LET'S FIX THE BANKING SYSTEM

INSTEAD OF THROWING MORE MONEY AT IT

I find it difficult to understand why so many intelligent people fail to understand the current banking crisis. It's not that difficult. Most housewives would analyze and understand it better than any expert I've listened to or read to date.

Let's face it, the banking* system is broken. The repairs recently suggested by two bankers and put into effect by the Government are only temporary repairs and no fundamental changes to the system are envisaged. Both here and abroad, governments have been trying to bail out the banking system by throwing billions into it. But, there is a huge hole in the good ship 'banking' and the solutions offered seem to me to be merely trying to find bigger and bigger pumps with which to try to stem the flow. Why not plug the hole? The truth is that the entire banking system needs to be re-structured and re-built on stronger foundations. The fundamentals are wrong and the very nature of modern banking, itself, must change.

*(Building societies operate in much the same way as banks, and when I refer to banks, I also mean building societies).

Experts tend to make the dangerous assumption that the fundamentals are sound. To them, the fundamentals are a 'given'. Housewives, on the other hand, survive by dealing with fundamental realities every day. They make no such assumptions. That's where they begin their assessments.

They put their money into current accounts in order to pay bills or make purchases. They want to store the money until they are ready to use it and then to distribute it as they see fit. While it is meant to be stored, in reality banks help themselves to it, they remove the money from your account, and either 'invest' or lend it in order to make money for themselves - in the hope that they can get the money back in time to meet your requirements.

In simple blunt English, that is gambling. Banks may or may not get it back in time and they may not get it back at all. Banks gamble with your money every day. Their only question seems to be: how big a gamble can they take? That is why bankers always talk about "risk assessment", a term for measuring the size of the gamble they take. But, let there be no doubt in your minds whatsoever, gambling is what the banks are doing with the money in your current accounts.

Now, think for a minute. If you put your furniture into a warehouse for storage until you decide where and when you want to use it and if, as you went out the front door, the warehouseman rented it out the back door, would you not have him charged with fraud? What's the difference?

Well, technically, there is a difference. Banks have been getting away with it for so long that what began as a fraud has been enshrined in law and is now legal. Under the law of precedence or 'established practice' as it is sometimes called, **title to your money transfers from you to the bank the minute you place it in your current account.** After that, it is no longer your money. You then become no more than an unsecured creditor of that bank and, believe it or not, secured creditors have first claim on your money.

One can be certain that no housewife would put her money into her current account if she was aware that, the moment she does so the title instantly transfers to the bank and it can then start to gamble with it. I am also certain that most housewives would recognize that this transfer of title is the point at which we need to start to repair the foundations of the banking system. Current account depositors want a safe place to store their money and the existing structure clearly is not secure. That is why taxpayers' money is continually being squandered in an attempt to protect private housekeeping money and the cash required for business' operations. Without such "ready cash floats," the entire economy would come to a grinding halt.

To fix the system properly and not merely tinker with it, I believe we should begin by having a good look at the Safety Deposit Current Account Bill that Lord Caithness moved in the House of Lords on the 30th of January 2008 and which was given its second reading on the 25th of April 2008. The Safety Deposit Current Account Bill requires all banks and building societies to provide a 'safety deposit current account' to any depositor who wishes one. In these 'safety deposit current accounts', **title to the money deposited remains with the depositor**. Banks cannot then remove the money and gamble with it. It must be kept separate (ring-fenced) from the banks' own money and cannot be used by any bank or its administrators to satisfy creditors – even secured creditors. It must remain the property of the depositors. The banks' role is then limited to merely storing and distributing depositors' money for them – for which they will, of course, charge appropriate fees.

The first step in any comprehensive restructuring of the banking system should be to enact such legislation which would change all existing 'current accounts' into Lord Caithness's 'safety deposit current accounts'. Banks will then no longer be legally entitled to help themselves to any of the money in any current accounts and to gamble with it. Whilst Lord Caithness's Bill was intended to offer every depositor a choice and, thus, to let the market, itself, steer the banking system to safety, regrettably that option has now gone and I believe that every current account must now be converted to Lord Caithness's 'safety deposit' status. **Such legislation would immediately secure all of the money in each depositor's current account.**

Having secured all current account depositors' funds in each bank, we must then make it possible for each and every depositor to withdraw all of their deposits **in cash** at any time or, theoretically, even simultaneously. At the moment, that would not be possible. The actual money in each account is simply a digital entry, a mere number on the bank's books of account. Depositors will want actual cash. But, even if banks put all of their existing cash aside for those accounts, there would not be enough cash in each bank with which to honour every account.

Therefore, the next thing the Government must do is to print enough paper money to ensure that every current account is fully backed by cash. It must then distribute enough cash (notes and coins) to each bank to fully cover the amount of money deposited into each of these 'safety deposit current accounts'. That cash must then be isolated, stored separately and kept only for the use of 'safety deposit current account' holders. It will not be available to administrators in the event of bank failure. That will leave all banks and building societies fully able to meet the simultaneous withdrawal of all current account deposits. Proper security and safety of the Public's funds would then be re-established. This would thus ensure that there would then never again be a reason for a 'run' on any bank.

A large part of this 'distribution' of cash must take the form of repayment of government debt held by each bank. All banks have extensive holdings of various forms of government debt which are held as 'reserve assets'. Repaying these 'reserve assets' will substantially reduce total government debt. It will also substantially reduce interest payments thereon, benefitting government budgets and allowing room for significant tax reductions. Nevertheless, there must be a sufficient distribution of cash to each bank to fully satisfy each and every 'safety deposit current account' depositor.

