

Why the Banks Are Out of Control

by Rowan Bosworth-Davies

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Why the British Financial Regulatory system is in such a drastic state, and why the banks are out of control.

Ever since my early visits to the USA in the early 1980s to study financial regulation with the SEC, the NASD, the CFTC and the major Exchanges, I have long reiterated my belief in the importance of the financial regulatory function in reining back the dishonest excesses of the financial sector.

Now, with yesterday’s news about Standard Chartered Bank and their wholesale disregard of US laws on sanctions, my belief is reinforced even more strongly. I hope that the US regulatory agency which has reported on SCB makes sure that their licence to conduct financial business in New York is removed. Without an ability to clear US dollars, any bank will go out of business very quickly. And what can SCB say, “that they didn’t know?” No, this episode is just yet another example of what has become an endemic culture of legal anomie within the banking system, where the Executives of the major banks have decided that they are “too big to jail,” and international laws do not apply to them when they become inconvenient.

Without any doubt, the scandal that has become the “banking collapse” in the UK (not my words, they are Vince Cable’s on the “Today Programme” on 26th July 2012), was caused by an excess of greed on the part of the banks, influenced both by a new environment of derivative abuse in the field of debt securitisation, but coupled with a culture of criminality which has been allowed to become endemic in the financial sector; an admixture of regulatory failure, influenced by political incompetence and the policy of a “light touch approach” towards regulation of banks; and the total failure of the regulators to understand and respond to the criminogenic culture inherent within the new product

models adopted by the practitioners whom they were supposed to oversee.

Lest anyone be tempted to observe that the financial problem started in the US, let me say that it was only allowed to become as bad as it did because the Americans, first under Reagan and later the younger George Bush, had demolished a superb regulatory edifice that had been in place since 1934, and had made a significant contribution to America's post-war financial hegemony!

Those US pioneers had taught us that without effective and professional regulators, armed with personal courage, good legal knowledge and sincere moral integrity, the financial sector it purports to regulate will run wild. The very reason that the SEC was created in the first place was to restore the integrity of the markets destroyed in the aftermath of the Wall Street Crash, a financial scandal caused by an epidemic of criminal operators who had undermined the credibility of the exchanges. The financial sector existed then, as it does today, to make money, lots of it, and it doesn't really care how it does it. Those who populate the financial markets are fairly crude creatures, motivated by greed and selfishness. You don't need to be very bright or intellectual to make money in the financial sector, but you do have to be willing to sacrifice any principles of honesty or integrity you may once have been born with. As Balzac once said, "behind every great fortune there is a great crime"!

Before anyone starts fulminating at these forthright statements, I am not interested in hearing any sob stories from financial players who seek to lay claim to a lifetime's dedication to the interests of others. I have been around this game for too long and seen too much to have any illusions about the truth of those remarks.

So, why and how has this state of affairs been allowed to develop?

The British have always adopted a schizophrenic attitude towards the way they view criminal activity. There is the crime of the streets, burglary, theft, mugging, joy-riding, rioting, committed by identifiable criminal types, and dealt with by the police. Then there is the kind of wrong-doing that takes place within the financial sector, but when it happens, it gets called something else (mis-selling), and is dealt with by regulatory agencies.

For some reason there is a complete distinction between the two courses of conduct. They are, and have always been dealt with differently; penalised differently; administered differently, and for some strange reason which I only finally understood after I had studied the work of Edwin Sutherland, considered differ-

ently by politicians, regulators and in many cases, even by the general public.

I once conducted an academic research project where I asked a group of financial services compliance officers to place in order of seriousness a series of criminal offences. In the general list I included six typical identifiable criminal offences such as theft, fraud, joy riding, robbery, while for the other six I used recognisable terms such as "insider trading," "churning," "misselling a financial product for the purposes of generating more commission," "misselling a financial product which meant that the client was no better off, but which generated more profit for the company," "front running," etc.

