

# Bank scandals and the case for public ownership

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8 February 2013

The bringing of charges against the rating agency Standard and Poor's by the US Justice Department has again highlighted the cesspool of illegality, conflict of interest and corrupt relations that lie at the very heart of the US and global financial system.

The \$5 billion civil lawsuit brought by the government claims that from September 2004 through October 2007 S&P "knowingly and with the intent to defraud, devised, participated in, and executed a scheme to defraud investors" through the sale of collateralized debt obligations backed by residential mortgage securities. According to the suit, the ratings agency "falsely represented" that its credit ratings were objective, while in reality its "desire for increased revenue and market share" led it to "downplay and disregard the true extent of the credit risks."

During the period covered by the charges, S&P issued credit ratings on more than \$2.8 trillion worth of residential-backed securities and about \$1.2 trillion worth of related products. The charges were brought after talks broke down over a cash settlement, with S&P claiming that if it admitted liability it would be open to other suits. It proposed a settlement of \$100 million.

The rating agency denies the charges, arguing that it reviewed the same data as the rest of the market, "including US government officials who in 2007 publicly stated that problems in the sub-prime market appeared to be contained."

The charging of S&P is just the latest in a series of corruption scandals to emerge in the global banking system.

In Germany, the federal supervisory agency BaFin is bringing to a conclusion an investigation into the role played by Deutsche Bank in the Libor (London Interbank Offered Rate) rate-rigging scandal, which

impacted \$350 trillion worth of financial transactions worldwide.

The bank's defence is that any manipulation of the Libor rate by its staff was the result of the action of "rogue traders". This defence ignores the fact that, in the words of the BaFin head investigator, the whole system was "practically an invitation to manipulate."

This is because the bank's money market traders who were involved in setting the Libor rates were also involved in betting vast amounts of money on the movement in these same rates. The British bank Barclays has already been fined \$450 million for its part in the Libor manipulation and at least 16 other major banks are under investigation.

The same conflicts of interest which lie at the heart of the Libor rate-fixing are at the centre of the S&P case.

S&P and the other major credit rating agencies were paid by the issuers of the securities that they rated, in this case the banks that created the residential mortgage-backed securities. S&P charged up to \$750,000 on every deal it rated. Faced with competition from other rating agencies, it had a vested interest in giving an inflated rating so that it would not lose business to its rivals. According to evidence gathered in the course of the investigation, the head of S&P's commercial mortgage-backed securities department sent out an email in which she said a meeting was planned to discuss adjusting criteria "because of the ongoing threat of losing deals."

The continuing scandals will no doubt give rise to calls for greater regulation and closer scrutiny of the operations of the banks, rating agencies and financial institutions. But such calls ignore the incestuous relationships between the finance houses and the regulators that are supposed to be overseeing their activities.

The recent sweetheart settlement between the US Office of the Comptroller of the Currency and ten major banks over pervasive fraud and illegality in the foreclosure of homeowners is a case in point. In 2011, regulators demanded that the banks employ consultants to determine whether borrowers had been wrongfully evicted. The consultants collected some \$2 billion in fees over the course of 14 months, a sum greater than half the \$3.3 billion in payouts to foreclosed homeowners under the settlement with the banks.

The private consulting firms, intimately tied to the banks, are paid by the very banks they are supposedly investigating, just as the credit rating agencies are paid by the banks whose securities they rate.

The corruption is so extensive that it has brought increasing and sometimes biting criticism from liberal writers. Matt Taibbi of the *Rolling Stone* magazine, for example, has documented how the government did not just bail out Wall Street with money but also “lied on Wall Street’s behalf, calling unhealthy banks healthy, and helping banks cover up just how much aid they were getting in secret.”

In a review of former US Treasury Secretary Timothy Geithner’s four-year term, *New York Times* journalist Gretchen Morgenson wryly noted that “the financial institutions that dominate the United States were rarely on the losing end in the Geithner years.”

Former inspector-general of the Troubled Asset Relief Program (TARP), Neil Barofsky was somewhat more scathing. Writing in the *Financial Times*, he said the “Geithner doctrine” of preserving the big banks no matter what the consequences had led to a “perversion of the US criminal justice system” and a two-tiered system of justice that “all but assures more excessive risk-taking, more crime and more crises.”

Such criticism may point to some of the more egregious examples of looting and fraud. But the liberal critics never press to the essential point. The corruption and illegality that characterise the global banking and financial system are not aberrations. Rather, they are essential to profit accumulation.

Karl Marx noted that when capital experienced a crisis and profits rates fell “there appears swindling and a general promotion of swindling by recourse to frenzied ventures” for the sake of trying to overcome the crisis.

But Marx was still pointing to somewhat exceptional

circumstances. Now the exception has become the rule. The past 30 years, following the end of the post-war capitalist boom, have been characterized by the rise of financialization and the ever greater separation of the accumulation of profit from the actual processes of production.

Under conditions where the valuation of financial assets is increasingly based on a series of complex mathematical models, and where changes in the underlying assumptions can bring major changes in the final outcome, transforming potential losses into profits, the way is open to manipulation and fraud. In fact, as the S&P case shows, the ever-present danger of being outstripped by one’s rivals compels such corruption as a matter of survival.

The stench emanating from the financial system is a product of the decay of the entire profit system. That system must be replaced by a higher socio-economic order in which the vast wealth created by the collective labour of the world working class is deployed to meet human need. The expropriation of the banks and finance houses, placing them under public ownership and democratic control, is the first step in implementing such a program.



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