Tabled information
Reference: 184/119(b)

Our Market, which art in heaven

And the Business Roundtable saith unto us, have faith.

BY DENIS WELCH

Well, you always knew it. You always had your suspicions. Now someone has done the homework and confirmed it. The Business Roundtable is really an evangelistic church in disguise. A religious researcher has analysed a truckload of BRT papers and concluded that, far from being a hard-headed bunch of businessmen guided by economic pragmatism, the Roundtablers base all their assertions on blind faith. They *believe*: and they want you to believe, too.

Believe in what? God, of course. But not the old chap up in the sky, the one who keeps a fatherly eye on us all; he's not in the frame any more. Nor are we talking about Allah or Brahma or the universal lifeforce or some such spiritual woolly-woofterism. The one God worshipped by the Business Roundtable is the Market – and the Market's word is law.

"At the heart of any religious movement," explains Barbara Vincent, "there is a Power that transcends and humbles humanity, and that needs to be respected and followed for its adherents to find fulfilment.

"The Market and Market Forces play this role in the documents of the New Zealand Business Roundtable. The Market is powerful. It provides. It allocates fairly with an 'Invisible Hand'. It solves problems. It cannot fail. It is without error."

Vincent is the Massey University student who went through nine years of BRT documentation counting the number of times that certain words and phrases were used, and analysing the way in which they were used.* She concluded, basically, that the BRT is off the planet: zealously convinced of its own righteousness, it promulgates visions of the ideal society that bear little relation to the "particular, practical, actual detail of the everyday".

But does this stop the Roundtablers from telling us how to lead our lives? Amazingly, no. If anything, rebuttal of their arguments only causes them to redouble their missionary drive to smash the false idols of state intervention and convert the world to unbridled capitalism. They see themselves as shining light into dark places; they preach the word of Our Market, which art in heaven.

Take the speech by BRT executive director Roger Kerr in which he says, "I hope with any policy topic that we pick up we continue to try to put a 'beacon on the hill', regardless of the immediate popularity of the idea." Now check out Matthew 5:14-16: "You are light for all the world ... And you, like the lamp, must shed light among your fellows, so that, when they see the good you do, they may give praise to your Father in heaven."

Not that the BRT acknowledges the Bible as an influence (although the similarity is uncanny). Every religious movement worth its salt has its own sacred scriptures, and Vincent shows how the BRT's holy writ can be traced back to the prophets Hayek and Friedman, via a closed circuit of international right-wing think-tanks, and beyond them to Adam Smith and John Stuart Mill. Enormous authority is attributed to this stream of thought, says Vincent, and anyone disagreeing with it is, ipso facto and whoops-a-daisy, guilty of heresy.

This way of thinking is not new, of course. Try this quote: "The only way to prevent the people from becoming habitually dependent on government is to bring the operations to a close."

And this one: "These things should be stopped now, or you run the risk of paralysing all private enterprise."

Roger Kerr referring to the DPB? Doug Myers on government spending programmes? The words are in fact those of British Treasury head Charles Trevelyan in 1847, opposing Irish famine relief schemes in the belief that they were bad for the moral character of the Irish. "It is a great object," wrote Trevelyan, while a million people starved to death, "not to revive the habit of dependence on government aid."

There's a place for old Charles in Market heaven – that great roundtable in the sky. There's a place for us all, if we only believe.

TRACE HODGSON

*Most popular noun: "system". Favourite grammatical trick: using nouns as adjectives, as in "incentive structures" and "efficiency gains". The words "men" and "women" never appear.

om?

ine the effects of slower and steady moves away ks and Dent sees a long, ugly ket from 2015 to 2025. He e.

: won't be a mad rush for the aid Sylvester Schieber, vice of research and information n consultants Watson Wyatt, mers will become more con- as they get older. It's more of ener than a complete wet

ie knows exactly what will when the boomers retire. no precedent for a generation baby boom during a modern : period so drawing parallels And, because boomers could h longer than their parents, ght start taking withdrawals i most people think.

help is on the way: the echo group, those born from 1982 2000, is nearly the same size oomers. They're entering the e now and they too will need for retirement, most likely corporate saving plans.

boomers dismiss any of a stampede to the exits. "If illion of us were going to re- he same time, I'd be con- " said Chris Pelkin, vice t of operations for First Amer- l Estate Tax Service in Den- lon't believe there will be a y impact on the stockmarket e than I believed in Y2K's of throwing our lives out of e said. Others simply plan to retirement, starting second r part-time work.

nany of the people who own on't need to sell them for re- . David Blitzer, strategist for & Poor's, said 75% of all ere owned by the wealthiest he population. "Their biggest is keeping the money from im. They won't be in a mad ell."

isn't so sure. "We expect a fall markets like Japan in the But he thinks the market has five years to rally as the rest oomers stuff money into the for retirement. "It's the best pportunity in many decades," d.

s nightmare scenario may not pass. But the boomers have phase of the economy, and they have moved through life. to believe they won't affect market too.

– USA Today.

Australians flock to community banking

As our People's Bank comes under pressure, Australia's community bank scheme gathers strength.

COMMUNITY-MINDED citizens are flocking to support the Bendigo Bank's community bank scheme with close to 50 branches set up and 30 more due to open by the end of the financial year.

Such is the level of interest that Bendigo Bank has been forced to slow the rollout of new outlets, postponing discussions with at least 100 other interested townships.

The townsfolk have not only proved to be eager customers but have stumped up $250,000 plus by becoming shareholders.

The altruistic elements of community banking are well documented: customers (especially businesses) are peeved at big bank branch closures and see a continuing bank branch as a way of kick-starting their often moribund local economies.

But how does the scheme stack up for customers and investors in terms of self interest? Community bank customers are subject to the same fees and interest rates as those offered by Bendigo Bank. They also have access to all Bendigo Bank products such as internet banking, ATMs and credit cards.

According to research from the rates and monitoring house Cannex, the Bendigo Bank/community bank's fees and rates are broadly in line with the market's. A key advantage is no account-keeping fees but this is possible at other banks if customers have reasonable account balances.

Bendigo Bank's internet and eftpos transaction fees are on the high end – both 60c – but at 60c a pop the branch cash withdrawal fee is markedly lower than bigger banks.

Broadly speaking, customers are no better or worse off if they switch from a big bank. But much to the annoyance of the big banks, Bendigo Bank and other regionals are not on the receiving end of criticism about retail fees when in fact some of them are higher.

For investors, the community banks have so far produced highly competitive returns.

According to Bendigo Bank head of community banking Russell Jenkins, five of the 46 branches have produced a dividend of between 4.5% and 7.5%. Of the remainder, only three are behind budget. Two are in Western Australia's drought-stricken wheatbelt and the third, in NSW, was hit by floods.

Jenkins said returns were made at the discretion of the bank's local board of management.

The profitable Upwey bank returned 7.5% a year while the Laverton scheme conserved capital to open a branch in nearby Altona. Returns are capped at 5 percentage points above the 90-day bank bill rate, currently 10%.

"That's pretty generous," Jenkins said.

"There aren't too many companies paying anything like a 10% dividend."

The $1 shares are transferable but so far have been limited to private transactions. Bendigo Bank is considering using the Bendigo Stock Exchange as the conduit for a more formal process.

In the meantime some individual community banks keep a register of interested buyers and sellers.

While the banks have rules to prevent one person (or related entity) from owing more than 10% of any one community bank, Bendigo Bank has seen considerable outside interest from prospective equity holders.

Paradoxically, the strong growth and increasing profitability of community banking raises the risk of the scheme becoming a victim of success.

If community bank shares start being transferred at hefty premiums, it is possible yield-hungry buyers could pressure banks into efficiency measures such as staff cuts which would run counter to the philosophy of maintaining face-to-face banking.

Bendigo Bank recognises the problem but Jenkins believes investors have the right to realise full value for their shares.

He noted one bank set up for $250,000 was valued at $350,000 soon after opening.

Others are not so sure the shares should ever be traded above their $1 nominal value. Upwey Community Bank manager Mike Fleming has received queries from people outside his community wanting shares and fears such a trend could erode the purpose of the scheme.

"We have trouble with people from any community buying into other communities," he said.

There is also a conflict between the commercial objectives of listed Bendigo Bank and the "softer" philosophies of the community banking division.

