May 16, 2012

Standing Up to Jamie Dimon: Is it SAFE?
Gerald Epstein

Jamie Dimon’s bravado railing against financial reform has morphed into contrition and a heavy diet of humble pie. After reportedly referring to Paul Volcker’s support of the “Volcker Rule” ban on risky proprietary trading and Federal Reserve Bank of Dallas’ President Richard W. Fisher’s support for downsizing the nation’s biggest banks as “infantile” and “non-factual”, Dimon, President of JP Morgan-Chase is now admitting “egregious mistakes” as his bank reports a minimum of $2 billion in losses on risky trades that just a few weeks ago he defended against press reports which he called a “tempest in a teapot.”

But, unless politicians stand up to Dimon and his ilk, Dimon’s mea culpas will prove no more lasting or meaningful than Allan Greenspan’s widely publicized admission of shock that his faith in the invisible hand of banker’s self-interest serving the public good was, after all, somewhat misplaced. (By bankers’ invisible hands, Greenspan presumably didn’t mean the hands that have been sneaking into taxpayers’ pockets.) Without a full assault on too big to fail banks’ use of taxpayer funds to make risky bets rather than create jobs and raise productivity and wages, Jamie Dimon, his Wall Street colleagues and friendly politicians will continue to destroy the remnants of the Dodd-Frank Act and other avenues for financial reform, as recently detailed by Matt Taibbi in Rolling Stone.

We still do not know exactly how Dimon and JP Morgan-Chase lost such massive amounts of money on complex trades, how much the ultimate bill will be, or what other financial institutions might have similar toxic trades going on. If the reform efforts following the financial crisis should have accomplished anything, it should have created more transparency about such matters, but the banks have fought transparency tooth and nail because they make more money in the shadows.

Nonetheless, as news reports and the excellent blog by Americans for Financial Reform’s Marcus Stanley explains, the trades were undertaken by the bank’s London based chief investment office, headed by Ina Drew, one of the most highly paid female Wall Street banker, who’s presumed job it was to invest the bank’s “excess cash” and hedge other risky positions that the bank might have in its portfolio. These sound like risk reducing kinds of activities, right? But more than a month ago Bloomberg News and the Wall Street Journal started reporting about massive, complex bets made by Bruno Iksil, whom they called the London Whale, because his trades made such waves in the markets. Hedge funds and even other banks started making bets against Iksil, and so far at least some of them have won – to the tune of $2 billion or more.
JP Morgan claimed these were hedges – meaning they were designed to (off-set) REDUCE the risk the bank was incurring elsewhere. But this idea does not square with the fact that the London Office was becoming a “profit center,” earning millions of dollars on trades. Suspicion is further raised by the fact that a number of the key traders in the London Office had been former proprietary traders from the New York office of the bank or from elsewhere. The adrenaline rush of prop trading and the money that goes with it is presumably hard to purge from the veins.

Indications are that the London Office were taking bets by buying credit default swaps (CDS) on some investments in an index of corporate bonds and the selling CDS on another index to hedge and to bet. Some news reports suggest that the bets and trade simply got more complicated and convoluted as time went on and they started going bad – a kind of Rube Goldberg set of cover-ups that just get one deeper and deeper into it.

JP Morgan argued that these kinds of “hedges” and bets were consistent with the current presumed interpretation of the Volcker Rule intended to ban proprietary trading, new rules that had come to allow so-called “portfolio hedging” – hedges that could be justified by off-setting some other unspecified risk someplace in the banks’ portfolio; such portfolio hedging, which had NOT been intended by Senators Levin and Merkley, who developed the language of the Volcker Rule, had been worked into the rules by relentless lobbying by Dimon and his fellow bankers with millions of dollars of lobbying largesse.

So, how do we stand up to Jamie Dimon and the other tax payer subsidized bankers that use the privileged position of tax payer underwritten banks to engage in risky activity that harms the real economy and generates massive salaries and bonuses for the bankers (Ina Drew is reportedly in line to make $14 million this year.)

First, we must unmask the Republican and Democratic politicians that have actively served to eviscerate the Dodd-Frank rules on proprietary trading, derivatives and swaps regulations and other parts of the Dodd-Frank regulations, in the name of job creation and liquidity enhancement. The regulators at the Federal Reserve, Securities and Exchange Commission (SEC) and others must be badgered to write and enforce rules that implement strict enforcement of the Dodd-Frank rules against proprietary trading, controls over derivatives, and other key Dodd-Frank provisions.

But such provisions will not be enough because banks will eventually find ways around them and continue to act like the world is one big casino and ponzi palace. There is increasing recognition by economists and public officials that the too big to fail banks need to be cut down to size. Senator Sherrod Brown has introduced the SAFE banking act which, like his proposal with Senator Ted Kaufman in 2008, is designed to limit the size of banks and put on hard leverage limits and size restrictions. Sherrod Brown’s SAFE banking act should get much more attention and support than it is getting.

Other actions which can work to reduce the riskiness of banks and reduce the tax payer’s liabilities are tougher capital requirements on banks as proposed by Stanford Business School’s Anat Admati, and enforcement of legal restrictions against bank fraud.
Still, there other fixes are needed to help transform this speculative banking into banking that will support the real development of the economy. These include a tough financial transactions tax; and public options in finance and banking so we are not as dependent on the behavior of these private bankers.

But less well understood is the role of austerity in making all of these solutions more difficult. With few attractive options to lend to businesses, which have little incentive to invest in plant and equipment in a stagnating economy, excess liquidity piles up on the balance sheets of banks and corporations. With lax regulation bankers have more and more incentive to undertake the dangerous gambles like those at JP Morgan. People must demand and politicians must enact an end to the policies of the austerity buzzards who are squashing jobs and economic growth, and preventing investments in people and in the transition to a green economy. As Keynes understood, unless the government takes a lead in job creation, a stagnating economy with massive liquidity will only encourage more speculation and more financial instability.