’s property and you become an unsecured creditor holding an IOU from the financial institution.  
   - A “Bail-In” is a quantum leap beyond a “Bail-out.” When governments are no longer willing to use taxpayer money to bail out banks that have gambled away their capital, the banks are now being instructed to “recapitalize” themselves by confiscating the funds of their creditors, turning debt into equity, or stock; and the “creditors” include the depositors who put their money in the bank thinking it was a secure place to store their savings.  
   - The big banks are the only banks that have this capability since they deal with derivatives and in so doing are given super priority status to reclaim assets of a failing institution.  
   - You can’t really blame the FDIC because they were forced into action when BofA and JP Morgan Chase moved their trillions of derivatives into their depository arms where the FDIC is supposed to guarantee the deposits. There is no way the government could make up the money lost if one of |


²⁰ In most legal systems, funds deposited are no longer the property of the customer. The funds become the property of the bank, and the customer in turn receives an asset called a deposit account (a checking or savings account). That deposit account is a liability of the bank on the bank’s books and on its balance sheet. Because the bank is authorized by law to make loans up to a multiple of its reserves, the bank’s reserves on hand to satisfy payment of deposit liabilities amounts to only a fraction of the total which the bank is obligated to pay in satisfaction of its demand deposits. The bank gets the money. The depositor becomes only a creditor with an IOU. The bank is not required to keep the deposits available for withdrawal but can lend them out, keeping only a “fraction” on reserve, following accepted fractional reserve banking principles. When too many creditors come for their money at once, the result can be a run on the banks and bank failure.
The confiscation of depositor funds in Cyprus was not only approved but mandated by the European Union, along with the European Central Bank and the International Monetary Fund. They told the Cypriots that deposits below €100,000 in two major bankrupt banks would be subject to a 6.75% levy or “haircut,” while those over €100,000 would be hit with a 9.99% “fine.” When the Cyprus national legislature overwhelmingly rejected the levy, the insured deposits under €100,000 were spared; but it was at the expense of the uninsured deposits, which took a much larger hit, estimated at about 60 percent of the deposited funds.\(^{21}\)

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<th>Mar 2013</th>
<th>Cypress becomes the first nation to experience this new policy of Bail-In to save failing banks by taking depositor funds.</th>
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| US Comptroller of the Currency office issues quarterly report on derivatives holdings.\(^{22}\) | Total Notional Derivatives\(^{23}\) US Exposure
- JP Morgan Chase ----------- $70.3 Trillion
- Citibank------------------------ $58.4 Trillion
- Bank of America--------------------------- $44.5 Trillion
- Goldman Sachs------------------------- $42.2 Trillion
- Total US banks------------------------ $232 Trillion

The 4 largest US banks hold 93% of the total derivatives contracts in the US. |

| March 2013 | Total Risk Based Capital
- JP Morgan Chase ----------- $153 Billion
- Citibank------------------------ $139 Billion
- Bank of America--------------------------- $141 Billion
- Goldman Sachs------------------------- $22 Billion

The numbers above are supposedly the amount of capital at risk in derivatives. The problem is with the accuracy of these amounts since they are calculated by the banks themselves and do not disclose how they arrived at these estimates. |

- In the January/February 2013 issue of The Atlantic an article titled, “What’s Inside America’s Banks,”\(^{24}\) by Jesse Eisinger and Frank Partnoy goes a long way in explaining why investors are so skeptical about bank stocks. The pair go through the annual report of Wells Fargo to try to see if even a very careful and close read can produce anything intelligible about the risks the bank is taking, how it is valuing its assets, and even what its assets and liabilities really are. What they discover is that this cannot be done. Banks are black boxes. The public disclosures are nearly useless, collections of overlawyered jargon that obscure more than they reveal. Even when Eisinger and Partnoy attempt to make very detailed inquiries into questions