The scheme is cleverly structured so Bendigo Bank receives half the income of each community bank, in return for backing the ventures in prudential and other ways.

In effect, the bank achieves a 50% cost-to-income ratio on the revenues sourced through community banks which is far more efficient than drawing revenue through their own network.

The community banking arm delivered $1 million to Bendigo Bank's net profit in 1999-2000. It's 2000-2001 results are expected to show a modest increase.

It is possible that, over time, community banking will be a major driver of Bendigo Bank's profits.

– Weekend Australian

Looting Main Street

How the nation's biggest banks are ripping off American cities with the same predatory deals that brought down Greece

★ *By Matt Taibbi* ★

If you want to know what life in the Third World is like, just ask Lisa Pack, an administrative assistant who works in the roads and transportation department in Jefferson County, Alabama. Pack got rudely introduced to life in post-crisis America last August, when word came down that she and 1,000 of her fellow public employees would have to take a little unpaid vacation for a while. The county, it turned out, was more than $5 billion in debt – meaning that courthouses, jails and sheriff's precincts had to be closed so that Wall Street banks could be paid.

As public services in and around Birmingham were stripped to the bone, Pack struggled to support her family on a weekly unemployment check of $260. Nearly a fourth of that went to pay for her health insurance, which the county no longer covered. She also fielded calls from laid-off co-workers who had it even tougher. "I'd be on the phone sometimes until two in the morning," she says. "I had to talk more than one person out of suicide. For some of the men supporting families, it was so hard – foreclosure, bankruptcy. I'd go to bed at night, and I'd be in tears."

Homes stood empty, businesses were boarded up, and parts of already-blighted Birmingham began to take on the feel of a ghost town. There were also a few bills that were unique to the area – like the $64 sewer bill that Pack and her family paid each month. "Yeah, it went up about 400 percent just over the past few years," she says.

The sewer bill, in fact, is what cost Pack and her co-workers their jobs. In 1996, the average monthly sewer bill for a family of four in Birmingham was only $14.71 – but that was before the county decided to build an elaborate new sewer system with the help of out-of-state financial wizards with names like Bear Stearns, Lehman Brothers, Goldman Sachs and JP Morgan Chase. The result was a monstrous pile of borrowed money that the county used to build, in essence, the world's grandest toilet – "the Taj Mahal of sewer-treatment plants" is how one county worker put it. What happened here in Jefferson County would turn out to be the perfect metaphor for the peculiar alchemy of modern oligarchical capitalism: A mob of corrupt local officials and morally absent financiers got together to build a giant device that converted human shit into billions of dollars of profit for Wall Street – and misery for people like Lisa Pack.

And once the giant shit machine was built and the note on all that fancy construction started to come due, Wall Street came back to the local politicians and doubled down on the scam. They showed up in droves to help the poor, broke citizens of Jefferson County cut their toilet finance charges using a blizzard of incom-

Illustration by Victor Juhasz

prehensible swaps and refinance schemes – schemes that only served to postpone the repayment date a year or two while sinking the county *deeper* into debt. In the end, every time Jefferson County so much as breathed near one of the banks, it got charged millions in fees. There was so much money to be made bilking these dizzy Southerners that banks like JP Morgan spent millions paying middlemen who bribed – yes, that's right, bribed, criminally *bribed* – the county commissioners and their buddies just to keep their business. Hell, the money was so good, JP Morgan at one point even paid Goldman Sachs $3 million just to back the fuck off, so they could have the rubes of Jefferson County to fleece all for themselves.

Birmingham became the poster child for a new kind of giant-scale financial fraud, one that would threaten the financial stability not only of cities and counties all across America, but even those of entire countries like Greece. While for many Americans the financial crisis remains an abstraction, a confusing mess of complex transactions that took place on a cloud high above Manhattan sometime in the mid-2000s, in Jefferson County you can actually see the rank criminality of the crisis economy with your own eyes; the monster sticks his head all the way out of the water. Here you can see a trail that leads directly from a billion-dollar predatory swap deal cooked up at the highest levels of America's biggest banks, across a vast fruited plain of bribes and felonies – "the price of doing business," as one JP Morgan banker says on tape – all the way down to Lisa Pack's sewer bill and the mass layoffs in Birmingham.

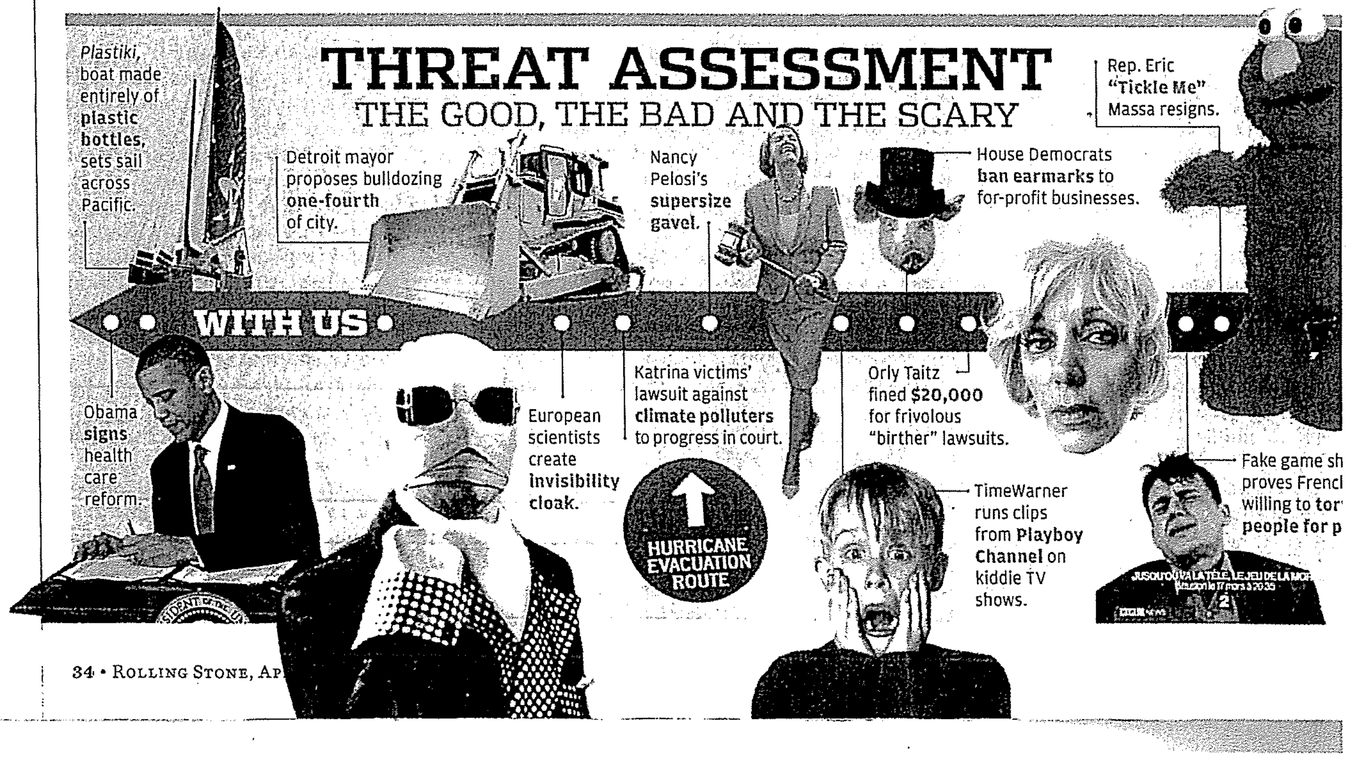
Once you follow that trail and understand what took place in Jefferson County, there's really no room left for illusions. We live in a gangster state, and our days of laughing at other countries are over. It's our turn to get laughed at. In Birmingham, lots of people have gone to jail for the crime: More than 20 local officials and businessmen have been convicted of corruption in federal court. Last October, right around the time that Lisa Pack went back to work at reduced hours, Birmingham's mayor was convicted of fraud and money-laundering for taking bribes funneled to him by Wall Street bankers – everything from Rolex watches to Ferragamo suits to cash. But those who greenlighted the bribes and profited most from the scam remain largely untouched. "It never gets back to JP Morgan," says Pack.

