## The Cyprus Template

# 'Bail-In' vs. Glass-Steagall

*LaRouchePAC TV's Dennis Mason and EIR Economics co-editor Paul Gallagher on April 4, discussed the differences between Franklin Roosevelt's Glass-Steagall approach to solving the financial crisis, and the bail-in crime of today.*

**Dennis Mason:** We've been reporting that what these guys are doing with the bail-in operation, is the same thing that was investigated with the Pecora Commission under FDR, legislated as crime, prosecuted.... They are essentially just stealing people's money to try to keep the bank going....

**Paul Gallagher:** Yes. This was notorious in the 1926-1930 period and the investigation of it—by Ferdinand Pecora—that the depositors were being converted into shareholders, and then losing the value of their shares, in a way that we have just seen done by fiat in Cyprus; that is, the deposits were taken, and the depositors were given essentially worthless shares—a 99.5% of their value—in the large bank that was failing.

And again, in Spain: Six different banks in Spain, where the depositors wound up with shares; and in that case, with most of those banks in Spain, including the big one, Bankia, which is bankrupt—the depositors had been duped in advance in the last three years into converting all or part of their deposits into shares. And then the shares, just a couple of weeks ago, became worthless, so they lost their deposits in the same way, while these insolvent banks, incredibly, remain open!

And that latter is exactly what constituted the main outrage, in the sense of driving the public outrage that resulted from it, in the Pecora hearings in 1933. The investigation had started in '32, but once they really got going with Ferdinand Pecora as the chief investigator in '33; he focussed on National City Bank, the largest commercial bank in the country at that time, with branches all over the country, and the way that it had mobilized its investment arm, National City Corporation, the investment bank affiliated with it, through intensive campaigns in every single National City Bank branch around the country, taking place involving the depositors, the employees. *Everyone* was being dragooned into buying National City stock with their deposits.

And then, they were being dragooned into buying other stocks that National City Company, the investment company, was speculating in, so as to support those speculations and make money for the insiders who were in the middle of these speculations.

When the Crash came in '29, and particularly in the following year, '30 and into early '31, most of these depositors who had been pulled in in this way, into converting their deposits to stock, lost most of the value, and were fleeced in exactly the same way as is happening today.

### Pecora Takes on National City

**Mason:** That's their life savings. Everything they've worked for just vanished.

**Gallagher:** Sure, sure. And the Senate report of June 6, 1934—which is the final Senate Banking Committee report on the entire investigation which Pecora carried out, which led to Glass-Steagall—that report is full of anecdotes, full of stories of people whose life savings were gone, including people who had had a good deal of money to start with. They lost it all in this process, while National City Bank remained, not only open, but until the Pecora hearings, retained a reputation very much like JPMorgan Chase today, as a soundly managed, very clever, very large, impregnable bank, and so on—until Pecora got hold of Charles Mitchell, the CEO of National City, and ruined him by showing exactly what his bank had done, to remain open in this way.

The report then goes through the language of the Glass-Steagall Act, which had been passed the year before the report was finally written; it goes through that language in order to make clear that the Glass-Steagall Act was passed, above all, to make this kind of practice


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*Paul Gallagher*

impossible, illegal, and to block any bank so situated from doing that. So, that was the first, absolutely clear statement, that there must be a bright dividing line between commercial banking and investment banking, and that that dividing line must be enforced by the Federal government, for all banks which are chartered as commercial banks under the Federal Reserve System.

That's where that comes from—the cleaning out of this theft of deposits that was being done by the so excellently reputed, impregnable National City Bank, the number-one bank at that time.

## How Glass-Steagall Worked

**Mason:** What these guys are saying today, is that we have cross-border institutions which are "globally significant" and therefore can't fail; and now, what we've been doing with the bail-out has been at the taxpayers' expense, so the bail-in brings funds into play to take the burden off the shoulders of the taxpayers.

**Gallagher:** Roosevelt didn't bother to say any of those things until after it was done. He closed all the banks that had not already closed, on March 4 of 1933; and in an 11-day period, he managed to mobilize the forensic resources of the regulators of the banks in the United States, in combination, to inspect every single one of 14,000 banks in the United States in an 11-day period of time. And in the course of that inspection, they compelled these banks to write off the clearly watered stock, the clearly worthless securities, what we today call by the clever name of "toxic securities"—but we leave them alone. They didn't use the word "toxic"; they just said, these are worth nothing, write them off.

And then, what resulted in that very brief and thorough examination, was one category of banks which were clearly unsound and remained closed; and Glass-Steagall incorporated deposit insurance for the first time in the history of this nation, in order to handle that situation; perhaps merely 4,000 banks had been closed down completely. It took the middle category of banks which were sound but illiquid at that point, and provided them with currency. The Federal Reserve, the RFC [Reconstruction Finance Corp.] jointly provided them with currency and liquidity to reopen, and allowed the sounder banks to reopen as they were, in a staged period over the next two weeks.