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\(^{23}\) A derivative is a financial instrument whose value depends on something else—a share of stock, an interest rate, a foreign currency, or a barrel of oil, for example. One kind of derivative might be a contract that allows you to buy oil at a given price six months from now. But since we don’t yet know how the price of oil will change, the value of that contract can be very hard to estimate. (In contrast, it’s relatively easy to add together the value of every share being traded on the stock market.) As a result, financial experts have to make an educated guess about the total amount at stake in all these contracts. One method simply adds up the value of the assets the derivatives are based on. In other words, if my contract allows me to buy 50 barrels of oil and the current price is $100, its “notional value” is said to be $5,000—since that’s the value of the assets from which my contract derives.
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<td><strong>A recent survey by Barclays Capital</strong>&lt;sup&gt;24&lt;/sup&gt; found that more than half of institutional investors did not trust how banks measure the riskiness of their assets. When hedge-fund managers were asked how trustworthy they find &quot;risk weightings&quot;—the numbers that banks use to calculate how much capital they should set aside as a safety cushion in case of a business downturn—about 60 percent of those managers answered 1 or 2 on a five-point scale, with 1 being &quot;not trustworthy at all.&quot; None of them gave banks a 5.</td>
<td><strong>No one, not even professional investors or bank personnel themselves know how much money is actually at risk in derivatives. If they don't know then a derivatives meltdown can happen at any time.</strong></td>
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<td><strong>Consider JPMorgan’s widely scrutinized trading loss in 2012. Before the episode, investors considered JPMorgan one of the safest and best-managed corporations in America. But then, in May, JPMorgan announced the financial equivalent of sudden cardiac arrest: a stunning loss initially estimated at $2 billion and later revised to $6 billion. It may yet grow larger as investigators are still struggling to comprehend the bank’s condition.</strong></td>
<td><strong>To put the notional derivatives exposure into perspective let’s compare it to secured deposits. On 12/31/12 the FDIC had $33 Billion in the depositor insurance fund and a reserve ratio of .45%&lt;sup&gt;26&lt;/sup&gt;. This equates to FDIC insured deposits of $7.3 Trillion. Comparing these two assets we find there are 32 times more notional derivatives ($232 Trillion) than there are total deposits ($7.3 Trillion) while the ratio of gross derivatives to deposit insurance is a disconcerting 7,030-to-1.</strong></td>
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<td><strong>Another way of looking at notional derivatives exposure is that the total US economy only generates $15.5 Trillion in Gross National Product per year. That equates to 14 years worth of GNP tied up in notional derivatives exposure, with the four main US banks soaking up over 13 years worth of the total.</strong></td>
<td><strong><a href="http://www.forbes.com/sites/halahtouryalai/2013/03/28/risk-is-back-americas-big-banks-are-knee-deep-in-derivatives/">http://www.forbes.com/sites/halahtouryalai/2013/03/28/risk-is-back-americas-big-banks-are-knee-deep-in-derivatives/</a></strong></td>
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</table>

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<sup>25</sup> Ibid.

<sup>24</sup> http://www.theatlantic.com/magazine/archive/2013/01/whats-inside-americas-banks/309196/?single_page=true

This infographic shows what $300 Trillion dollars of notional value the derivatives exposure would look like when compared to big bank assets and currency in circulation. The first infographic, a few pages above, gave some scale to the $25 Billion FDIC insurance fund in proportion to the $9294 Billion of deposits at commercial banks. That infographic is present in this one too, it just so small that it’s difficult to discern.

At [http://demonocracy.info/infographics/usa/derivatives/bank_exposure.html](http://demonocracy.info/infographics/usa/derivatives/bank_exposure.html) there is another infographic that compares the derivatives exposure for each big bank and summarizes them in a different way.

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**Bank for International Settlements**

- **May 2013**

  - Page 3, **“OTC” derivatives notional amounts outstanding totaled $633 Trillion”** at end-December 2012...
  - Page 3, “The gross market value of all contracts, i.e., the cost of replacing the contracts at current market prices, equaled $24.7 Trillion at end-2012.” This is also called Mark-to-Market value.
  - Report can be obtained from BIS site: [http://www.bis.org/publ/otc_hy1305.pdf](http://www.bis.org/publ/otc_hy1305.pdf)
  - It can also be obtained from my site at: [http://www.randylangel.com/downloads.html](http://www.randylangel.com/downloads.html)
  - Detailed statistics are available at: [http://www.bis.org/statistics/derdetailed.htm](http://www.bis.org/statistics/derdetailed.htm)

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27 Over the counter (OTC) derivatives refer to contracts that are negotiated between two parties rather than through an exchange.

28 A derivative is a financial instrument whose value depends on something else—a share of stock, an interest rate, a foreign currency, or a barrel of oil, for example. One kind of derivative might be a contract that allows you to buy oil at a given price six months from now. But since we don’t yet know how the price of oil will change, the value of that contract can be very hard to estimate. (In contrast, it’s relatively easy to add together the value of every share being traded on the stock market.) As a result, financial experts have to make an educated guess about the total amount at stake in all these contracts. One method simply adds up the value of the assets the derivatives are based on. In other words, if my contract allows me to buy 50 barrels of oil and the current price is $100, its “notional value” is said to be $5,000—since that’s the value of the assets from which my contract derives. If you make that same calculation for every derivative and add those numbers together at the end of 2012, you get something around $633 trillion—the “notional value” of the world’s over-the-counter derivatives (“over the counter” derivatives refer to contracts that are negotiated between two parties rather than through an exchange), according to the Bank of International Settlements, “Statistical release: OTC derivatives statistics at year end-December 2012” page 3.