There was so much money to be made in the Birmingham deal that Wall Street banks invested $7 million in bribes.

If you want to get all Glenn Beck about it, you could lay the blame for this entire mess at the feet of weepy, tree-hugging environmentalists. It all started with the Cahaba River, the longest free-flowing river in the state of Alabama. The tributary, which winds its way through Birmingham before turning diagonally to empty out near Selma, is home to more types of fish per mile than any other river in America and shelters 64 rare and imperiled species of plants and animals. It's also the source of one of the worst municipal financial disasters in American history.

Back in the early 1990s, the county's sewer system was so antiquated that it was leaking raw sewage directly into the Cahaba, which also supplies the area with its drinking water. Joined by well-intentioned citizens from the Cahaba River Society, the EPA sued the county to force it to comply with the Clean Water Act. In 1996, county commissioners signed a now-infamous consent decree agreeing not just to fix the leaky pipes but to eliminate *all* sewer overflows – a near-impossible standard that required the county to build the most elaborate, ecofriendly, expensive sewer system in the history of the universe. It was like ordering a small town in Florida that gets a snowstorm once every five years to build a billion-dollar fleet of snowplows.

The original cost estimates for the new sewer system were as low as $250 million. But in a wondrous demonstration of the possibilities of small-town graft and contract-padding, the price tag quickly swelled to more than $3 billion. County commissioners were literally pocketing wads of cash from builders and engineers and other contractors eager to get in on the project, while the county was forced to borrow obscene sums to pay for the rapidly spiraling costs. Jefferson County, in effect, became one giant, TV-stealing, unemployed drug addict who borrowed a million dollars to buy the mother of all McMansions – and just as it did during the housing bubble, Wall Street made a business of keeping the crook in his house.



THE THREE AMIGOS To win lucrative and deceptive deals in Alabama, Charles LeCroy of JP Morgan (left) funneled $3 million to Bill Blount (center), a local broker who served as a bagman for Larry Langford (right), the then-president of the county commission.

As one county commissioner put it, "We're like a guy making $50,000 a year with a million-dollar mortgage."

To reassure lenders that the county would pay its mortgage, commissioners gave the finance director – an unelected official appointed by the president of the commission – the power to automatically raise sewer rates to meet payments on the debt. The move brought in billions in financing, but it also painted commissioners into a corner. If costs continued to rise – and with practically every contractor in Alabama sticking his fingers on the scale, they were rising fast – officials would be faced with automatic rate increases that would piss off their voters. (By 2003, annual interest on the sewer deal had reached $90 million.) So the commission reached out to Wall Street, looking for creative financing tools that would allow it to reduce the county's staggering debt payments.

Wall Street was happy to help. First, it employed the same trick it used to fuel the housing crisis: It switched the county from a fixed rate on the bonds it had issued to finance the sewer deal to an adjustable rate. The refinancing meant lower interest payments for a couple of years – followed by the risk of even larger payments down the road. The move enabled county commissioners to postpone the problem for an election season or two, kicking it to a group of future commissioners who would inevitably have to pay the real freight.

But then Wall Street got really creative. Having switched the county to a variable interest rate, it offered commissioners a crazy deal: For an extra fee, the banks said, we'll allow you to keep paying a fixed rate on your debt to us. In return, we'll give you a variable amount each month that you can use to pay off all that variable-rate interest you owe to bondholders.

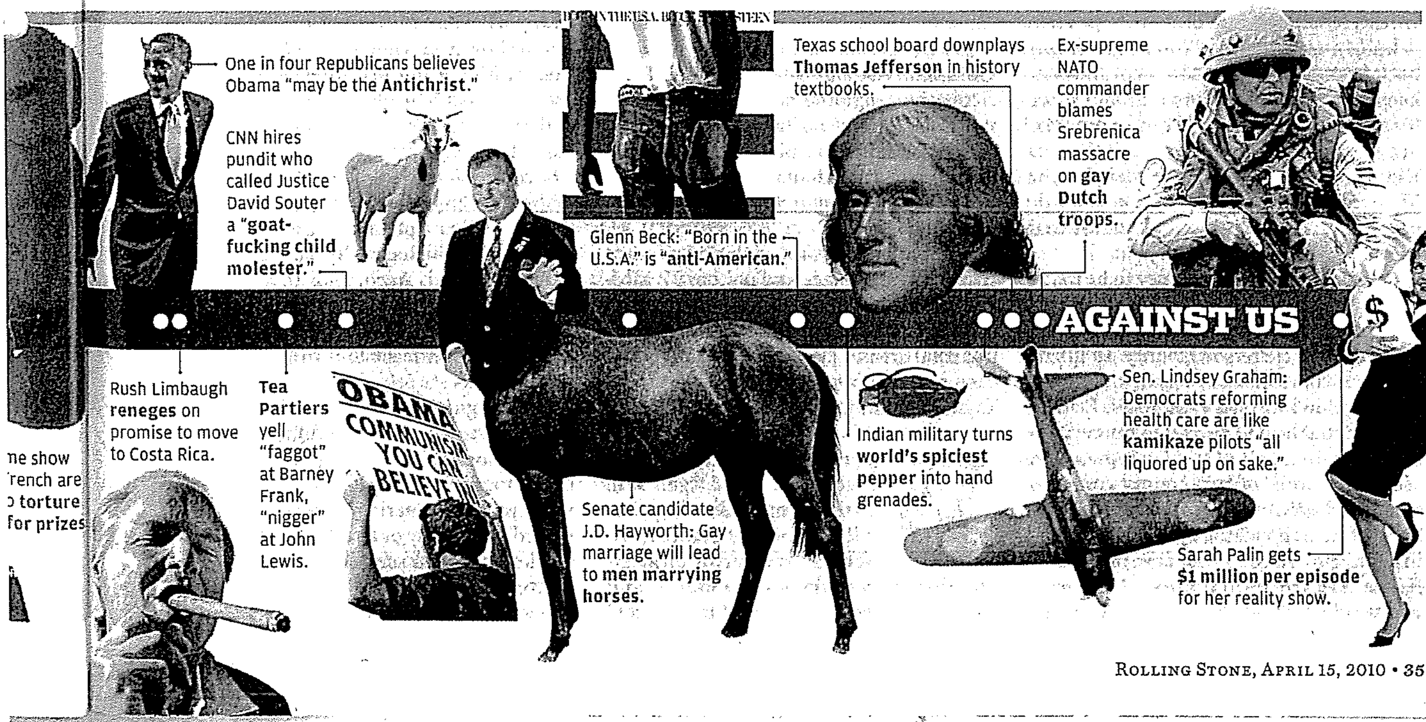
In financial terms, this is known as a *synthetic rate swap* – the spidery creature you might have read about playing a role in bringing down places like Greece and Milan. On paper, it made sense: The county got the stability of a fixed rate, while paying Wall Street to assume the risk of the variable rates on its bonds. That's the *synthetic* part. The trouble lies in the *rate swap*. The deal only works if the two variable rates – the one you get from the bank, and the one you owe to bondholders – actually match. It's like gambling on the weather. If your bondholders are expecting you to pay an interest rate based on the average temperature in Alabama, you don't do a rate swap with a bank that gives you back a rate pegged to the temperature in Nome, Alaska.

Not unless you're a fucking moron. Or your banker is JP Morgan.

IN A SMALL OFFICE IN A FEDERAL building in downtown Birmingham, just blocks from where civil rights demonstrators shut down the city in 1963, Assistant U.S. Attorney George Martin points out the window. He's pointing in the direction of the Tutwiler Hotel, once home to one of the grandest ballrooms in the South but now part of the Hampton Inn chain.

"It was right around the corner here, at the hotel," Martin says. "That's where they met – that's where this all started."

