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Think Your Money is Safe in an Insured Bank Account? Think Again.

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Global Research, July 05, 2013

Region: Europe, USA
Theme: Global Economy

A trend to shift responsibility for bank losses onto blameless depositors lets banks gamble away your money.

When Dutch Finance Minister Jeroen Dijsselbloem told reporters on March 13, 2013, that the Cyprus deposit confiscation scheme would be the template for future European bank bailouts, the statement caused so much furor that he had to retract it. But the "bail in" of depositor funds is now being made official EU policy. On June 26, 2013, *The New York Times reported* that EU finance ministers have agreed on a plan that shifts the responsibility for bank losses from governments to bank investors, creditors and uninsured depositors.

Insured deposits (those under €100,000, or about $130,000) will allegedly be "fully protected." But protected by whom? The national insurance funds designed to protect them are inadequate to cover another system-wide banking crisis, and the court of the European Free Trade Association ruled in the case of Iceland that the insurance funds were not intended to cover that sort of systemic collapse.

Shifting the burden of a major bank collapse from the blameless taxpayer to the blameless depositor is another case of robbing Peter to pay Paul, while the real perpetrators carry on with their risky, speculative banking schemes.

Shuffling the Deck Chairs on the Titanic

Although the bail-in template did not hit the news until it was imposed on Cyprus in March 2013, it is a global model that goes back to a directive from the Financial Stability Board (an arm of the Bank for International Settlements) dated October 2011, endorsed at the G20 summit in December 2011. In 2009, the G20 nations agreed to be regulated by the Financial Stability Board; and bail-in policies have now been established for the US, UK, New Zealand, Australia, and Canada, among other countries. (See earlier articles here and here.)

The EU bail-in plan, which still needs the approval of the European Parliament, would allow European leaders to dodge something they evidently regret having signed, the agreement known as the European Stability Mechanism (ESM). Jeroen Dijsselbloem, who played a leading role in imposing the deposit confiscation plan on Cyprus, said on March 13 that "the aim is for the ESM never to have to be used."

Passed with little publicity in January 2012, the ESM imposes an open-ended debt on EU member governments, putting taxpayers on the hook for whatever the ESM's overseers demand. Two days before its ratification on July 1, 2012, the agreement was modified to make the permanent bailout fund cover the bailout of private banks. It was a bankers' dream – a permanent, mandated bailout of private banks by governments. But EU governments are now balking at that heavy commitment.

In Cyprus, the confiscation of depositor funds was not only approved but mandated by the EU, along with the European Central Bank (ECB) and the IMF. They told the Cypriots that deposits below €100,000 in two major bankrupt banks would be subject to a 6.75 percent levy or "haircut," while those over €100,000 would be hit with a 9.99 percent "fine." When the Cyprus national legislature overwhelming rejected the levy, the insured deposits under €100,000 were spared; but it was at the expense of the uninsured deposits, which took a much larger hit, estimated at about 60 percent of the deposited funds.

The Elusive Promise of Deposit Insurance

While the insured depositors escaped in Cyprus, they might not fare so well in a bank collapse of the sort seen in 2008-09. As Anne Sibert, Professor of Economics at the University of London, observed in an April 2nd article on *VOX*:

> Even though it wasn't adopted, the extraordinary proposal that small depositors should lose a part of their savings – a proposal that had the approval of the Eurogroup, ECB and IMF policymakers – raises the question: Is there any credible protection for small-bank depositors in Europe?

She noted that members of the European Economic Area (EEA) – which includes the EU, Switzerland, Norway and Iceland – are required to set up deposit-insurance schemes covering most depositors up to €100,000, and that these schemes are supposed to be funded with premiums from the individual country's banks. But the enforceability of the EEA insurance mandate came into question when the Icelandic bank Icesave failed in 2008. The matter was taken to the court of the European Free Trade Association, which said that Iceland did not breach EEA directives on deposit guarantees by not compensating U.K. and Dutch depositors holding Icesave accounts. The reason: "The court accepted Iceland's argument that the EU directive was never meant to deal with the collapse of an entire banking system." Sibert comments:

> [T]he precedents set in Cyprus and Iceland show that deposit insurance is only a legal commitment for small bank failures. In systemic crises, these are more political than legal commitments, so the solvency of the insuring government matters.

