Rep. Henry Gonzalez calls for congressional probe of George Soros

by Jeffrey Steinberg

Rep. Henry Gonzalez (D-Tex.), the chairman of the powerful House Banking Committee, delivered a speech on the House floor on June 18, calling for an investigation of international speculator George Soros. Gonzalez's speech caused immediate international shockwaves. Both Soros and the New York Federal Reserve issued responses within 24 hours; *Barron's* magazine, a publication of Dow Jones, featured the Gonzalez speech on its front page, and the *Baltimore Sun* gave prominent play to the Gonzalez-Soros conflict on June 19.

Gonzalez situated his call for a probe into Soros's multi-billion-dollar speculative run on the British pound last September, in the context of growing concern that the entire market in financial derivatives (see *EIR*'s *Feature* on May 28) is totally out of control and is on the verge of a blowout. "I have long believed that growing bank involvement in derivative products is, as I say and repeat, like a tinderbox waiting to explode," the chairman warned.

In his speech, for the second time in June, Gonzalez credited *EIR* as a valuable source of documentation of "the enormous exposure on what is known as the off-balance sheet accounts of our largest banks." On June 10, Chairman Gonzalez had inserted the text of an *EIR* Banking column by John Hoefle into the *Congressional Record.*

Did Soros manipulate the markets?

In his June 18 speech, Gonzalez announced that he would be calling upon the Federal Reserve and the Securities Exchange Commission (SEC) to launch a probe of Soros and his Quantum Fund:

"Another related concern I have about the derivatives market involves speculation. Recent press accounts state that Mr. George Soros, the manager of the Quantum Fund, made over $1 billion in betting against the British pound. I am interested in knowing how Mr. Soros was able to make such profits, how much of his investment capital is from bank loans, the U.S. bank exposure to Mr. Soros's fund, and the role derivatives played in earning Mr. Soros that windfall.

"In the near future, I will ask the Federal Reserve and SEC to review Mr. Soros's impact on the foreign exchange market to determine if it is possible for an individual actor such as Mr. Soros to manipulate the foreign exchange market.

"At a minimum, it is in the best interest of the Federal Reserve and other central banks to fully understand Mr. Soros' methodology for manipulating the FX [foreign exchange] market. After all, they are competing head-on with Mr. Soros in an effort to manipulate the value of various currencies."

The very next day, a spokesman for Soros Fund Management defensively told Reuters that "the Federal Reserve, the U.S. Treasury, and the SEC are fully familiar with our foreign currency operations. If they have any further questions, we will answer them fully and candidly just as we have in the past."

Representative Gonzalez's call comes at a critical moment. Since early June, Soros has been personally leading an assault on the German deutschemark, a move that could wipe out what little remaining real investment is going into Central Europe and the states of the former Soviet Union (see article p. 4).

New salvo against derivatives

While Gonzalez's call for the Soros probe grabbed the headlines, the majority of his June 18 remarks were addressed to the broader crisis brought about by the increasing involvement of the largest commercial banks in the derivatives markets. Excerpts follow.

"Mr. Speaker, the reason I rise today is to supply for the *Record* some specifics on the discussions that I have been entailing here on the House floor in the last two special orders in which mostly it has been in general terms, with the exception of some very disturbing specifics that I entered into the *Record,* and for which I wish to acknowledge the source of the contribution of the enormous exposure on what is known as the off-balance sheet accounts of our largest banks to the publication known as *EIR,* and a very, in my opinion, a very eminent writer and expert on banking matters.

"These specifics today will have to do with the general question that, as I say and repeat, is a disturbing problem known as derivative products. If this is not properly confronted, it can be very well the most serious and critical major crisis in our next banking dilemma, and particularly as it would impact on the American banking and financial system.

"In the past year or so our domestic bank supervisors and their international counterparts have begun to discuss and grapple to a certain extent with the risks posed by the banking involvement in derivative products. International conferences have been held, and impressive reports have been generated discussing a wide array of issues surrounding the ever-growing worldwide market in derivative products, which I have explained today represents a tremendous amount of money, a trillion dollars or so, being instantaneously transferred from the money capital centers of the world. . . .