They means Charles LeCroy and Bill Blount, the two principals in what would become the most important of all the corruption cases in Jefferson County. LeCroy was a banker for JP Morgan, serving as managing director of the bank's southeast regional office. Blount was an Alabama wheeler-dealer with close friends on the county commission. For years, when Wall Street banks wanted to do business with municipalities, whether for bond issues or rate swaps, it was standard practice to reach out to a local sleazeball like Blount and pay him a shitload of money to help seal the deal. "Banks would pay some local consultant, and the consultant would then



CLOCKWISE FROM TOP LEFT: LUCA BABINI/REVO/NEWSCOM; ISTOCK PHOTO; CHARLES DHARAPAK/AP IMAGES; ISTOCK PHOTO, DIGITALLY ALTERED BY "ROLLING STONE"; FISHER-PRICE; NO CREDIT; JOHN GILHOOLEY/ZUMA; EVERETT COLLECTION; INFROGMATION; EVERETT COLLECTION; J. SCOTT APPLEWHITE/AP IMAGES

TOP, FROM LEFT: JOSEPH KACZMAREK/AP IMAGES; MICHELLE WILLIAMS/"BIRMINGHAM NEWS"/LANDOV; TAMIKA MOORE/"BIRMINGHAM NEWS"/LANDOV. BOTTOM, CLOCKWISE FROM TOP LEFT: PETE SOUZA/THE WHITE HOUSE, DIGITALLY ALTERED BY "ROLLING STONE"; SUSAN BOYER/USDA; NO CREDIT; NEW-YORK HISTORICAL SOCIETY; SPEC. KALIE FRANTZ/U.S. ARMY; KENNY HOLSTON/U.S. ARMY, DIGITALLY ALTERED BY "ROLLING STONE"; AP IMAGES; GANNON ANJO, DIGITALLY ALTERED BY "ROLLING STONE"; ROSS D. FRANKLIN, DOUG ANTCZAK/NHGRI, DIGITALLY ALTERED BY "ROLLING STONE"; BILL CLARK/NEWSCOM; ERIC RISBERG/AP IMAGES funnel money to the politician making the decision," says Christopher Taylor, the former head of the board that regulates municipal borrowing. Back in the 1990s, Taylor pushed through a ban on such backdoor bribery. He also passed a ban on bankers contributing directly to politicians they do business with – a move that sparked a lawsuit by one aggrieved sleazeball, who argued that halting such legalized graft violated his First Amendment rights. The name of that pissed-off banker? "It was the one and only Bill Blount," Taylor says with a laugh.

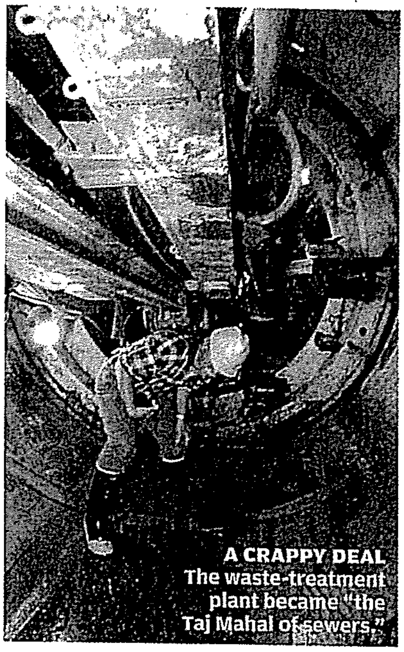
Blount is a stocky, stubby-fingered Southerner with glasses and a pale, pinched face – if Norman Rockwell had ever done a painting titled "Small-Town Accountant Taking Enormous Dump," it would look just like Blount. LeCroy, his sugar daddy at JP Morgan, is a tall, bloodless, crisply dressed corporate operator with a shiny bald head and silver side patches – a cross between Skeletor and Michael Stipe.

The scheme they operated went something like this: LeCroy paid Blount millions of dollars, and Blount turned around and used the money to buy lavish gifts for his close friend Larry Langford, the now-convicted Birmingham mayor who at the time had just been elected president of the county commission. (At one point Blount took Langford on a shopping spree in New York, putting $3,290 worth of clothes from Zegna on his credit card.) Langford then signed off on one after another of the deadly swap deals being pushed by LeCroy. Every time the county refinanced its sewer debt, JP Morgan made millions of dollars in fees. Even more lucrative, each of the swap contracts contained clauses that mandated all sorts of penalties and payments in the event that something went wrong with the deal. In the mortgage business, this process is known as *churning*: You keep coming back over and over to refinance, and they keep "churning" you for more and more fees. "The transactions were complex, but the scheme was simple," said Robert Khuzami, director of enforcement for the SEC. "Senior JP Morgan bankers made unlawful payments to win business and earn fees."

Given the shitload of money to be made on the refinancing deals, JP Morgan was prepared to pay whatever it took to buy off officials in Jefferson County. In 2002, during a conversation recorded in Nixonian fashion by JP Morgan itself, LeCroy bragged that he had agreed to funnel payoff money to a pair of local companies to secure the votes of two county commissioners. "Look," the commissioners told him, "if we support the synthetic refunding, you guys have to take care of our two firms." LeCroy didn't blink. "Whatever you want," he told them. "If that's what you need, that's what you get. Just tell us how much."

Just tell us how much. That sums up the approach that JP Morgan took a few months later, when Langford announced that his good buddy Bill Blount would henceforth be involved with every financing transaction for Jefferson County. From JP Morgan's point of view, the decision to pay off Blount was a no-brainer. But the bank had one small problem: Goldman Sachs had already crawled up Blount's trouser leg, and the broker was advising Langford to pick *them* as Jefferson County's investment bank.

The solution they came up with was an extraordinary one: JP Morgan cut a separate deal with Goldman, paying the bank $3 million to fuck off, with Blount taking a $300,000 cut of the side deal. Suddenly Goldman was out and JP Morgan was sitting in Langford's lap. In another conversation caught on tape, LeCroy joked that the deal was his "philanthropic work," since the payoff amounted to a "charitable donation to Goldman Sachs" in return for "taking no risk."



A CRAPPY DEAL The waste-treatment plant became "the Taj Mahal of sewers."

That such a blatant violation of antitrust laws took place and neither JP Morgan nor Goldman have been prosecuted for it is yet another mystery of the current financial crisis. "This is an open-and-shut case of anti-competitive behavior," says Taylor, the former regulator.

WITH GOLDMAN OUT OF the way, JP Morgan won the right to do a $1.1 billion bond offering – switching Jefferson County out of fixed-rate debt into variable-rate debt – and also did a corresponding $1.1 billion deal for a synthetic rate swap. The very same day the transaction was concluded, in May 2003, LeCroy had dinner with Langford and struck a deal to do yet *another* bond-and-swap transaction of roughly the same size. This time, the terms of the payoff were spelled out more explicitly. In a hilarious phone call between LeCroy and Douglas MacFaddin, another JP Morgan official, the two bankers groaned aloud about how much it was going to cost to satisfy Blount:

LeCroy: I said, "Commissioner Langford, I'll do that because that's your suggestion, but you gotta help us keep him under control. Because when you give that guy a hand, he takes your arm." You know?

MacFaddin: [*Laughing*] Yeah, you end up in the wood-chipper.

All told, JP Morgan ended up paying Blount nearly $3 million for "performing no known services," in the words of the SEC. In at least one of the deals, Blount made upward of 15 percent of JP Morgan's entire fee. When I ask Taylor what a legitimate consultant might earn in such a circumstance, he laughs. "What's a 'legitimate consultant' in a case like this? He made this money for doing jack shit."

As the tapes of LeCroy's calls show, even officials at JP Morgan were incredulous at the money being funneled to Blount. "How does he get 15 percent?" one associate at the bank asks LeCroy. "For doing what? For not messing with us?"

"Not messing with us," LeCroy agrees. "It's a lot of money, but in the end, it's worth it on a billion-dollar deal."

That's putting it mildly: The deals wound up being the largest swap agreements in JP Morgan's history. Making matters worse, the payoffs didn't even wind up costing the bank a dime. As the SEC explained in a statement on the scam, JP Morgan "passed on the cost of the unlawful payments by charging the county higher interest rates on the swap transactions." In other words, not only did the bank bribe local politicians to take the sucky deal, they got local taxpayers to pay for the bribes. And because Jefferson County had no idea what kind of deal it was getting on the swaps, JP Morgan could basically charge whatever it wanted. According to an analysis of the swap deals commissioned by the county in 2007, taxpayers had been overcharged at least $93 million on the transactions.

