Australian Citizens Party

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MEDIA RELEASE

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Bankers' solution to derivatives danger could bring down international financial system

The leading institutions of the bankrupt trans-Atlantic financial system issued a report on 16 August, warning that there are no mechanisms in place at this time that can prevent a blow-out of the $600 trillion-plus global financial derivatives bubble, should any one major party default on its derivatives.

Derivatives are the toxic and often fraudulent financial bets that blew up the global financial system when Lehman Brothers went bankrupt in 2008. Germany's giant Deutsche Bank, among the most derivatives-riddled financial institutions in the world, is looking increasingly like the next Lehman Brothers, and experts fear its imminent failure will bring down the entire global financial system due to its extensive derivatives bets with banks all over the world. Australia's banking system is particularly vulnerable, having more than doubled its exposure to derivatives since the 2008 crisis, from $14 trillion to $32 trillion.

US physical economist Lyndon LaRouche has warned for three decades that derivatives, inherently fictitious, must simply be written off, a measure which can be safely and effectively carried out under a restored Glass-Steagall regime, where commercial banks that serve normal people and the real economy are kept completely separate from investment banks that gamble in derivatives. But Wall Street and City of London wizards insisted they had everything under control; that the danger of an uncontrollable chain of derivatives defaults such as that which blew out the global system in 2007-08, had been resolved by centralising derivatives trading in a few "clearing houses", which would be responsible for ensuring that derivative trades would be covered in the case of defaults.

The Bank for International Settlements' Committee on Payments and Market Infrastructures and the International Organisation of Securities Commissions (IOSCO)—representing between them the world's central banks and securities regulators—prepared the report, which admits that the central counter-parties (CCPs), as the clearing houses are called, which are supposed to be the risk managers and guarantors for derivatives contracts, have no means to do so, and that the CCPs themselves have become a threat to the system.

The *Financial Times* of London put it this way: "Four years after guidelines were introduced, a survey of 10 derivatives clearing houses found that some did not have sufficient policies or procedures to ensure they had enough money to keep going, or to replenish diminished reserves. Others needed to improve their stress tests, the report said."

The *Wall Street Journal* summarised the content of the BIS/IOSCO report: "Clearinghouses still have shortcomings in their risk-management and recovery practices, which could have marketwide ramifications in the case of default."

Business Insider, at least, had the guts to admit that the results of that survey "are slightly terrifying", because if the clearing houses don't work, derivatives are "just unexploded nuclear bombs nestling deep in the financial system".

The International Swaps and Derivatives Association sent an email to *Business Insider* acknowledging, in its understated way, that "several clearing houses have become systemically important as a result of global clearing mandates, and it's vital this infrastructure is as secure as possible, which means establishing a credible and robust recovery and resolution framework". In turn, the Financial Stability Board (FSB), established in 2009 by the G20 Finance Ministers for the express task of overseeing "prudent" handling of the global financial system, and headed by the Bank of England's Mark Carney, issued a note on 16 August "calling for public comment from the industry [*sic*] to help develop resolution strategies and plans for winding down CCPs in the case of a global financial shock. Respondents have until 17 October to reply to questions set out by the FSB," the *Wall Street Journal*reported.

The *WSJ* coverage implies that the report was prepared on the insistence of China, the current head of the G20, which has placed the safety of central clearing houses "high on the agenda" of the upcoming 4-5 September G20 summit, which China is hosting. When it took over the G20 in December 2015, China immediately revived the G20 International Financial Architecture Committee, forcing discussion of the global system back onto the agenda.

The global campaign to reinstate the Glass-Steagall principle is gathering political momentum all over the world. The CEC is leading the fight for a Glass-Steagall separation of Australia’s banks, to protect Australians from the looming crash. This does not require a Royal Commission, and indeed is too urgent to wait for that process—join the CEC’s fight to achieve Glass-Steagall now!