It Can Happen Here: The Bank Confiscation Scheme for US and UK Depositors

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Confiscating the customer deposits in Cyprus banks, it seems, was not a one-off, desperate idea of a few Eurozone "troika" officials scrambling to salvage their balance sheets. A joint paper by the US Federal Deposit Insurance Corporation and the Bank of England dated December 10, 2012, shows that these plans have been long in the making; that they originated with the G20 Financial Stability Board in Basel, Switzerland (discussed earlier here); and that the result will be to deliver clear title to the banks of depositor funds.

New Zealand has a similar directive, discussed in my last article here, indicating that this isn't just an emergency measure for troubled Eurozone countries. New Zealand's Voxy reported on March 19th:

> The National Government [is] pushing a Cyprus-style solution to bank failure in New Zealand which will see small depositors lose some of their savings to fund big bank bailouts . . . .
>
> Open Bank Resolution (OBR) is Finance Minister Bill English's favoured option dealing with a major bank failure. If a bank fails under OBR, all depositors will have their savings reduced overnight to fund the bank's bail out.

Can They Do That?

Although few depositors realize it, legally the bank owns the depositor's funds as soon as they are put in the bank. Our money becomes the bank's, and we become unsecured creditors holding IOUs or promises to pay. (See here and here.) But until now the bank has been obligated to pay the money back on demand in the form of cash. Under the FDIC-BOE plan, our IOUs will be converted into "bank equity." The bank will get the money and we will get stock in the bank. With any luck we may be able to sell the stock to someone else, but when and at what price? Most people keep a deposit account so they can have ready cash to pay the bills.

The 15-page FDIC-BOE document is called "Resolving Globally Active, Systemically Important, Financial Institutions." It begins by explaining that the 2008 banking crisis has made it clear that some other way besides taxpayer bailouts is needed to maintain "financial stability." Evidently anticipating that the next financial collapse will be on a grander scale than either the taxpayers or Congress is willing to underwrite, the authors state:

> An efficient path for returning the sound operations of the G-SIFI to the private sector would be provided by exchanging or converting a sufficient amount of the unsecured debt from the original creditors of the failed company [meaning the depositors] into equity [or stock]. In the U.S., the new equity would become capital in one or more newly formed operating entities. In the U.K., the same approach could be used, or the equity could be used to recapitalize the failing financial company itself—thus, the highest layer of surviving bailed-in creditors would become the owners of the resolved firm. In either country, the new equity holders would take on the corresponding risk of being shareholders in a financial institution.

No exception is indicated for "insured deposits" in the U.S., meaning those under $250,000, the deposits we thought were protected by FDIC insurance. This can hardly be an oversight, since it is the FDIC that is issuing the directive. The FDIC is an insurance company funded by premiums paid by private banks. The directive is called a "resolution process," defined elsewhere as a plan that "would be triggered *in the event of the failure of an insurer* . . . ." The only mention of "insured deposits" is in connection with existing UK legislation, which the FDIC-BOE directive goes on to say is inadequate, implying that it needs to be modified or overridden.

An Imminent Risk

If our IOUs are converted to bank stock, they will no longer be subject to insurance protection but will be "at risk" and vulnerable to being wiped out, just as the Lehman Brothers shareholders were in 2008. That this dire scenario could actually materialize was underscored by Yves Smith in a March 19th post titled **When You Weren't Looking, Democrat Bank Stooges Launch Bills to Permit Bailouts, Deregulate Derivatives**. She writes:

> In the US, depositors have actually been put in a worse position than Cyprus deposit-holders, at least if they are at the big banks that play in the derivatives casino. The regulators have turned a blind eye as banks use their depositaries to fund derivatives exposures. And as bad as that is, the depositors, unlike their Cypriot confreres, aren't even senior creditors. Remember Lehman? When the investment bank failed, unsecured creditors (and remember, depositors are unsecured creditors) got eight cents on the dollar. One big reason was that derivatives counterparties require collateral for any exposures, meaning they are secured creditors. The 2005 bankruptcy reforms made derivatives counterparties senior to unsecured lenders.

One might wonder why the posting of collateral by a derivative counterparty, at some percentage of full exposure, makes the creditor "secured," while the depositor who puts up 100 cents on the dollar is "unsecured." But moving on – Smith writes:

> Lehman had only two itty bitty banking subsidiaries, and to my knowledge, was not gathering retail deposits. But as readers may recall, Bank of America moved most of its derivatives from its Merrill Lynch operation [to] its depositary in late 2011.