JP Morgan was far from alone in the scam: Virtually everyone doing business in Jefferson County was on the take. Four of the nation's top investment banks, the very cream of American finance, were involved in one way or another with payoffs to Blount in their scramble to do business with the county. In addition to JP Morgan and Goldman Sachs, Bear Stearns

CHARLES NESBITT/"BIRMINGHAM NEWS"/LANDOV paid Langford's bagman $2.4 million, while Lehman Brothers got off cheap with a $35,000 "arranger's fee." At least a dozen of the county's contractors were also cashing in, along with many of the county commissioners. "If you go into the county courthouse," says Michael Morrison, a planner who works for the county, "there's a gallery of past commissioners on the wall. On the top row, every single one of 'em but two has been investigated, indicted or convicted. It's a joke."

The crazy thing is that such arrangements – where some local scoundrel gets a massive fee for doing nothing but greasing the wheels with elected officials – have been taking place all over the country. In Illinois, during the Upper Volta-esque era of Rod Blagojevich, a Republican political consultant named Robert Kjellander got 10 percent of the entire fee Bear Stearns earned doing a bond sale for the state pension fund. At the start of Obama's term, Bill Richardson's Cabinet appointment was derailed for a similar scheme when he was governor of New Mexico. Indeed, one reason that officials in Jefferson County didn't know that the swaps they were signing off on were shitty was because their adviser on the deals was a firm called CDR Financial Products, which is now accused of conspiring to overcharge dozens of cities in swap transactions. According to a federal antitrust lawsuit, CDR is basically a big-league version of Bill Blount – banks tossed money at the firm, which in turn advised local politicians that they were getting a good deal. "It was basically, you pay CDR, and CDR helps push the deal through," says Taylor.

In the end, though, all this bribery and graft was just the table-setter for the real disaster. In taking all those bribes and signing on to all those swaps, the commissioners in Jefferson County had basically started the clock on a financial time bomb that, sooner or later, had to explode. By continually refinancing to keep the county in its giant McMansion, the commission had managed to push into the future that inevitable day when the real bill would arrive in the mail. But that's where the mortgage analogy ends – because in one key area, a swap deal differs from a home mortgage. Imagine a mortgage that you have to keep on paying even *after* you sell your house. That's basically how a swap deal works. And Jefferson County had done 23 of them. At one point, they had more outstanding swaps than New York City.

Judgment Day was coming – just like it was for the Delaware River Port Authority, the Pennsylvania school system, the cities of Detroit, Chicago, Oakland and Los Angeles, the states of Connecticut and Mississippi, the city of Milan and nearly 500 other municipalities in Italy, the country of Greece, and God knows who else. All of these places are now reeling under the weight of similarly elaborate and ill-advised swaps – and if what happened in Jefferson County is any guide, hoo boy. Because when the shit hit the fan in Birmingham, it *really* hit the fan.

FOR JEFFERSON COUNTY, THE deal blew up in early 2008, when a dizzying array of penalties and other fine-print poison worked into the swap contracts started to kick in. The trouble began with the housing crash, which took down the insurance companies that had underwritten the county's bonds. That rendered the county's insurance worthless, triggering clauses in its swap contracts that required it to pay off more than $800 million of its debt in only *four* years, rather than 40. That, in turn, scared off private lenders, who were no longer interested in bidding on the county's bonds. The banks were forced to make up the difference – a service for which they charged enormous penalties. It was as if the county had missed a payment on its credit card and woke up the next morning to find its annual percentage rate jacked up to a million percent. Between 2008 and 2009, the annual payment on Jefferson County's debt jumped from $53 million to a whopping $636 million.

It gets worse. Remember the swap deal that Jefferson County did with JP Morgan, how the variable rates it got from the bank were supposed to match those it owed its bondholders? Well, they didn't. Most of the payments the county was receiving from JP Morgan were based on one set of interest rates (the London Interbank Exchange Rate), while the payments it owed to its bondholders followed a different set of rates (a municipal-bond index). Jefferson County was suddenly getting far less from JP Morgan, and owing tons more to bondholders. In other words, the bank and Bill Blount made tens of millions of dollars selling deals to local politicians that were not only completely defective, but blew the entire county to smithereens.

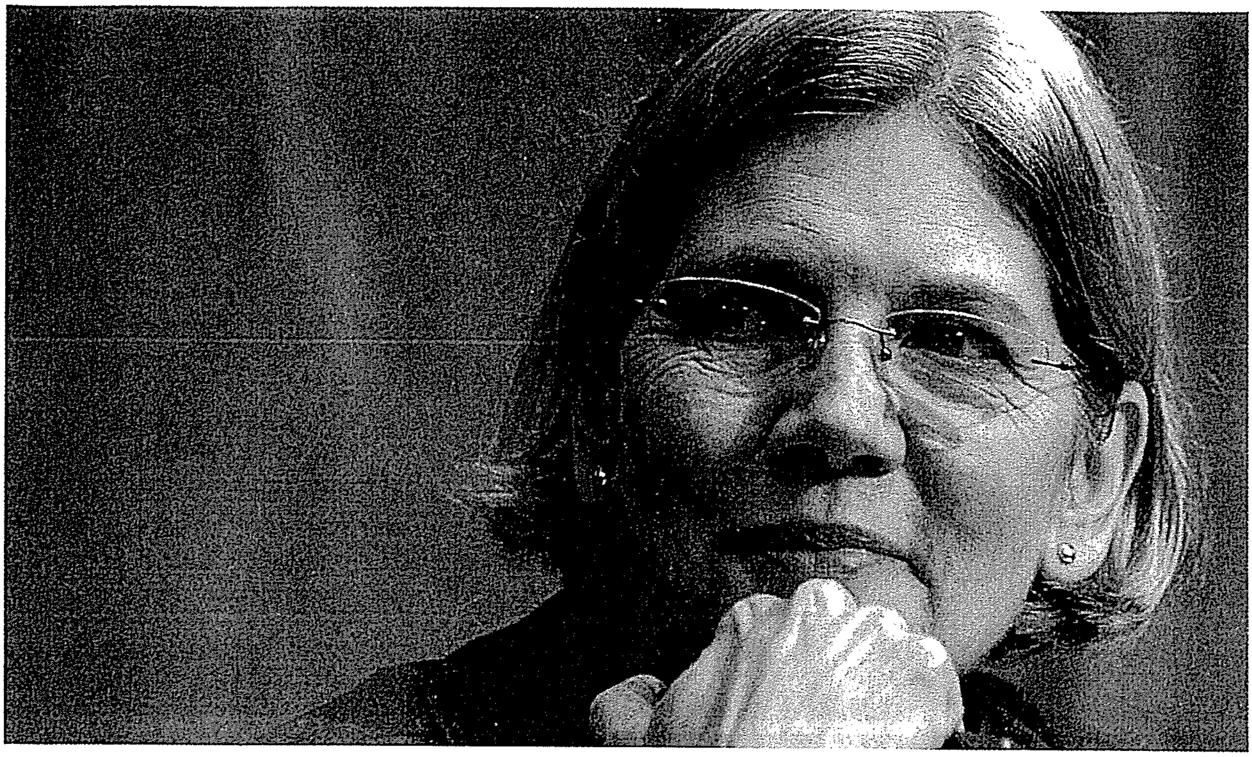
> On a sewer project that was supposed to cost $250 million, the county now owed $1.28 *billion* just in interest and fees.

And here's the kicker. Last year, when Jefferson County, staggered by the weight of its penalties, was unable to make its swap payments to JP Morgan, the bank canceled the deal. That triggered one-time "termination fees" of – yes, you read this right – $647 million. That was money the county would owe no matter what happened with the rest of its debt, even if bondholders decided to forgive and forget every dime the county had borrowed. It was like the herpes simplex of loans – debt that does not go away, ever, for as long as you live. On a sewer project that was originally supposed to cost $250 million, the county now owed a total of $1.28 *billion* just in interest and fees on the debt. Imagine paying $250,000 a year on a car you purchased for $50,000, and that's roughly where Jefferson County stood at the end of last year.

Last November, the SEC charged JP Morgan with fraud and canceled the $647 million in termination fees. The bank agreed to pay a $25 million fine and fork over $50 million to assist displaced workers in Jefferson County. So far, the county has managed to avoid bankruptcy, but the sewer fiasco had downgraded its credit rating, triggering payments on other outstanding loans and pushing Birmingham toward the status of an African debtor state. For the next generation, the county will be in a constant fight to collect enough taxes just to pay off its debt, which now totals $4,800 per resident.