"While these activities on the part of the regulators—for instance, the comptroller of the currency has expressed his intent to evaluate and see what could be done from the regulatory standpoint, and then the BIS [Bank for International Settlements] has announced, after the great debacle last Sept. 16 in the European currency market caused by the derivative, speculative movement, overnight. So that is how susceptible this whole situation is, and as I repeat, a house of cards, really. And how long can a house of cards stand?

"So I think a lot more has to be done to ensure that the banks and the regulators fully understand the risks posed by derivative products; and that capital that is put aside to cover may not be necessarily the answer at this time as it was in the case of the convergence of capital standards or the enhancement of capital standards.

"The urgency of my message is underscored by the fact that the U.S. bank regulators admit that they still do not fully understand the individual bank and systematic risks posed by derivatives. They admit that there needs to be improvements in international regulatory coordination and that there is a desperate need for more standardized and detailed disclosure of derivative product activities.

"I have long believed that growing bank involvement in derivative products is, as I say and repeat, like a tinderbox waiting to explode. In the case of many market innovations, regulation lags behind until the crisis comes, as it has happened in our case with S&Ls and banks. And we are still not out of the woods there.

"We must work to avoid, if it is possible to do so now, a crisis related to derivative products before, once again, ultimately, bacause of our peculiar system of so-called bank deposit insurance system, the taxpayer is left holding the bag.

"Last year I directed that GAO [General Accounting Office] to study the issue of bank derivative products and their activities.

"That study has not been completed. It will be out later this year. Until then, some members of my staff, the most diligent, will continue to monitor this phenomenon.

"In the next several weeks I will ask the bank regulators for detailed information regarding their work thus far and what, if any, has resulted from their evaluations.

"I am dedicated to ensuring that this remains a front-burner issue, as I have attempted to do now for some time. As I say and repeat, the stakes are very high, though they may not be apparent—as they were not in 1987, 1986, 1985, until the dam burst and we had the taxpayers to the tune of several hundred billion dollars, and it is still not finished, the great debacle of the S&L system and related financial institutional problems. . . .

"The entire situation, in my mind, is too volatile for us to act in a cavalier fashion and ignore it and not even discuss it. . . .

"Now, as I said, the primary purpose of a derivative is to guard against the fluctuation. But how can you guard against fluctuation if you are betting, as you do in the futures market generally, or the stock market, or for that matter in my book? The way the things are now and as manipulative as these markets are, I would just as soon take my risks, if I were the betting kind, at Las Vegas.

"The fluctuation in the price of the underlying value of the assets, these assets could be anything ranging from coal, currency, market-backed securities, pork bellies, orange juice, all of these are future gambling, if you will. . . .

"Steps need to be taken to ensure that bank managements and bank regulators fully understand the risks of derivative product activities. Market participants and bank regulators must ensure that banks have adequate risk monitoring systems in place and that those systems are functioning properly.

"The total credit exposure from derivative products at the money center banks is well in excess of 100% of their capital. This enormous concentration of risk could pose an ominous threat to an individual bank if the underlying assets associated with the derivative product turn sour. I am worried that a large credit default or systematic problem in an underlying market could cause a catastrophe that could easily eclipse the capital of our largest banks, and endanger our deposit insurance fund.

"I am concerned that banks and the bank regulatory agencies may not fully understand the implications of their activities and the dangers derivatives pose to the stability of our financial system. Statistics on derivative products held by bank holding companies indicate that credit exposure problems from derivative products held by individual banks, as well as collectively, are potentially enormous.

"The sheer magnitude of the bank holdings of derivative products and the vulnerability of certain banks raises serious questions about the systematic risks posed by derivative products and the means used to regulate derivative markets to ensure the deposit insurance fund is protected.

"This is disturbing because all you have to do is remember the threats posed by bank exposure to LDC [lesser developed countries'] debt, real estate speculation, and highly leveraged transactions to realize that the bank regulators have a rather dismal track record of identifying systematic risks."