Its "depositary" is the arm of the bank that takes deposits; and at B of A, that means lots and lots of deposits. The deposits are now subject to being wiped out by a major derivatives loss. How bad could that be? Smith quotes Bloomberg:

> . . . Bank of America's holding company . . . held almost $75 trillion of derivatives at the end of June . . . .
>
> That compares with JPMorgan's deposit-taking entity, JPMorgan Chase Bank NA, which contained 99 percent of the New York-based firm's $79 trillion of notional derivatives, the OCC data show.

$75 trillion and $79 trillion in derivatives! These two mega-banks alone hold more in notional derivatives *each* than the entire global GDP (at $70 trillion). The "notional value" of derivatives is not the same as cash at risk, but according to a cross-post on Smith's site:

By at least one estimate, in 2010 there was a total of $12 trillion in cash tied up (at risk) in derivatives . . . .

$12 trillion is close to the US GDP. Smith goes on:

> . . . Remember the effect of the 2005 bankruptcy law revisions: derivatives counterparties are first in line, they get to grab assets first and leave everyone else to scramble for crumbs. . . . Lehman failed over a weekend after JP Morgan grabbed collateral.
>
> But it's even worse than that. During the savings & loan crisis, the FDIC did not have enough in deposit insurance receipts to pay for the Resolution Trust Corporation wind-down vehicle. It had to get more funding from Congress. This move paves the way for another TARP-style shakedown of taxpayers, this time to save depositors.

Perhaps, but Congress has already been burned and is liable to balk a second time. Section 716 of the Dodd-Frank Act specifically prohibits public support for speculative derivatives activities. And in the Eurozone, while the European Stability Mechanism committed Eurozone countries to bail out failed banks, they are apparently having second thoughts there as well. On March 25th, Dutch Finance Minister Jeroen Dijsselbloem, who played a leading role in imposing the deposit confiscation plan on Cyprus, told reporters that it would be the template for any future bank bailouts, and that "the aim is for the ESM never to have to be used."

That explains the need for the FDIC-BOE resolution. If the anticipated enabling legislation is passed, the FDIC will no longer need to protect depositor funds; it can just confiscate them.

Worse Than a Tax

An FDIC confiscation of deposits to recapitalize the banks is far different from a simple tax on taxpayers to pay government expenses. The government's debt is at least arguably the people's debt, since the government is there to provide services for the people. But when the banks get into trouble with their derivative schemes, they are not serving depositors, who are not getting a cut of the profits. Taking depositor funds is simply theft.

What should be done is to raise FDIC insurance premiums and make the banks pay to keep their depositors whole, but premiums are already high; and the FDIC, like other government regulatory agencies, is subject to regulatory capture. Deposit insurance has failed, and so has the private banking system that has depended on it for the trust that makes banking work.

The Cyprus haircut on depositors was called a "wealth tax" and was written off by commentators as "deserved," because much of the money in Cypriot accounts belongs to foreign oligarchs, tax dodgers and money launderers. But if that template is applied in the US, it will be a tax on the poor and middle class. Wealthy Americans don't keep most of their money in bank accounts. They keep it in the stock market, in real estate, in over-the-counter derivatives, in gold and silver, and so forth.

Are you safe, then, if your money is in gold and silver? Apparently not – if it's stored in a safety deposit box in the bank. Homeland Security has reportedly told banks that it has authority to seize the contents of safety deposit boxes without a warrant when it's a matter of "national security," which a major bank crisis no doubt will be.

The Swedish Alternative: Nationalize the Banks

Another alternative was considered but rejected by President Obama in 2009: nationalize mega-banks that fail. In a February 2009 article titled "Are Uninsured Bank Depositors in Danger?", Felix Salmon discussed a newsletter by Asia-based investment strategist Christopher Wood, in which Wood wrote:

> It is . . . amazing that Obama does not understand the political appeal of the nationalization option. . . . [D]espite this latest setback nationalization of the banks is coming sooner or later because the realities of the situation will demand it. The result will be shareholders wiped out and bondholders forced to take debt-for-equity swaps, if not hopefully depositors.

On whether depositors could indeed be forced to become equity holders, Salmon commented:

> It's worth remembering that depositors are unsecured creditors of any bank; usually, indeed, they're by far the largest class of unsecured creditors.

President Obama acknowledged that bank nationalization had worked in Sweden, and that the course pursued by the US Fed had not worked in Japan, which wound up instead in a "lost decade." But Obama opted for the Japanese approach because, according to Ed Harrison, "Americans will not tolerate nationalization."

But that was four years ago. When Americans realize that the alternative is to have their ready cash transformed into "bank stock" of questionable marketability, moving failed mega-banks into the public sector may start to have more appeal.

Ellen Brown *is an attorney, chairman of the Public Banking Institute, and the author of eleven books, including* Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free*. Her websites are webofdebt.com and ellenbrown.com.* For details of the June 2013 Public Banking Institute conference in San Rafael, California, see here.

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