The city of Birmingham was founded in 1871, at the dawn of the Southern industrial boom, for the express purpose of attracting Northern capital – it was even named after a famous British steel town to burnish its entrepreneurial cred. There's a gruesome irony in it now lying sacked and looted by financial vandals from the North. The destruction of Jefferson County reveals the basic battle plan of these modern barbarians, the way that banks like JP Morgan and Goldman Sachs have systematically set out to pillage towns and cities from Pittsburgh to Athens. These guys aren't number-crunching whizzes making smart investments; what they do is find suckers in some municipal-finance department, corner them in complex lose-lose deals and flay them alive. In a complete subversion of free-market principles, they take no risk, score deals based on political influence rather than competition, keep consumers in the dark – and walk away with big money. "It's not high finance," says Taylor, the former bond regulator. "It's low finance." And even if the regulators manage to catch up with them billions of dollars later, the banks just pay a small fine and move on to the next scam. This isn't capitalism. It's nomadic thievery.

CHARLES NESBITT/"BIRMINGHAM NEWS"/LANDOV



The Watchdog

Elizabeth Warren may be the only person in Washington who stands between us and Wall Street's next meltdown

★ *By Tim Dickinson* ★

With the stock market on a roll and employment beginning to pick up, it's easy to think that the economy has finally turned the corner. Leading bankers and politicians assure us that the financial crisis is behind us – and the reckless gambles that cratered the global economy will never be repeated. But Elizabeth Warren, Washington's top financial watchdog, has news for you. The economy may be growing at long last – but unless Congress gets serious about reforming our financial system, we're doomed to repeat a catastrophic cycle of boom, bust and bailouts. "We have one slim chance, right now," says Warren, "to put the too-big-to-fail genie back in the bottle."

If Congress can deliver on President Obama's promise of financial reform, Warren says, it can create the conditions needed for 50 years of economic growth and shared prosperity – just as the Depression-era reformers did in the 1930s. But if lawmakers simply paper over the crisis, she warns, Wall Street's rash bets will continue to be rewarded – and the next crisis will be far worse. "It will be TARP 2.0," Warren says, "and our economy will never be the same."

A professor of law at Harvard, Warren has become the folk hero of the bailout era. Appointed to oversee the $700 billion TARP bailout, she's the one official in Washington who can be counted on to champion the interests of the middle class. As chair of the Congressional Oversight Panel – the aptly named COP – Warren exposed Hank Paulson's big lie: The initial round of TARP money was a $78 billion giveaway to Wall Street's most reckless banks, not, as Bush's treasury secretary claimed, a fair exchange of cash for equity. In a true display of bipartisanship, Warren has also kept the heat on the Obama administration, grilling senior officials over their sweetheart treatment of AIG. (For a six-minute primer in Warren's prosecutorial prowess, search YouTube for "Timmy Geithner squirm.")

In the process, Warren has transformed her obscure post into a bully pulpit. As the intellectual architect of the proposed Consumer Financial Protection Agency, she has waged a relentless media campaign to ensure that the government safeguards borrowers from toxic financial products the same way the FDA protects patients from toxic drugs. Warren's critics have tried to paint her as a self-righteous, bank-hating, ivory-tower elitist. Sen. Richard Shelby, a Republican from Alabama, calls the consumer agency "the nanny state at its worst," and the U.S. Chamber of Commerce has launched an all-out campaign to "Stop the CFPA," claiming that it "would make a bad economy even worse."

If Warren has all the right enemies, she has also cultivated powerful friends. At the White House, she speaks directly to presidential wingman David Axelrod, and Obama himself has made the case for her agency on *The Tonight Show.* Warren strategized with Rep. Barney Frank, chairman of the House Financial Services Committee, to steer the CFPA to passage in the House. "She has a great sense of how to operate politically," Frank says. And in the Senate, where debate on reform is just

ANN HEISENFELT/GETTY IMAGES

heating up, Majority Whip Dick Durbin calls Warren his "go-to person."

But Warren isn't taking any chances. "She's carried this fight way beyond Washington to the American people," says Nobel Prize-winning economist Joe Stiglitz, who lauds Warren as a one-woman bulwark against the bank lobby. "So many of our politicians have failed us – and she has filled the gap."

WARREN'S LOOK MAY BE librarian chic – rimless glasses, bobbed hair parted down the middle and tucked primly behind her ears – but her style is more aw-shucks Midwestern than populist fireball. She adheres strictly to the Charles Schulz book of cursing – "Good grief!" and "Holy guacamole!" – delivered without a hint of irony. When we meet at a cafe near the White House, she mentions in passing that she bakes a mean peach cobbler – a recipe she inherited, no joke, from her Aunt Bee.

Warren's unwavering defense of the middle class stems from her own experience – first as a child in Oklahoma, then as a professor researching bankruptcy law. Her parents grew up during the Dust Bowl, and by the time Warren was born in 1949, "they were beaten down financially." Fleeced by a business partner, her father was forced into a series of tough, dead-end jobs. Traveling salesman. Maintenance man. He suffered a heart attack. They lost the family car. At age 16, Warren managed to earn a full-ride scholarship to George Washington University. Working as a summer associate on Wall Street, she saved enough money to get her teeth straightened. But while her own hard work paid off, her family continued to struggle. "My dad, my brothers, my mother – they're good people who said, 'I'll do my best. I'll get out there, and I'll make this work.' But they're also living proof that it's *hard*."

Given her own bootstrap ethic, Warren began her academic career deeply skeptical of those she saw as taking the easy way out. As a young law professor in Texas in the early 1980s, she embarked on a research project on bankruptcy expecting to "expose deadbeats – people who take advantage of a too-generous legal system." But the data and the case files told a much different story. Warren discovered that most Americans who file for bankruptcy are hardworking folks who play by the rules – and wind up losing, through no fault of their own. They get sick. Their marriages hit the rocks. Their parents need nursing care. "These are my people," she says. "That, for me, was transformative."

The lesson was reinforced a decade later when Citibank invited Warren to propose ways to minimize its losses from cardholders in financial trouble. Warren had simple advice: When borrowers show signs of distress – missed payments and plunging credit scores – cut them off from new lines of credit. But after she finished her presentation, a banker at the back of the room bluntly rejected her suggestion. "We have no interest in cutting back on our lending to these people," he told Warren. "They are the ones who provide most of our profits."

That moment, Warren says, "began to change my whole vision of consumer finance." She came to see Wall Street banks as predators, offering too-easy credit and too-complex contracts designed to "trick and trap" borrowers into recurring fees and exploding interest rates. "If people ended up in bankruptcy," she realized, "it didn't matter for the profit model."

Today, says Warren, the fortunes of Wall Street and the fortunes of Main Street have become disastrously oppositional. Despite profiting from taxpayer bailouts, Wall Street has only made life more miserable for those scraping by in what she calls the "real economy." Banks are refusing to modify mortgages for the hard-strapped homeowners they deceived, and now they're even bilking credit-worthy borrowers with arbitrary interest-rate hikes. Worse, Warren says, bankers like Jamie Dimon of JP Morgan Chase have testified before Congress that we should expect cycles of boom and bust to recur every five to seven years. "What pisses me off – I didn't say that – what makes me so *angry* is that the financial collapse was not a natural phenomenon like a hurricane or a drought," she says. "It was the consequence of a series of deliberate regulatory choices. That Jamie Dimon has figured out how to make a profit off of that may make him willing to tolerate booms and busts – but for the rest of us, the consequences are catastrophic."

> Citibank told Warren it planned to keep on lending to distressed consumers: "They provide most of our profits."

EVEN WITH WARREN'S PLAINspokenness, the battle over financial reform involves a host of complex and confusing options. Should Congress break up big banks? Regulate toxic deals like credit-default swaps? Expand the power of the Federal Reserve? Warren is well aware that politicians from both parties, whatever their differences, are eager to vote for a bill that they can tout as having reined in Wall Street. "They're going to call this *reform*, no matter what," she says. The question is: Will it do any good?

