JP Morgan Fiasco Shows Need for Glass-Steagall

by John Hoefle

May 14—The May 10 surprise announcement by JP Morgan Chase of a $2 billion loss on derivatives trades, and the response to that loss by its critics, form a delicious irony. The bank which led the crusade against Lyndon LaRouche's demand for reimplementing Roosevelt's 1933 Glass-Steagall law, the bank which has fought tooth-and-nail against any and all financial regulation for decades, has now been mortally wounded by its own speculative hand, and has brought on the next stage of global financial meltdown. And thanks to JP Morgan's greed and arrogance, thanks to the whole trans-Atlantic financial system's recidivism in committing the exact same speculative lunacy that brought the global financial system to its knees in 2007-08, Glass-Steagall is back on the table in a big way.

"The system is about to blow," Lyndon LaRouche stated on May 12. "The U.S. and British banking system is in the process of collapse right now. The new wave of collapse is happening," and it is going to rapidly spread, LaRouche noted. The implosion of the Spanish banking system—including the London-run Inter-Alpha Group giant Banco Santander, and its friendly rival BBVA—is an expression of the same financial meltdown that is bringing down the entire trans-Atlantic system.

"It's important to note how stupid people are," LaRouche added. "I mean, here you have a banking crisis which has been going on, since I warned against it in 2007. And in 2008, they went into a bailout! And what I was fussing against was that: No bailout! And they went to a bailout!"

As a result of not heeding LaRouche's demand, from 2007 onward, for Glass-Steagall and replacing the current financial house of cards with a production-oriented credit system, the edifice is now imploding. "This present financial system, in its present form, is now extinct," LaRouche emphasized. "It's dead. The bodies are still moving because, with these kinds of animals, they're not so good on brains, so they don't know when they're dead. And that's what it is: This is all dead. The whole system is dead!"

The only solution to this, is the one advocated by LaRouche. Reinstate Glass-Steagall; close the Fed and replace it with a new National Bank of the United States; impose strict regulations, and enforce them tightly. The attempts to "fix" the current British-model financial system have failed. We have to junk that system, and return to American System economics, not only in the United States, but in the world as a whole.

Morgan's Loss

The $2 billion loss announced by JP Morgan, is of course just the tip of the tip of the iceberg. JP Morgan itself reportedly has at least $100 billion in exactly the kind of losing derivatives bets that led to the $2 billion admission. And JP Morgan may be the biggest deriva-

JP Morgan's $2 billion loss was "egregious" and self-inflicted," admitted CEO Jamie Dimon. The surprise announcement has revived calls for Glass-Steagall.

tives addict in the U.S. banking system, but it is hardly alone in this. Every big bank in the U.S. and Europe is in trouble, sitting on piles of worthless assets, covering up giant losses, and fighting for survival. In Europe, the dominoes are falling one by one, with the Spanish bank bailout simply the latest in an unending, and inevitable meltdown. The whole system is finished.

JP Morgan Chase held an extraordinary conference call on the afternoon of May 10, to announce that it had lost at least $2 billion in the derivatives markets. The losses, in the words of bank CEO Jamie Dimon, were "egregious, self-inflicted," and the result of a strategy that was "flawed, complex, poorly executed, and poorly monitored."

The loss stems from trades made by JP Morgan's Chief Investment Office (CIO), and in particular, with trades made by the CIO in London. It appears that the bank was placing huge bets which arbitraged the difference in price between the cost of a credit default swap on an index, and the cost of the buying credit default swaps individually on the same companies. Not only that, but it appears that the bank was using its market power to manipulate the price of those credit default swaps in its favor.

The CIO office, which supposedly was being used to hedge bets held elsewhere in the bank, appears to have become a giant proprietary trading operation, placing bets for the bank itself. According to its filings with the Securities and Exchange Commission (SEC), the CIO unit had nearly as much market exposure on an average day in 2011, as did the bank's much larger investment-banking operation. The CIO unit appears, in effect, to have become something of an internal hedge fund. Everything indicates that they had been tasked to generate quick speculative profits, to cover up what was likely an even larger hole in the bank's balance sheet.

