Financial Scam: Hanky-Panky at the Fed

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It's the biggest flim-flam in the nation's history. But, thanks to the Congressional Research Service, the scam has been exposed and the public can now get a good look at the type of swindle that passes as monetary policy.

Here's the scoop: When Fed chairman Ben Bernanke initiated the first round of Quantitative Easing (QE), the stated goal was to revive the flagging housing market by purchasing $1.25 trillion in mortgage-backed securities (MBS) from the country's biggest banks. The policy was a ripoff from the get-go. No one wanted these mortgage stinkbombs that were stitched together from subprime loans to unqualified applicants. But because the banks were already busted–and because the $700 billion TARP was barely enough to keep the ventilator running until the next bailout came through– the Fed helped to conceal its real objectives behind an elaborate PR smokescreen. In truth, the Fed must have colluded with the banks to move the toxic assets off their books (and onto the Fed's balance sheet) with the proviso that the banks withhold foreclosed homes from the market.

By keeping the extra homes off-market, supply went down, demand went up (slightly), and housing showed signs of a rebound. The withholding of supply was synchronized with the Firsttime Homebuyers credit, which provided an $8,000 subsidy to new home buyers. This pumped up housing sales and further concealed what was really taking place, which was a gigantic transfer of public wealth to the banks in exchange for putrid assets that no one wanted. Naturally, the process kept the market from correcting and added vast numbers of foreclosed homes to the shadow inventory.

During this same period, the Fed worked out an agreement with Congress to pay the banks interest on the reserves it created at the banks. (Note: The MBS were exchanged for reserves) At the time, many experts questioned the wisdom of the Fed's plan saying that the reserves would not lead to another credit expansion. And they were right, too. In fact, it didn't stop the slide in housing either which resumed with gusto as soon as QE ended and the banks started dumping more foreclosed homes onto the market.

So, why would the Fed add more than a trillion dollars in reserves to the banking system if it really served no earthly purpose? Was it just so the banks would be able to earn interest on those reserves? Surely, that wouldn't be nearly enough to remove the ocean of red ink on their balance sheets. So, what was Bernanke really up to?

On Tuesday, Senator Bernie Sanders office released a CRS report titled "Banks Play Shell Game with Taxpayer Dollars" that sheds a bit light on the shady ways the Fed conducts its business. Sanders "found numerous instances during the financial crisis of 2008 and 2009 when banks took near zero-interest funds from the Federal Reserve and then loaned money back to the federal government on sweetheart terms for the banks."

So, now we have irrefutable proof that the Fed was simply handing out money to the banks. More importantly, the report shows that this was not just a few isolated incidents, but a pattern of abuse that increased as the needs of the banks became more pressing. In other words, giving away money became policy. Is it any wonder why the Fed has fought so ferociously to prevent an audit of its books?

From Sander's report: "The banks pocketed interest on government securities that paid rates up to 12 times greater than the Fed's rock bottom interest charges, according to a Congressional Research Service analysis conducted for Sanders."

Are you kidding me; 12 times more than what the Fed was getting in return?

That's larceny, my friend. Grand larceny.

More from the Sanders report: "This report confirms that ultra-low interest loans provided by the Federal Reserve during the financial crisis turned out to be direct corporate welfare to big banks," Sanders said. "Instead of using the Fed loans to reinvest in the economy, some of the largest financial institutions in this country appear to have lent this money back to the federal government at a higher rate of interest by purchasing U.S. government securities."

And, what they didn't lend back to Uncle Sam at a hefty rate of interest, they plunked into equities to ignite Bernanke's Stock Market Blastoff, the final phase of bubblemania.

So, let's use an analogy to explain what the Fed was doing: Imagine that you provide your son, Kirby, with a weekly allowance of $50. And Kirby–showing an uncanny aptitude for career banking–says, "Dad, I'd like to loan this money back to you at 10 per cent per annum." Would that be a good deal for you, Dad, or would dearest Kirby be taking you to the cleaners?

That's what Bernanke was doing "at rates up to 12 times greater than the Fed's rock bottom interest charges." So the question is, if Bernanke was already involved in this type of hanky-panky, what would keep him from raising the stakes a bit and really putting his friends back in the clover? Honor? Integrity?

Not likely.

What I'd like to know is whether the Fed has been creating reserves at the banks, reserves that the banks have then converted into government bonds (USTs) and sold back to the Fed during QE2? In other words, is this another circular trade (like we see in the Sanders report) whose only purpose is to funnel more money to the banks?

And–if that's NOT the case– then where did the banks come up with $600 billion in US Treasuries that they just sold to the Fed? After all, in testimony before the Financial Crisis Inquiry Commission (FCIC), Bernanke admitted that 12 of the 13 biggest banks in the country were underwater after Lehman Brothers defaulted. If that's true, then where did they get the $600 billion in Treasuries?

It's not a question of whether the Fed has been abusing its power. It's just a matter of "how much".

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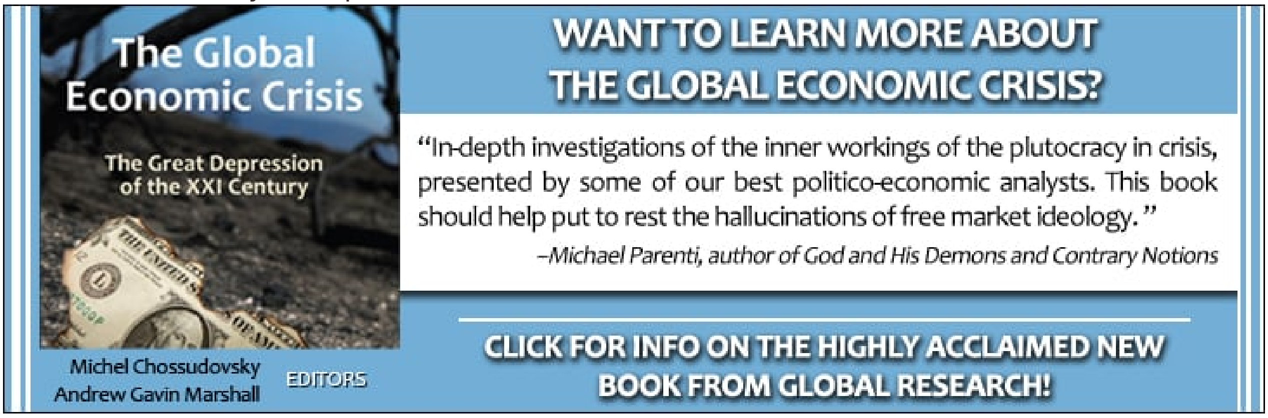

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