The Federal Reserve and Bank of America Initiate a Coup to Dump Billions of Dollars of Losses on the American Taxpayer

By Washington's Blog
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Bloomberg reports that Bank of America is dumping derivatives onto a subsidiary which is insured by the government – i.e. taxpayers.

Yves Smith notes:

> If you have any doubt that Bank of America is going down, this development should settle it …. Both [professor of economics and law, and former head S&L prosecutor] Bill Black (who I interviewed just now) and I see this as a desperate move by Bank of America's management, a de facto admission that they know the bank is in serious trouble.
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> The short form via Bloomberg:
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>> Bank of America Corp. (BAC), hit by a credit downgrade last month, has moved derivatives from its Merrill Lynch unit to a subsidiary flush with insured deposits, according to people with direct knowledge of the situation…
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>> Bank of America's holding company — the parent of both the retail bank and the Merrill Lynch securities unit — held almost \$75 trillion of derivatives at the end of June, according to data compiled by the OCC. About \$53 trillion, or 71 percent, were within Bank of America NA, according to the data, which represent the notional values of the trades.
>>
>> 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.
>
> Now you would expect this move to be driven by adverse selection, that it, that BofA would move its WORST derivatives, that is, the ones that were riskiest or otherwise had high collateral posting requirements, to the sub. Bill Black confirmed that even though the details were sketchy, this is precisely what took place.
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> And remember, as we have indicated, there are some "derivatives" that should be eliminated, period. We've written repeatedly about credit default swaps, which have virtually no legitimate economic uses (no one was complaining about the illiquidity of corporate bonds prior to the introduction of CDS; this

was not a perceived need among investors). They are an inherently defective product, since there is no way to margin adequately for "jump to default" risk and have the product be viable economically. CDS are systematically underpriced insurance, with insurers guaranteed to go bust periodically, as AIG and the monolines demonstrated. [Background.]

The reason that commentators like Chris Whalen were relatively sanguine about Bank of America likely becoming insolvent as a result of eventual mortgage and other litigation losses is that it would be a holding company bankruptcy. The operating units, most importantly, the banks, would not be affected and could be spun out to a new entity or sold. Shareholders would be wiped out and holding company creditors (most important, bondholders) would take a hit by having their debt haircut and partly converted to equity.

This changes the picture completely. This move reflects either criminal incompetence or abject corruption by the Fed. Even though I've expressed my doubts as to whether Dodd Frank resolutions will work, dumping derivatives into depositaries pretty much guarantees a Dodd Frank resolution will fail. 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. [Background.] **So this move amounts to a direct transfer from derivatives counterparties of Merrill to the taxpayer, via the FDIC,** which would have to make depositors whole after derivatives counterparties grabbed collateral. It's well nigh impossible to have an orderly wind down in this scenario. You have a derivatives counterparty land grab and an abrupt insolvency. 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. No Congressman would dare vote against that. This move is Machiavellian, and just plain evil.

The FDIC is understandably ripshit. Again from Bloomberg:

> The Federal Reserve and Federal Deposit Insurance Corp. disagree over the transfers, which are being requested by counterparties, said the people, who asked to remain anonymous because they weren't authorized to speak publicly. The Fed has signaled that it favors moving the derivatives to give relief to the bank holding company, while the FDIC, which would have to pay off depositors in the event of a bank failure, is objecting, said the people. The bank doesn't believe regulatory approval is needed, said people with knowledge of its position.

Well OF COURSE BofA is gonna try to take the position this is kosher, but the FDIC can and must reject this brazen move. But this is a bit of a fait accompli,and I have NO doubt BofA and the craven, corrupt Fed will argue that moving the derivatives back will upset the markets. Well too bad, maybe it's time banks learn they can no longer run roughshod over regulators. And if BofA is at that much risk that it can't survive undoing this brazen move, that would seem to be prima facie evidence that a Dodd Frank resolution is in order.

Bill Black said that the Bloomberg editors toned down his remarks considerably. He said, "Any competent regulator would respond: "No, Hell NO!" It's time that the public also say no, and loudly, to this new scheme to loot

> taxpayers and save a criminally destructive bank.

Professor Black provided a "bottom line" summary in a separate email:

> 1.The bank holding company (BAC) is moving troubled assets held by an entity not insured by the public (Merrill Lynch) to the Bank of America, which is insured by the public
> 2. The banking rules are designed to prevent that because they are designed to protect the FDIC insurance fund (which the Treasury guarantees)
> 3. Any marginally competent regulator would say "No, Hell NO!"
> 4. The Fed, reportedly, is saying "Sure, no worries" by allowing the sale of an affiliate's troubled assets to B of A
> 5. This is a really good "natural experiment" that allows us to test whether the Fed is protects the public or the uninsured and systemically dangerous institutions (the bank holding companies (BHCs))
> 6. We are all shocked, shocked [sarcasm] that Bernanke responded to the experiment by choosing to protect the BHC at the expense of the public.

Karl Denninger writes:

> So let's see what we have here.
>
> Bank customer initiates a swap position with Bank. In doing so they **intentionally** accept the credit risk of the institution they trade with.
>
> **Later** they get antsy about perhaps not getting paid. Bank **then shifts that risk to a place where people who deposited their money and had no part of this transaction wind up backstopping it.**
>
> **This effectively makes the depositor the "guarantor" of the swap ex-post-facto**.
>
> That the regulators are allowing this is an **outrage**.
>
> If you're a Bank of America customer and continue to be one you deserve whatever you get down the line, whether it comes in the form of higher fees and costs assessed upon you or something worse.

Stand Up to the Coup

Bank of America has repeatedly become insolvent due to fraud and risky bets, and repeatedly been bailed out by the government and American people. The government and banks are engineering an age of *permanent* bailouts for this insolvent, criminal bank (and the other too big to fails). Remember, this is the same bank that is refusing to let people close their accounts.

This is yet another joint effort by Washington and Wall Street to screw the American people, and to trample on the rule of law.

The American people will be stuck in nightmare of a never-ending depression (yes, we are currently in a depression) unless we stand up to the overly-powerful Fed and the too big to fail banks.

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