To make sense of what needs to happen, Warren distilled for ROLLING STONE the three-part litmus test she uses to determine whether a proposed reform will actually protect consumers and ensure that we're rebuilding the economy on a solid foundation rather than erecting another house of cards. Think of them as Warren's Rules for Reform:

RULE ONE

GIVE THE LITTLE GUY A FIGHTING CHANCE

FOR WARREN, A STRONG, INDEPENDENT consumer-protection agency is at the heart of any meaningful financial reform. If a cholesterol medicine carried a one-in-five risk of *causing* a heart attack, it would never get approval from the FDA. But a subprime mortgage that carries the same risk of ending in foreclosure, she points out, can be sold without any warning label. Such predatory products – running the gamut from payday loans to reverse mortgages – juice corporate profits by exploiting consumers who play by the rules, only to discover that the bank can change their interest rate without warning.

Warren's relentless focus on consumer protection has earned her honest criticism on Capitol Hill, even from her admirers. Sen. Ted Kaufman, a Democrat from Delaware, worries that the contentious debate over the CFPA will distract Congress from the larger question of how to rein in big banks. "If we don't do something about too-big-to-fail and we go through a crisis like this again," he says, "the cost to consumers is going to be extraordinary – even if we have a consumer-protection agency."

But Warren believes such criticism misses the point: Creating a safe and transparent marketplace for borrowers will ultimately protect Wall Street and the entire economy. The agency would have the power to police the kind of predatory lending – subprime mortgages being the key example – that not only drove individual borrowers into ruin, but became "toxic assets" as they were sliced, diced and securitized by banks looking for lucrative new instruments. "This whole economy failed one bad mortgage at a time," Warren says. "The raw material that fed into the crisis was *bad consumer financial products*. If nobody can sell mortgage-backed securities based on trillions of dollars of unpayable instruments, there's a lot less risk in the overall system."

As Warren envisions it, the CFPA would streamline government by consolidating regulatory authority now spread among seven bureaucracies – including the Office of the Comptroller of the Currency, which is run by a former bank lobbyist. The new agency would police everything from car loans to home mortgages, ensuring that borrowers understand the costs and risks of a financial product before signing on the bottom line. In 1980, Warren points out, the average credit-card agreement fit on a single page. Today, it is more than 30 pages of incomprehensible legalese. "The maze of fine print and undisclosed practices," she says, makes signing up for a Visa card "like putting your head in a lion's mouth and hoping he isn't hungry." The CFPA would make choosing a credit card or mortgage a straightforward decision, based on the best available terms. Informed speculators would still be able to flip a house, but the agency would stop predatory lenders from refinancing a grandmother out of her home with a defective loan.

Much of the debate surrounding the agency has centered on where it should be housed. Warren is agnostic about location, as long as the agency hews to a four-point checklist: Is the agency headed by a presidential appointee? Does it have independent budget authority so it can't be zeroed out by a hostile Congress? Can it make and enforce its own rules? And does its scope cover the full range of financial products?

In the end, Warren is confident that she can hold the line on these criteria to ensure that the new agency doesn't degenerate into a regulatory mush. "We'll have something strong here," she vows, "or we'll have nothing at all."

RULE TWO

MAKE BANKERS PAY FOR THEIR MISTAKES

AS A BANKRUPTCY LAWYER, WARREN believes that regulatory reform must put the possibility of failure back on the table for America's biggest banks.

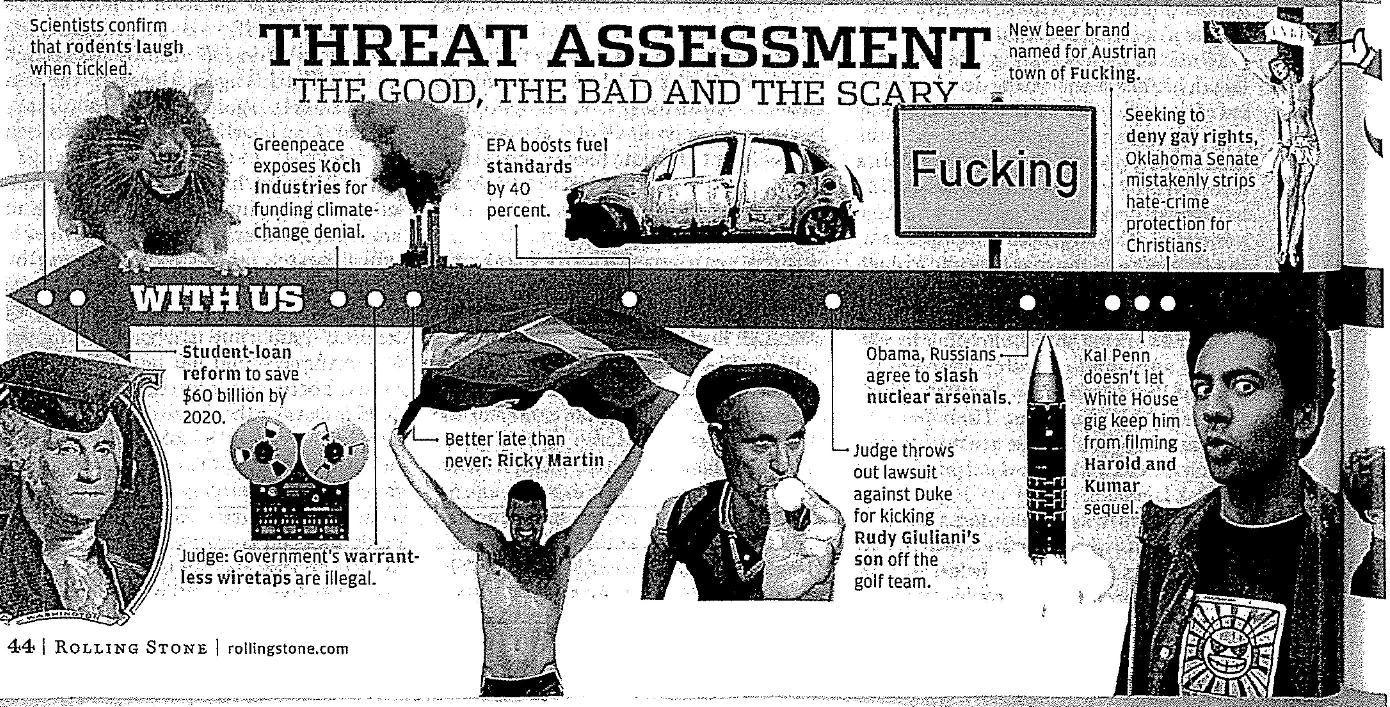
Americans tend to think of Too Big to Fail in terms of the billions of dollars it cost us in TARP funds and Federal Reserve guarantees. But Warren insists that the problem is best understood as a permanent form of federal insurance – one extended only to the world's richest and riskiest financial institutions, and one that produces ongoing hidden costs. In March, for example, the rating agency Moody's disclosed that it has upgraded Citi's debt solely because it believes the government will step in to prevent default. How much does the government charge for that guarantee? "Zero. Zip. Nada," says Warren. "They paid not a penny for an insurance policy that's worth billions." That gives big banks an advantage over smaller competitors, fueling consolidation and encouraging risk.

As Warren sees it, there are three basic strategies available for ending the era of Too Big to Fail. Break up the banks. Prohibit them from engaging in too-risky behaviors, such as running their own hedge funds with federally insured deposits. Or create a credible form of bankruptcy that enables regulators to pull the plug on failing banks before they take down the entire economy. Although she believes all three will probably need to be used in concert, Warren views the third element as the linchpin. "I hope it is never necessary to kill off one of these companies, because that's a scary moment," she says. "But that's the point of law. Bankruptcy is there to have a set of rules in place for the potentially catastrophic moment."

Warren believes there are two reforms necessary to make bankruptcy work for massive, interconnected financial firms. First, make the process as painful as possible for those responsible. "The bankers have to know that they'll go down with the ship," she says. "Under TARP, the executives got to keep their jobs and earn bigger and fatter bonuses than ever before." Wall Street needs to know, she says, that if their institutions falter, top management will get sacked, shareholders will be wiped out, and creditors will get back pennies on the dollar. "It has to be tough enough so that the Goldman Sachs of the future will want to manage themselves – no matter what – to avoid bankruptcy."

> Rather than sparking a ban on accounting tricks, Enron offered Wall Street a "giant how-to manual" for gaming the system.