The EU can mandate that governments arrange for deposit insurance, but if funding is inadequate to cover a systemic collapse, taxpayers will again be on the hook; and if they are unwilling or unable to cover the losses (as occurred in Cyprus and Iceland), we're back to the unprotected deposits and routine bank failures and bank runs of the 19th century.

In the US, deposit insurance faces similar funding problems. As of June 30, 2011, the FDIC deposit insurance fund had a balance of only $3.9 billion to provide loss protection on $6.54 trillion of insured deposits. That means every $10,000 in deposits was protected by only $6 in reserves. The FDIC fund could borrow from the Treasury, but the Dodd-Frank Act (Section 716) now bans taxpayer bailouts of most speculative derivatives activities; and these would be the likely trigger of a 2008-style collapse.

Derivatives claims have "super-priority" in bankruptcy, meaning they take before all other claims. In the event of a major derivatives bust at JPMorgan Chase or Bank of America, both of which hold derivatives with notional values exceeding $70 trillion, the collateral is liable to be gone before either the FDIC or the other "secured" depositors (including state and local governments) get to the front of the line. (See here and here.)

Who Should Pay?

Who should bear the loss in the event of systemic collapse? The choices currently on the table are limited to taxpayers and bank creditors, including the largest class of creditor, the depositors. Imposing the losses on the profligate banks themselves would be more equitable , but if they have gambled away the money, they simply won't have the funds. The rules need to be changed so that they cannot gamble the money away.

One possibility for achieving this is area-wide regulation. Sibert writes:

> [I]t is unreasonable to expect the area as a whole to bail out a particular country's banks unless it can also supervise that country's banks. This is problematic for the EEA or even the EU, but it may be possible – at least in the Eurozone – when and if [a] single supervisory mechanism comes into being.

A single regulatory agency for all Eurozone banks is being negotiated; but even if it were agreed to, the US experience with the Dodd-Frank regulations imposed on US banks shows that regulation alone is inadequate to curb bank speculation and prevent systemic risk. In a July 2012 article in *The New York Times* titled "Wall Street Is Too Big to Regulate," Gar Alperovitz observed:

> With high-paid lobbyists contesting every proposed regulation, it is increasingly clear that big banks can never be effectively controlled as private businesses. If an enterprise (or five of them) is so large and so concentrated that competition and regulation are impossible, the most market-friendly step is to nationalize its functions.

The Nationalization Option

Nationalization of bankrupt, systemically-important banks is not a new idea. It was done very successfully, for example, in Norway and Sweden in the 1990s. But having the government clean up the books and then sell the bank back to the private sector is an inadequate solution. Economist Michael Hudson maintains:

Real nationalization occurs when governments act in the public interest to take over private property. . . . Nationalizing the banks along these lines would mean that *the government would supply the nation's credit needs. The Treasury would become the source of new money, replacing commercial bank credit*. Presumably this credit would be lent out for economically and socially productive purposes, not merely to inflate asset prices while loading down households and business with debt as has occurred under today's commercial bank lending policies.

Anne Sibert proposes another solution along those lines. Rather than imposing losses on either the taxpayers or the depositors, they could be absorbed by the central bank, which would have the power to simply write them off. As lender of last resort, the central bank (the ECB or the Federal Reserve) can create money with computer entries, without drawing it from elsewhere or paying it back to anyone.

That solution would allow the depositors to keep their deposits and would save the taxpayers from having to pay for a banking crisis they did not create. But there would remain the problem of "moral hazard" – the temptation of banks to take even greater risks when they know they can dodge responsibility for them. That problem could be avoided, however, by making the banks public utilities, mandated to operate in the public interest. And if they had been public utilities in the first place, the problems of bail-outs, bail-ins, and banking crises might have been averted altogether.

Ellen Brown is an attorney, president of the Public Banking Institute, and author of twelve books, including Web of Debt and its recently-published sequel The Public Bank Solution. Her websites are http://WebofDebt.com, http://PublicBankSolution.com, and http://PublicBankingInstitute.org.

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