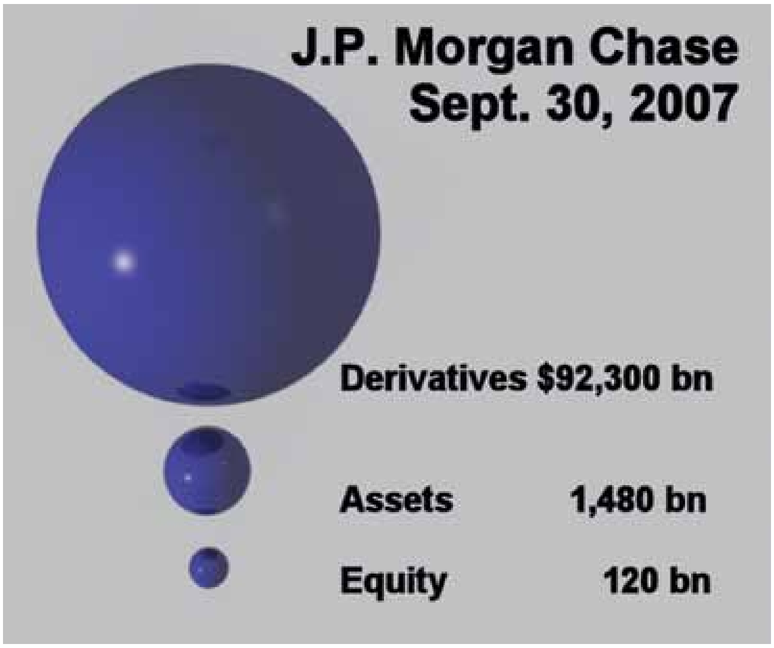
The positions taken by the CIO became so large that they were distorting the market, and causing some of the bank's competitors to complain. But Morgan's strength was also its weakness—once the competitors figured out what Morgan was doing, they began to move against it. The result was $2 billion in losses in five weeks, with more to come, as some of the bank's bets are still open. Dimon admitted in the conference call that the losses could grow by another $1 billion, and that may be an underestimate.

Political Fallout

The response to JP Morgan's loss announcement was felt far beyond the banking sector. Dimon himself admitted during the conference call that loss "plays right into the hands of a bunch of pundits out there" who advocate stronger regulation of the banks.

JP Morgan has hated Glass-Steagall for a very long time, as it was one of the prime targets of President Franklin Roosevelt's original law in 1933. Glass-Steagall was passed because the big banks—led by JP Morgan—had been caught red-handed manipulating markets, bribing officials, and stealing from their customers. FDR used Glass-Steagall to break up the big banks, forcing them to choose between being commercial banks or investment banks. No more would customer deposits be used by the banks to speculate and manipulate for their own benefit. As a result of Glass-Steagall, JP Morgan was forced to split into two parts, the commercial bank JP Morgan & Company, and the investment bank Morgan Stanley.

FIGURE 1



After FDR's death, JP Morgan began pushing to undo the strict, modern regulations that had been imposed under his Presidency. The push bore fruit beginning in the 1950s, and in 1984, the bank launched a concerted attack on Glass-Steagall, in the form of a pamphlet authored by Alan Greenspan, at the time a director of the bank. During the 1980s and 1990s, JP Morgan was in the vanguard of the deregulation market, and in particular, in beating back all efforts to regulate derivatives.

When Jamie Dimon took over the bank in 2005, he continued this assault on modern bank regulation. In the wake of the "banking crisis of 2008" (which we put in quotes because it is far from over), JP Morgan Chase (formed by the 2000 merger of JP Morgan with Chase Manhattan) gained an undeserved reputation as being largely untouched by the crisis, and Dimon gained an equally undeserved reputation as Wall Street's top banker—and a possible candidate to succeed Tim Geithner as Treasury Secretary. Backed by Wall Street's lobbying and public relations machine, Dimon became the leading spokesman for the anti-regulation crowd, and also began whining loudly about supposed public mistreatment of bankers! That, from a man whose bank got $25 billion from the TARP (Troubled Assets Relief Program), and $391 billion in loans from the Federal Reserve Bank.