But as for those closed banks, then, the assets that they did have were sold. And this has always been the function of the FDIC, in insolvencies of banks: It's to come in, close it, take over, get rid of the management, sell the assets, and on that basis make the depositors as whole as possible, with the floor being the insured amount, but depending on the asset sale, to make the depositors whole, with as much above that insured amount, up to the total amount that they had deposited, as is possible. And usually, it has fallen somewhere in between; usually, they've been able to come relatively close to the total amount of deposits that people had in that bank.

Roosevelt then, having gone through that process, clearly saw the Glass-Steagall Act as institutionalizing it, and making it permanent: that under the Glass-Steagall Act, these commercial banks were going to be subjected *quarterly* to the same kind of inspection by the Federal Reserve, under that Act. And in order to make sure that they were not going back to reinvesting in the same kind of speculative gambles that they had been in before, but were rather making loans. Not that there's no risk to that, but that they were making sound and regulated lending, and if they were not, the Glass-Steagall Act empowered the government to remove them from access to the Federal deposit window and other kinds of Federal support, and essentially, put them out on their own.

So it has worked in that way.

In contrast, what you see in the Cyprus case, and the Spain cases, is the astonishing attempt—here's the Bank of Cyprus, the biggest bank there, with a credit rating of "default," not even "selective default," but *"default"*, meaning *insolvency*! And yet, that bank has been kept open, and there has been every effort to maintain the assets of that bank at as high a value as possible, and to maintain the ability of that bank to repay the European Central Bank for collateral loans, for all of this bad Greek government debt and Greek bank debt that the bank had.

That is a complete reversal, at the expense of the depositors, of what has been done, ever since deposit insurance became generally widespread. You don't leave the bank open and take the depositors' money; you don't have the bank survive the depositors, you have the depositors survive the bank. And what's been done in Cyprus and in Spain, it's the opposite.

## Dodd-Frank: Save the Banks

**Mason:** It seems to me, that a large part of the fight to restore Glass-Steagall in the United States is this question of guts in expressing the sovereignty of the United States, against this kind of thing.

**Gallagher:** Well, we know politically, from fighting to restore the Glass-Steagall Act, and from talking to lawmakers at the Federal and state level, that Dodd-Frank was designed, drafted, especially on the side of Barney Frank with all of his Wall Street contacts. In fact, his earlier bill in this direction had been more or less drafted for him by Crédit Suisse, and if you go back to when Glass-Steagall was repealed [in 1999], it appears from a recent PBS documentary, that these Wall Street banks spent $350 million in the '97-'98 Congressional election cycle to get it repealed.

So the Dodd-Frank Act, we know from that kind of pressure, and from direct admissions, was a substitute, an attempt to keep Glass-Steagall from being reenacted, after the crash of 2007-08. Had Dodd-Frank not been shoved in there, you would have had Glass-Steagall, and in fact, there were five different bills which had been introduced in the House in that same period, to restore Glass-Steagall.

So, if you start from the fact that this is an avoidance of Glass-Steagall, on the part of Wall Street, then you look at, what does it call for in its so-called "Title 2" when a big bank is insolvent—the same situation we just saw manhandled in Cyprus, and the economy crushed there—and you see that it says, to do what was done there. It says, save the taxpayers in their capacity as *taxpayers*, by taking their money in their capacity as *depositors*, and in their capacity as perhaps *holders of bonds* in this bank. Take it from them on that side, so as, supposedly, not to take it from the taxpayers, or not to take any bailout money from the taxpayers. And keep the bank open—and the Dodd-Frank language is specific—do so, in such a manner as to maximize the value of the assets of the bank, minimize any disruption to the financial markets and the financial system, that is, prop the assets up as much as possible, while keeping the bank open.

And the more you look, you see that every guideline that has come out since 2010, from London—from the FSB [Financial Stability Board], from the European Commission, from other supranational bodies like that, and also of course, in Dodd-Frank—every guideline says the same thing. And it's interesting that in New Zealand, they've gone whole-hog and done it, and it's written right in the law, and the banks have it already in their computers, how much the depositors are going to lose, in the resolution of this bank, this particular bank involved.

So, it's because the reenactment of Glass-Steagall was blocked in '07-'08, and then again, in 2010, when it had *strong* support, and was crushed in the Senate by the White House and by the Treasury, Geithner; it was blocked, and we get instead, these open bank resolution regimes, which rape the depositors of their deposits.