Without exception, in excess of 60 respondents put the identifiable ordinary crimes first in the list, while putting the financial issues last. It was as if activities which could be described in conventional criminal terms assumed a far greater degree of social opprobrium than did financial crimes, even though in pure legal definitions, all the offences alleged were equally criminal and all should be investigated and punished equally seriously.

It was a classic illustration of what Professor Michael Levi of Cardiff University once referred to as the huge social gulf that existed between the crimes of the streets as opposed to the crimes in the suites!

There is absolutely no reason why someone who steals a car or robs a post office should be considered to be any different from a person who trades in securities using inside information, who allows his institution to be used for the purposes of laundering of criminal money, or who helps himself to funds deposited with him for the purposes of investment.

One of the greatest tragedies of the British regime of financial regulation, and one of its biggest failings, is that none of those who hold down senior roles within the upper reaches of the regulatory agencies, have ever once undertaken even the simplest form of criminal investigation. They have never even arrested so much as a shoplifter, and they do not know how criminals will behave when they are being investigated; they do not know what evidence is needed to bring these persons before a court and to obtain a safe and proper conviction; they do not know how to go about acquiring even the most basic evidence which can be used to convict a criminal; and perhaps most importantly of all, they do not understand how to conduct themselves when they are being required to investigate a pattern of behaviour which might prove to possess important criminal consequences. Put more simply, they simply do not under-

stand the signs of crime, and they are therefore ill-equipped to deal with them even when they are staring them in the face!

Yet these are the very people we put in charge of our regulatory agencies, and we give them very complex investigatory powers. Members of the “Great and Good,” people who have held down no doubt important roles in academe or the law, (even the Serious Fraud Office has been seriously criticised for its administrative failings), banking or other areas of financial business, former civil servants or senior partners in leading firms of accountants (if ever there was a serious conflict of interests it is in appointments such as these), or people who are seconded from other regulatory environments, but who have no experience at all in dealing with criminals.

While they all possess undoubted skills and experience, the one thing they all have in common is a complete lack of any understanding of the function of the criminal temperament.

And the people they recruit are cast in the same mould. They use the age-old civil service tests of suitability: are they the “safe pair of hands,” or “is he one of us,” requirements which succeed only in maintaining a regime of ineptitude. I simply cannot recall how many former senior, experienced police detectives, men and women who have real skill and experience in dealing with major criminals, have ever been recruited to become senior figures in the regulatory agencies.

There may be some who have found a niche in the business sector, albeit not too many, and at not too elevated a rank, but I cannot think of a single former detective currently holding down an important role in any financial regulatory agency.

It is as if the skills required to catch common working class thieves are considered to be unsuitable to catch criminals from a more elevated social sector of society.

I have observed this phenomenon for so many years, and I have come to the single and unpalatable conclusion that it has to be driven by the class element. Putting it more simply, it is as if society is happy to leave detectives to deal with the criminal classes, but they don’t want “Mr Plod” stumbling around among the more delicate sensibilities to be found in the financial sector.

How else can you explain the fact that when I was a detective, I could charge a man with an offence which could result in his being incarcerated for life, without the need for any approval from anyone in Government, whereas if I wanted to charge a businessman with an

offence subject to the Companies Act with a maximum period of imprisonment of 2 years, I was required to seek the authority of the Secretary of State for Trade and Industry first?

The civil service and the civil administrative function simply refuse to acknowledge the skills and the knowledge of police. It has been ever thus. During my career, even when I could demonstrate that my squad was dealing with named US mafia-organised criminals who were setting up share dealing operations in London, DTI officials refused to do anything about it, and just laughed at us, accusing us of “seeing the mafia behind every bush”!

So, this episode of bank malfeasance is an excellent opportunity for Government to take a close look at the way in which the financial sector is policed, because unless something drastic is done to change the way in which the financial sector is regulated, then we shall continue to suffer from the kind of scandals that have made London a cess-pit, the venue of first resort for every con-man, scam-artist and bankster in the world, rapidly ensuring our descent into the ranks of the global pariah states.

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