Archegos meltdown: another warning of a deep-seated crisis

Nick Beams
2 April 2021

The blowup of the private investment firm Archegos last month has not set off a crisis of the global financial system. But the type of highly speculative operations in which it was engaged, financed to the tune of tens of billions of dollars by some of the world's biggest banks, certainly have the potential to do so.

In the wake of the debacle, a number of questions arise: how many more, much bigger, time bombs are out there ticking away? Where are they located, and what could set them off?

Writing in the *Financial Times*, columnist Gillian Tett noted that when an avalanche takes place on a snowfield, the root cause is not an idiosyncratic shock, but instability in the underlying snowpack.

The immediate trigger of the Archegos avalanche was the decisions by the US media group ViacomCBS to take advantage of the near tripling of its share price over the past year—one of many companies whose shares have skyrocketed as a result of the trillions of dollars pumped into the financial system by the Fed—to issue a further $3 billion worth of stock.

This set off a fall in the company's shares which hit Archegos because it had made big bets on the share price continuing to rise, together with similar bets on other companies, including Chinese tech stocks, which also had started to fall.

Archegos, a so-called family firm set up in 2012 by Bill Hwang, who had been convicted of illegal share trading and forced to pay a $44 million fine, had financed his deals with funding provided by major banks using a derivative known as total return swaps.

Under this system, the banks purchased shares, in return for a lucrative fee, which they held, agreeing to pay Archegos what it would have received had it actually owned the shares. If the price went up or dividends were paid, then the bank paid a return to Archegos. But if the investment failed, then Archegos would have to pay the bank.

The extent of the leverage was extraordinary. Attracted by the fat fees from such services, the banks enabled Archegos to amplify its buying power, sometimes by as much as eight times its own capital.

When the share price of ViacomCBS and other stocks bought on behalf of Archegos began to fall sharply, the banks made a margin call, requiring Archegos to put up more collateral to the banks. When it was unable to do so, there was a rush for the exits as the banks then sought to sell off the stocks they held in order to try to minimise their losses.

Goldman Sachs and Morgan Stanley were first out the door and managed to escape with relatively little damage. But the Japanese investment bank Nomura and Credit Suisse were not as fast and now face losses of $2 billion and $3 billion to $5 billion, respectively. Total losses incurred by the banks that financed Archegos could reach as much as $10 billion.

The use of derivatives has proved very popular among banks in recent years because it has enabled them to obtain fees without having to report their dealings.

According to a report in the *Financial Times*, in 2019 global banks earned an estimated $11 billion from equity financing via the use of derivatives, including total return swaps used by Archegos, double the level in 2012. And the rate of their use has been accelerating.

The *New York Times* reported that there has been a sharp rise in the use of stock-related derivatives in the recent period. The amount of outstanding equity derivatives has more than doubled since 2015, rising from $50 billion to more than $110 billion in the first half of 2020, according to calculations by the Bank for International Settlements.

The implosion of Archegos as a result of a margin call draws attention to the significant expansion of this form of speculation over the past year as banks have sought to

© World Socialist Web Site

take advantage of the ultra-cheap money provided by the Fed.

The *Sydney Morning Herald* reported that according to the US Financial Industry Regulation Authority, margin loans have risen from $479.3 billion a year ago to more than $813 billion, outstripping even the accelerated growth in the market capitalisation of Wall Street.

The Archegos debacle has brought forward the now familiar calls following every incident of financial turmoil for greater oversight and regulation by authorities. The Securities and Exchange Commission issued what amounted to a pro forma statement that it was monitoring the situation.

Democratic Senator Elizabeth Warren, one of the party's advocates for greater oversight, said in an emailed statement that the Archegos meltdown had "all the makings of a dangerous situation."

"We need transparency and strong oversight to ensure that the next hedge fund blowup doesn't take the economy down with it," she said.

But such calls, based on the illusions promoted so assiduously by the Democrats over decades, that the capitalist financial system can somehow be regulated and made to work in the interests of society, have been exposed by long experience.

There were similar calls after the implosion of Long Term Capital Management in 1998. But then came the tech wreck of 2000-2001 and the collapse of Enron. This was followed by the sub-prime mortgage speculative bubble that sparked the global financial crisis of 2008.

The response of the Democrats in the Obama administration was to bail out the banks. The Fed, under the chairmanship of Ben Bernanke and then Democrat appointee Janet Yellen, now Treasury Secretary in the Biden administration, provided the banks, hedge funds and Wall Street speculators with trillions of dollars of essentially free money to continue the very activities that led to the 2008 crash.

And as for the Dodd-Frank legislation, introduced under the claim that it would prevent a recurrence of the 2008 collapse, the increased use of derivatives at the centre of the Archegos debacle, was the outcome of the efforts by the banks and Wall Street to get around the very minor restrictions it imposed.

As the managing principal of the financial consultancy firm Finadium, Josh Galper, told the *Financial Times* that the growth of the equity swap market at the centre of the Archegos operations developed as the "natural outgrowth" of the Dodd-Frank regulations.

The outcome of this process has been that rather becoming more transparent, the system has become even more opaque. The increased use of financial derivatives means that several banks can provide financing to a single client without other banks being aware of it. Consequently, if a bank thinks it can reduce its exposure by offloading it to another bank it can find that the bank is also exposed to the same fund.

The Archegos event is not a one-off isolated incident, but another indication of broader trends. It comes in the wake of the Wirecard debacle last year and Greensill meltdown earlier this year, both of which involved major banks.

Fuelled by the endless supply of money from the banks, used to finance ever-increasing speculation, the entire global financial system is heading at ever greater speed towards a disaster.

One indication of that speed came on Thursday when Wall Street's S&P 500 index set a new record high of 4000 in the midst of the largest decline in global growth, triggered by the COVID-19 pandemic, since the Great Depression. It took 1227 trading days for the S&P to advance 1000 points from 2000 to 3000, but the advance from 3000 to 4000 was achieved in just 434.

The threat of another financial disaster—the consequences of which will far outstrip the devastation of the 2008 crisis—now hangs over the entire global economy. The answer is not calls for greater regulation to try to contain the explosive contradictions of the financial system for experience has shown that is impossible.

The only viable and realistic perspective is the fight for a socialist program—the taking of political power by the working class, ending the domination of society by the financial oligarchy, and the complete economic reorganisation of society starting with the bringing of the entire financial system into public ownership under democratic control.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site