## Iceland or Cyprus

**Mason:** And the real effects of that raping of the deposits are tantamount to genocide, because when you look at, for example, Greece, since the beginning of the implementation of the Troika policy, or, if you look at Spain, or if you look now at Cyprus, where they've been running essentially, as banks had been closed, on a cash economy. And so, you've had many stores shutting down, you've had access to medical supplies limited. In the case of Spain, you have a youth unemployment rate which is [60%—ed.]

**Gallagher:** Yes, it's tremendously broadening the base of who bears the cost of these bank failures, and therefore, tremendously broadening the suffering, which results from the failure of large banks in these circumstances. As you indicated, in those economies, business have just been choked from operating at all, because they're the ones that always lose the most in a shutdown of a bank, because they have operating accounts which tend to be at the upper range of insured and beyond; so they're bound to lose something. But when you get these kinds of capital controls and shutdowns like in Spain and Cyprus, these businesses can't function at all.

And in Greece, the austerity has run to the point that it's just murdering people: They're committing suicide, they can't get medications. So, what they have done is tremendously broaden out the base of austerity and suffering which results from what should be done in an orderly way, sacrificing the value of these "blessed assets," these securities, which supposedly have to be protected.

There's one country in the world in the last five years, that has done it the orderly way—that's Iceland, which had two insolvent banks, each of which was bigger in relationship to their economy, than even the Cyprus banks are in relationship to the tiny Cyprus economy. And yet, Iceland closed both of those banks down, against *tremendous* threats and pressure, particularly from London, which wanted them to make whole the value of all of these assets out of somehow the funds of taxpayers in Iceland.

There was tremendous pressure against it, but they closed those down in an orderly way, even though they were very large banks. The result was relatively good: Not only were the insured deposits covered, but a sizable chunk of the uninsured deposits was covered as well, by selling the assets in the way you're supposed to do it. And they certainly removed the management. Now they're prosecuting them; they're in criminal prosecutions now. In Iceland, one of the committees of the parliament there has passed through a banking separation or Glass-Steagall Act, to the full Parliament, for a vote. And Iceland has a very un-European unemployment rate right now of 5.5% officially.

Now, it's a small economy, but nonetheless, it is a matter of political will, and courage, and leadership, to say, "The hell with all this pressure; we're going to close these banks in a proper way, no matter how big they are." If they're insolvent, they're not too big to close, they're not too big to reorganize, in the orderly way that we know from Roosevelt on.

## Close Down Wall Street!

**Mason:** And if we do that in the United States, that opens the door for Europe to be able to follow suit.

**Gallagher:** Absolutely! Close down Wall Street. I mean, that's really what it comes down to: Implement the Glass-Steagall Act, and in a certain period of time, with the sell-off that will be required by all these thousands of securities units that these big commercial banks have, sell 'em off; those units are not going to survive. There is going to be the need to put national credit into the economy. Those banks aren't lending anyway, those biggest banks, and they're going to have to be led into lending by national credit.

*But the point is, that you're not going to take their assets, and put the burden of supporting their assets, at their current market value, on the broad, broad shoulders of the whole population and just crush the economy, the way it's been done in Greece, and in Spain, and in Portugal, in Ireland—incredible!*

You know, Ireland went from 26% debt-to-GDP ratio to 127% debt-to-GDP ratio, in one fell swoop, in bailing out these two, what were really London banks, headquartered in Ireland.

So that's the point. And even in the case of Charles Mitchell and National City Bank, there was about $300 million lost, by National City depositors in '29 and '30. In the economy of that time, that was a *huge* amount of suffering. This represented about 2 million shares that they had been conned or dragooned into buying with their deposits, in which they lost that money—*huge* austerity against those people at that time! Just from that one bank that Pecora put on the skewer—and that's where the term "bankster" came from, in those hearings....

So, we have to do it, immediately, on the Glass-Steagall principle. This is clearly going to happen to depositors here. We're now connected to this reignited European bank crisis, with banks failing in one country after another; we're connected, and it's already in the Dodd-Frank law, that it's going to be treated in the same way. They can make all of the assurances that they want, that they won't touch insured deposits.

But let's just look at what the European Commission did, and then what they said. They said, on March 26, in this statement by their spokeswoman Chantal Hughes: Yes, we used the Cyprus model across Europe, it is the new template, yes. But, we would never, ever, touch the insured deposits up to the level of EU100,000. *One week earlier, they were taking 7% of the insured deposits in Cyprus, in order to prop up those banks*, and by all reports it was the European Commission, the very same bureaucracy that had insisted that they take the insured deposits as well—and then a week later, they're saying, "never, never would we take insured deposits"!

So, when you read that in Dodd-Frank, it's words on paper in the same way. In a crisis, they won't be stopped.