The second key, Warren says, is to close the loophole that Wall Street lobbyists carved out in 2005, when Congress overhauled the nation's bankruptcy laws. Before the latest crisis, Chapter 11 bankruptcy was a tool powerful enough to wind down even massive, interconnected



institutions like Enron. But the loophole introduced in 2005 allowed the holders of derivative contracts to ignore the freeze on a bankrupt company's assets. The collapse of Lehman Brothers brought the entire economy to its knees, says Warren, because derivatives holders were allowed by law to make a run on the bank, hollowing out Lehman's carcass while the firm's other creditors were frozen out. The resulting panic sparked a market-wide contagion, which led to TARP. If financial reform doesn't shut down this derivatives loophole, Warren warns, "it's not real."

The tricky part of big-bank bankruptcy, Warren knows, is that taxpayer money may have to be made available to "fund runways for the bad landings." That requires Congress to perform a balancing act: It needs to hold banks accountable for their mistakes while injecting enough money into the system to stop a cascade of failures. "If they don't find a way to calm the creditors, then the next Uncle Hank won't use the bankruptcy authority," says Warren. "Instead, he will do a wholesale bailout – which is TARP 2.0."

RULE THREE

STOP COOKING THE BOOKS

THE GOOD NEWS IS THAT WARREN'S first two rules have a significant chance of becoming law. The House has already passed a version of the CFPA. And the bill under consideration in the Senate grapples seriously with bankruptcy authority – though Warren cautions that "the pieces are not all quite there yet."

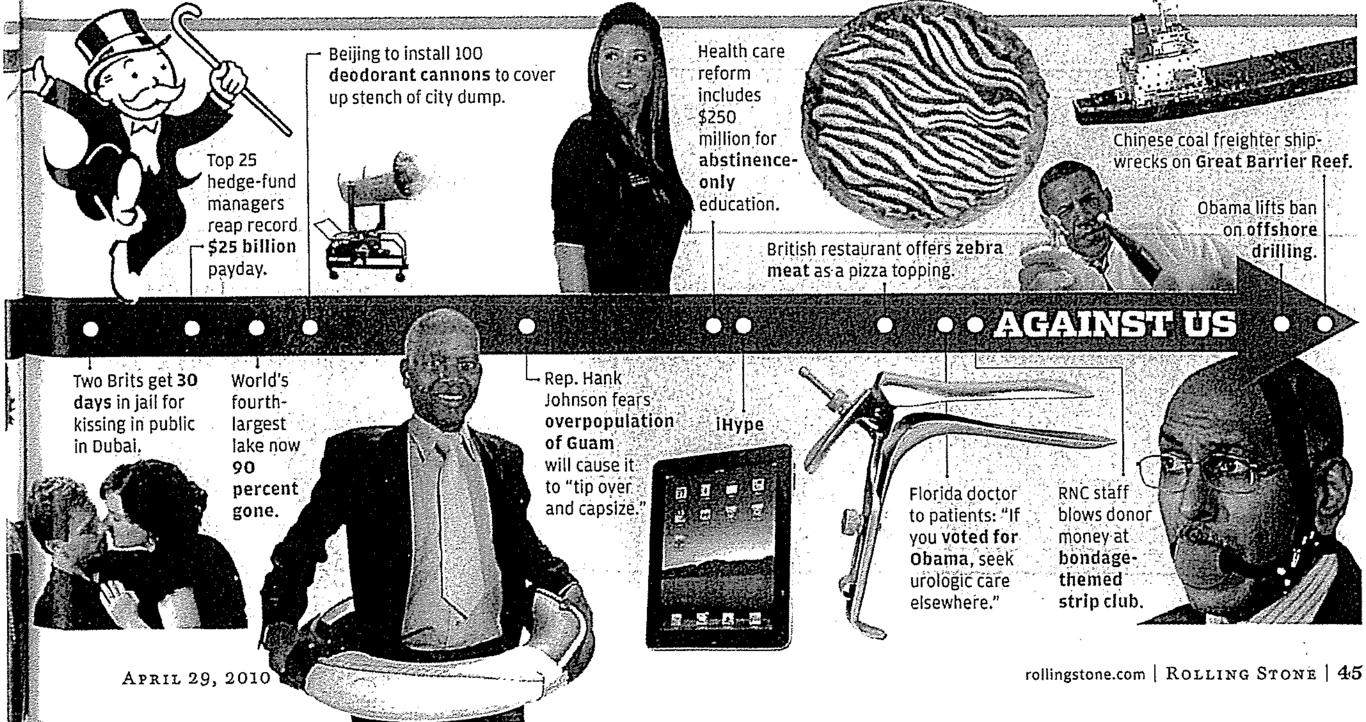
The bad news is that there's another key to reform that's not contemplated in either bill: accounting reform. The fixes passed by Congress after the collapse of Enron in 2001, it turns out, were nothing but cosmetic changes that papered over the crisis. They did nothing to stop Lehman Brothers from inventing off-book accounting scams with code names like "Repo 105," or to force AIG to report the massive risks it was amassing, or to prevent Goldman Sachs from masking Greece's debt with phantom trades. "Was Enron a giant how-to manual?" asks Warren. "Have we learned nothing from Enron but how to do it? It's in everybody's analysis now of what went wrong in the current crisis – and yet there's virtually no serious call to deal with it."

If anything, funny-money accounting has received a federal seal of approval. Remember all those "toxic assets" that TARP funds were supposed to buy up and dispose of? They're still on the books of big banks. The only thing that's changed are the accounting rules. With a wink from federal regulators, banks can now pretend that such assets are worth more than any buyer would pay for them. The same behavior has defined the response to the looming crisis in commercial mortgages. By the end of 2010, Warren calculates, half of all commercial real estate loans will be underwater. But so far, the government's response has been, once again, to simply tweak the rules for how to account for loans in default.

The goal of financial reform is to lay out the rules of the road for the next 50 years. But the best guardrails, Warren says, aren't going to make much difference if our economic engine blows up because we failed to make the necessary repairs. With toxic assets and commercial real estate, the economy's "check engine" light has gone on twice. But instead of fixing what's wrong, we effectively told the mechanic, *Just turn off the damn light.* This "extend-and-pretend approach," says Warren, destroys transparency and makes financial statements meaningless. "If this part doesn't get fixed," she warns, "then every effort to rebuild the economy will ultimately fail."

Warren knows that passing real reform will be tough, given the influence of Wall Street. Over the past decade, the financial sector has spent nearly $4 billion – more than any other industry – to sway policy in Washington. Capitol Hill now swarms with more than 1,400 bank lobbyists – three for every member of Congress. Chris Dodd, the chairman of the Senate Banking Committee, is not seeking re-election, in part, because of a scandal in which the nation's largest subprime lender gave him a sweetheart deal on his mortgage. And President Obama's top economic advisers played a central role in lifting key regulation, as Larry Summers did in the Clinton White House, and failing to police the reckless bets that caused the crisis, as Timothy Geithner did as head of the New York Fed. "There are times I despair," Warren says. "A year and a half ago, I thought that the will would be there to rewrite the rules of the road. But the Wall Street lobbyists have so dominated the conversation in Washington that even the most obvious reforms have become a heavy lift."

But Warren hasn't given up. In recent weeks, she says, the prospects for meaningful reform have gotten considerably brighter, thanks to the president's victory on health care. "There was a point that Washington would have accepted *anything,*" she says. "A couple of statutes that there could be a nice signing ceremony around – and everyone dusts their hands off and says, 'That's great. We're done.' But we're past that point. I don't think they can get away with that anymore."



CLOCKWISE FROM TOP LEFT: PARKER BROTHERS; PENWUJI.COM; MAGGIE WILSON/NEWSCOM; NO CREDIT; PETE SOUZA/THE WHITE HOUSE, ALTRENDO/GETTY IMAGES, DIGITALLY ALTERED BY "ROLLING STONE"; MARITIME SAFETY QUEENSLAND; CHIP SOMODEVILLA/GETTY IMAGES, DIGITALLY ALTERED BY "ROLLING STONE"; MONARCH MEDICAL; APPLE; IMAGE SOURCE/GETTY IMAGES, DIGITALLY ALTERED BY "ROLLING STONE"; NEWSCOM