Trans-Atlantic Banks Face Explosion from Eurozone

by Paul Gallagher

Jan. 21—A series of egregious events in January indicated the threat of a crash of the huge zombie banks of the Eurozone. These banks have been heavily supported by the U.S. Federal Reserve since the 2008 collapse, and are interconnected with the biggest U.S.-based banks in a highly dangerous trans-Atlantic financial system.

U.S. Treasury Secretary Jack Lew spent two days in early January visiting European capitals in Germany, France, and Portugal, to demand that the governments dramatically increase the size of the "bank resolution fund" they just created—which is supposed to handle big failing banks while expropriating their unsecured creditors and uninsured depositors—and that the European Central Bank (ECB) buy assets from big banks in Fed-style "quantitative easing."

Back in the U.S., Lew summed up his demand at an event sponsored by the Council on Foreign Relations Jan. 16: The resolution fund for bank failures is inadequate, "We don't think it's big enough. We don't think it's fast enough."

That same week, on Jan. 15, the *Financial Times* had warned, and events soon proved the truth of the warning, that EU Banking Commissioner Michel Barnier had moved any form of "bank separation," however slight, totally off the European banking agenda. In November and December, Barnier had made statements about "introducing a policy of bank separation" early in 2014, but that abruptly and completely disappeared in what became, by Jan. 13, the proposed EU "Single [Bank] Resolution Mechanism Treaty." Barnier rejected all recommendations made by the original Liikanen Group—which Barnier had created in June 2012 to examine bank separation proposals—although those were as far away from the principles of Glass-Steagall as any in Europe except the demands of the big banks themselves not to regulate them at all. This latter is what Barnier decided on.

Barnier's proposal is expected to be published in late January or February, but it is not designed to go into effect before 2018, or maybe even 2020, for some of the "systemic" banks. Whether the draft will be debated by the outgoing Europarliament, whether it will be on the agenda of the newly elected Parliament after the May elections, whether the European Union (EU) governments will okay it before the year 2015 or 2016, is totally uncertain. What is certain though, is that, should anything happen that required new bailouts and bail-ins, the Commission will okay that, and banks will not be separated in Europe, but instead be protected against any serious attempt to regulate.

Then when the legislative proposal for a European "Single Resolution Mechanism" (SRM) was published Jan. 13—the one whose bail-in/bail-out fund Lew was denouncing as much too small—it ruled out any attempt by any EU member-state to move in the direction of Glass-Steagall. Ring-fencing of banking operations "creates obstacles to the exercise of fundamental freedoms and distorts competition in the internal market," the proposed intergovernmental treaty for a Single Resolution Mechanism asserts.

The choice is now between immediate implementation of Glass-Steagall principles, or bank panic and financial crash worse than 2008.

Leverage Bet of 35:1

Over the weekend of Jan. 12-13, global bank regulators, including the Federal Reserve and the ECB, made a shocking "don't touch the banks" agreement which showed just how great their fears are about a blowout of big European banks. Meeting at the Bank for International Settlements (BIS) in Basel, Switzerland, the regulators agreed that the banks' minuscule capital ratios should not be touched, leaving them at 3% (or about 35:1), indefinitely. The regulators went along on every point with the biggest trans-Atlantic banks, leaving the leverage ratios untouched after what the *Financial Times* called "ferocious resistance" by the banksters to proposals to raise the ratio to 6% (or 16:1), or to 8% (about 12:1 leverage). Moreover, they agreed to change the definition of bank assets *back to one which includes almost none of the derivatives exposure*, or other off-balance-sheet structured investments, of the so-called systemically important financial institutions (SIFIs).

The decision at the BIS was hailed by ECB president Mario Draghi, who is now under intense pressure to print money ("quantitative easing") to support these SIFIs. But the decision is an insane one, simply illustrating the regulators' extreme fear of placing any pressure for soundness on banks which are not lending, and are near blowout. These 35:1 and similar leverage ratios destroyed Lehman, Bear Stearns, and would have collapsed many others without TARP, FDIC, and Federal Reserve-led bailouts which are still continuing.

The biggest British and Eurozone banks have no ability to raise capital because of their toxic condition, except from government bailouts, or by confiscating creditors and depositors in "bail-ins." Witness the steady postponements of the Italian government's attempts to get Monte dei Paschi di Siena, the world's oldest and Italy's third-biggest bank, to raise capital before it fails, despite two bailouts.

The big banks also do not want to be forced to get any less big—the other way to raise their capital ratios. The only thing the Eurozone big banks will now have to do, is to drop the "risk-weighting" which makes even their tiny capital ratios fraudulent—and they may have to make that change as early as . . . 2018. "The big banks can now exhale," wrote the German financial daily *Handelsblatt*.

They could, that is, if they were breathing, not the zombies they are. Combined with the leaked reports that the Single Resolution Mechanism Treaty and EU bank union head Michel Barnier will *not* regulate any breakup or even ring-fencing of banks, the picture is clear: The Eurozone banks are too fragile to be touched in any way while they "stumble toward the next crash," to quote former British Prime Minister Gordon Brown in the *New York Times* Dec. 16. (See "EU Banking Union To Impose Dictatorship," following this article, for a full analysis of the SRM Treaty.)

Down with Dodd-Frank

The Jan. 12 decision is also another blow to the phony Dodd-Frank Act, and to the holiday boastings of Federal Reserve chairman Ben Bernanke that the United States was just about to impose a 6% non-risk-adjusted capital ratio (16:1 leverage) on the U.S.-based SIFIs on Jan. 1. That Dodd-Frank regulation was reported, in the second week of January, to have been put off, due to fierce opposition from the U.S. banksters, who insisted on waiting to "harmonize" it with European rules! The FDIC's Thomas Hoenig is now alone, says the *Financial Times*, in continuing to fight for a 6% non-risk-adjusted ratio counting derivatives exposure; although the paper's article supported him.

The source of all this anxiety showed itself nakedly on Jan. 19 when Deutsche Bank, Europe's largest, and with the world's biggest derivative's exposure, reported a loss of $1.35 billion in the fourth quarter of 2013, and warned of ongoing distress in 2014, which its chief executives ominously referred to as "the turning point" for the bank. Deutsche Bank had investment bank losses, falling revenue, had to make provisions for credit losses on "toxic" assets, and other provisions for litigation on the rapidly increasing judicial and regulatory investigations of its crimes. The *Wall Street Journal* reported Jan. 20 that this was "a likely precursor to other European lenders absorbing financial hits."

The fourth quarter of 2013 also showed a drop in lending by the European banks as a whole, by more than EU100 billion, mirroring the situation with the biggest U.S.-banks, thus continuing to starve the U.S. and European economies of credit.