Parmalat

'The Banks Aimed Their Gun at Our Head'

by Claudio Celani

On Jan. 9, police raided the Milan offices of the Bank of America, in the most spectacular development of the ongoing investigation into the Parmalat bankruptcy case. As *EIR* wrote last week, the Italian food firm Parmalat, whose insolvency revealed a hole of 8-plus billion euros, had become a vehicle for derivatives-backed financial operations led by national and international banks, in schemes used to support the expansion of the global financial bubble.

Bank of America (BA) became Parmalat's main bond placer in 2001, displacing J.P. Morgan which, with 25% of the overall issue, estimated at Eu8 billion, is still the largest owner of Parmalat bonds. Investigators believe that BA, like other banks, knew that Parmalat was bankrupt and its bonds were junk, but sold them at high value nevertheless. Complicity in covering up Parmalat's state of bankruptcy include the fact that Parmalat could write in its books a nonexistent $4 billion account, in order to cover its losses and back up bond issues. When the situation became unsustainable, in mid-December, BA dropped Parmalat by announcing that the account was nonexistent, thus declaring Parmalat insolvent.

Bank of America's murky role in the corporate bond sector in general has been recently exposed by one of its executives. On Nov. 13, 2003, just before the Parmalat scandal broke out, Duncan Goldie-Morrison, who was driven out of the bank in March 2003, submitted a complaint to the National Association of Securities Dealers, charging that the bank used "creative accounting" in regard to investments and junk bond portfolios. But BA is in no way the only bank involved in the Parmalat fraud scheme, nor the only one using such "creative accounting" in its activity. Along with BA, prosecutors in Milan and Parma are investigating J.P. Morgan Chase, Morgan Stanley, Citicorp, ABN, Banco Santander, Deutsche Bank, as well as all the largest Italian banks. "The banks put their gun at our head," declared Parmalat founder Calisto Tanzi, now under arrest.

One episode out of Tanzi's interrogation records, reported to the press, involves Morgan Stanley, for example, and it is paradigmatic for showing how the banks blackmailed Parmalat into issuing bonds and, sometimes, into buying them back on short notice when the banks needed liquidity. Tanzi reported that Parmalat's financial manager, Ferraris, "had been contacted, last June, by a Morgan Stanley Italia manager, who had said that there was an institutional investor wanting to invest Eu300 million in corporate bonds, and he asked us if we had interest in the deal. Ferraris then contacted Nextra, the firm indicated by Morgan Stanley. The agreement was that the bond should be bought by the investor and, he added, conditions for us were not favorable but, given the situation (i.e., Parmalat's bankruptcy), it was profitable for us to issue those bonds even if their rates would be at the highest values." A few months later, the scenario changes radically. "Ferraris came to me and told me: 'Nextra wants us to buy the bonds back.' On my request for explanation, he answered: 'They aimed a gun at my head.' " Nextra's request, Tanzi explained, "was accompanied with threats that the real financial condition of the firm would be revealed to the markets."

Why were the banks blackmailing Parmalat into issuing bonds? The answer is simple: The corporate bond sector has been used, together with the real estate sector, as a milk-cow for generating paper money in order to support the financial bubble in its terminal stage. The instruments used for this purpose are called Collateralized Debt Obligations (CDO), a form of credit derivatives. A CDO is bank-issued paper representing a collection of corporate bonds, issued by bank-owned entities, such as their securities operations, and then sold to investment funds or private customers. Since the single bond risk is spread out over the different corporate bonds contained in the CDO, banks can place the CDO at a higher price. It has been extimated that the overall value of CDOs is more than $500 billion. Now, as the world recession has produced casualties in the corporate sector, the CDO pyramid has been shaken, but CDOs holders have failed to show those losses on their books. To the contrary, more bonds have been placed in the effort to generate more profits. And more junk has been added to paper, according to the principle that the higher the risk, the higher the yield. Countless Parmalats are out there to be discovered, functioning as milk-cows for the bond magicians.

The research units of the banks' securities operations, such as the Banc of America Securities Research Unit, led by one David Goldman, have provided mathematical models aiming at both forecasting the trend in the corporate bond market, and at manipulating it into the desired direction, i.e., the one offering the largest profit opportunities at alleged minimal risk. CDOs promised to offer the minimal risk, since in the case of defaults, losses would be spread on as many private investors as possible throughout the globe. In reality, as usual, it does not work as the magicians and their models promise. Some corporate bonds have even been concentrated in CDO issues, as was the case for the telecom sector. And it could be the same in the case of Parmalat bonds. Fitch Ratings says that 69 CDOs it rates had a total exposure of about Eu700 million to Parmalat, and this figure does not include CDOs which Fitch does not rate.

This is why Lyndon LaRouche correctly compares the Parmalat default not with the Enron, but with the LTCM default in 1998, for the similarity in the systemic risk represented by the interconnection of the derivatives pyramid.

As for Parmalat's productive entities, they are currently protected by law, after the firm filed for bankruptcy reorganization. Enrico Bondi, current bankruptcy administrator, must present his reorganization plans to the government before Jan. 20. Only then, will it be known whether Parmalat will be chopped up and sold to its creditors or not. Bondi's credentials, as well as the fact that he has appointed Lazard and Mediobanca investment banks as financial advisors, is not a good omen for the 36,000 workers employed by Parmalat, as well as for the thousand of farmers who represent Parmalat's vendors.

The other front is represented by 100,000 Italian citizens who have been manipulated by their banks into buying Parmalat bonds, and now have lost their savings. This issue has boosted the role of Finance Minister Giulio Tremonti, who had already opened hostilities against the central bank and the Italian banking system for a similar case, the 2002 default of the Cirio food company. Tremonti is now emerging as the leader of a bipartisan coalition converging on the necessity to reform the current national regulatory system. Tremonti is also indicated as a possible successor to Prime Minister Silvio Berlusconi as the latter's legal problems threaten to jeopardize his premiership in the coming months.

However, for a financial reform to be really effective, it has to give back the national government actual sovereignty over credit and currency, toward a national bank-type of policy as advocated by Lyndon LaRouche. Italy has to start back where the Italian Parliament stopped, namely, at the 2002 resolution calling on the government to organize internationally for "a new financial system able to promote the real economy and punish financial speculation." Only by implementing that policy, can any government or leader survive the financial and other kinds of turbulence of the coming months.