So when JP Morgan and Dimon shot themselves in the foot with their derivatives disaster, the fallout came quickly.

Re-Regulate Now!

A fair amount of the discussion revolved around the Dodd-Frank Act, with its Volcker Rule provision against proprietary trading. Dimon had been a leading opponent of the Volcker Rule, claiming that it would hurt Wall Street and hurt America. But the more serious responses cited Glass-Steagall.

"We really do need this boundary between traditional banking—that is, taking deposits and making loans—and hedge-fund style investing," said Sen. Jeff Merkley (D-Ore.) in a conference call on May 11.

"JP Morgan's losses are a stark warning about the dangers of having major banks take these risky bets, so-called proprietary bets," said Sen. Carl Levin (D-Mich.) on the same call.

"What just happened at JP Morgan—along with its leaders' cavalier dismissal followed by lame reassurance—reveals how fragile and opaque the banking system continues to be, why Glass-Steagall must be resurrected, and why the Dallas Fed's recent recommendation that Wall Street's giant banks be broken up should be heeded," former Labor Secretary Robert Reich wrote on his blog.

The call for Glass-Steagall was picked up by many others, and is now gaining strength. Rather than worry about the Dodd-Frank Act with its Volcker Rule, a law passed as little more than a cover for doing nothing, we need to strike now, before Wall Street can regroup.

The Drain in Spain

The day before JP Morgan admitted its big loss, the Spanish government escalated the bailout of its banking sector by nationalizing Bankia, that nation's fourth-largest bank. The Bankia takeover is part of a larger operation, demanded by the British Empire, to create a "bad bank" where losses from the entire Spanish banking sector can be dumped.

Bankia was formed less than two years ago, in December 2010, when the Spanish government merged seven ailing *cajas*—savings banks—into a new bank.

As part of the deal, the government pumped EU4.5 billion into Bankia's parent holding company, BFA. In 2011, Bankia went public. Now, in 2012, this creature of a previous bailout is being bailed out again—and is still going to be bankrupt after this second bailout!

While Bankia is clearly suffering from property loans in the Spanish real estate bubble, the bigger danger is in the two Spanish giants, Banco Santander and BBVA. Santander is the biggest bank in the Eurozone by market capital, and a leading member of the bankrupt Inter-Alpha Group. Santander has significant operations in Britain, and both Santander and BBVA have large exposure to Ibero-America. Santander, in particular, is a key bank in the Brazilian carry trade, which has generated the cash flow that has so far kept Santander a step ahead of the Grim Reaper.

Spanish banks have also borrowed heavily from the European Central Bank in their efforts to appear solvent, and Santander CEO Emilio Botin, while claiming that his bank is "just fine," is demanding that the ECB give the banks even more money.

That the Spanish bailout was only beginning was signalled by the *Financial Times,* the Rothschild-controlled mouthpiece of the City of London. "If the government wants to restore trust in the banks and sovereign debt, the solution has to be both industrial in scale, and unimaginably bigger than the market expects—as TARP was in the U.S.," the *FT'*s Lex column insisted May 10.

Talk about recidivism.

The lesson of Bankia is the same lesson we've seen elsewhere in Europe and in the U.S. *Bailouts do not work.* And they are not intended to work. The banks are hopelessly insolvent, being kept "alive" by the cash flows from the bailout. But the bailout is just an illusion, a form of derivative itself. The actual content of Britain's policy, is the imposition of full-tilt fascist austerity, global depopulation, and the destruction of the nation-state in order to install a supranational financial dictatorship over the rubble.

The only alternative that will work is what LaRouche has detailed since 2007. Perhaps others, internationally, will now be prepared to listen and act, with the implosion of the Empire's House of Morgan.

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