The banks will, of course, charge appropriate storage and distribution fees for their services. These fees will be subject to review by the proper banking authorities. The banks will also still generate substantial income from their other 'investments'. They will be able to continue in business.

Unlike the cost of the banker designed 'bailouts', the cost to the taxpayer would be limited to the cost of printing and distributing the new notes. There will be no billions wasted here. Rather, there will be a reduction in the amount of government debt and the cost of supporting it. Nor will the printing of this new money cause any inflation. The money printed will only be giving substance to the money already in existence in each account, but presently merely recorded as numbers in the banks' books. In these new 'safety deposit current accounts', the money will no longer be able to be used by the banks to gear or multiply their deposits, thereby eliminating a threat of future inflation.

Now, having fully secured the deposits of all current account holders at little cost to the taxpayer under the terms of Lord Caithness's Bill, the next thing that needs to be addressed is the deposits of savings account depositors.

Each bank and building society will still have in it all of the existing private loans outstanding, or private 'investments' each institution has made. These 'investments' will represent a substantial proportion of the money previously held in both current account deposits and savings account deposits. Having already separated current accounts and protected them, all of the private 'investments' will now be available solely to satisfy savings account depositors. Some of those private 'investments' will be sound and others may be less so. A means needs to be provided to determine the actual total value of such 'investments' and to provide each depositor with the correct portion or entitlement.

When all of the cash in each bank has been transferred to the new 'safety deposit current accounts', most banks will have no cash left to honour any savings deposits that fall due.

Nevertheless, savers will require cash money when their deposits mature in order either to put it into their new 'safety deposit current account' or to transfer it to someone else's 'safety deposit current account'. Therefore some other means must be made available both to determine the value of these investments and to provide access to the cash such value represents.

It is recommended that further legislation be enacted requiring all banks and building societies to form open ended investment funds***** and to place all of their investments into these new funds, and to issue shares or units in exchange for each savings deposit account. All of the shares must be issued to depositors – none to any bank or its employees – and each shareholding must represent the portion of each new open ended fund held by each depositor.

Markets could then be established and shares sold (or units redeemed) at the discretion of the investor and according to the terms of the fund. The buyers in these markets will be those who have excess cash in their 'safety deposit current accounts' and who don't want to continue to pay storage fees. They would rather hold an investment that earns for them. Markets would then come into existence where these shares would be bought and sold. The market value of each company (fund) would then be determined and so, too, the market value of each share (unit).

It is this new market to which those seeking funds will then need to turn. Historically, bank lending has provided new money for those in need who are able to meet bank criteria. However, banks make loans which increase the deposit base and, thereby, create new money. **Inflation inevitably follows the creation of such new money.** Under the system as it currently exists, bank lending is the primary producer of new money and, therefore, the primary producer of inflation.

Under the corrected system, businesses which could previously borrow when in need, will find it difficult to borrow and will have to recognize that they are under-capitalized. They will have to offer new shares, preference or otherwise, at a price acceptable to subscribers, to raise sufficient cash to see them through those periods when they previously borrowed. Placements can occur when the opportunities for investment become more attractive than the cost of storing money in the banks. **This way, no new money will be created by banks.** That role will then revert to governments where it should always have been.

These new open-ended investment funds will receive money in the form of income from their investments, from the sale of investments and from the issuance of new shares (units). All of this money must be deposited in their own 'safety deposit current accounts'. With this cash they can then make new investments, buy back shares and meet redemptions, etc. Other than management fees, none of this money should be available to the banks, themselves, for their own use.

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***** "Investment funds" will be comprised of open-ended collective vehicles i.e open-ended investment companies, unit trusts or mutual funds.

The roles of Banks and building societies for what were previously savings accounts would then revert to managing these investment funds for the shareholders (unit holders), for which they would charge fees which were reviewable by the banking authorities.

The above two actions would fully protect existing current account depositors, provide maximum protection to all savings account depositors and allow banks to continue to generate revenue. Thus, bank shareholders will be protected from total loss and provided with the means for generating future earnings.

None of these changes will cost taxpayers significant money. Indeed, these changes should substantially reduce government debt and budgets through reduced interest payments on government debt and allow room for potentially substantial tax cuts.

Unfortunately, the very expensive steps currently being undertaken and/or proposed are merely sticking plasters for a wound that will not heal itself. Different types of plasters have been tried in the past: Bretton Woods, The Basle Agreement, etc., but their purpose has always been to prop up and allow the same flawed system to continue. That is, in fact, what the financial establishment wants. They know how the existing system works and how to profit from it. As demonstrated by the size of some 'bonuses', the current system provides bankers with the means to generate risky and excessive profits. It is natural that they don't want to change the existing system.

Historically, in both the UK and the US, those who needed money have had to turn to banks to borrow money. Banks, of course, were happy to lend while they had their hands deep into their depositors' funds. Borrowing suited many. It suited some because it allowed them to finance their businesses without losing control. Others believe the only way to buy a house is to have a mortgage. So, there has been a huge demand for loans and banks have created money according to demand. It is this continued excessive production of new money that has produced such destructive inflation in recent years.

It used to be the case that banks required substantial security in order to back each loan. Therefore, only those who already have assets could borrow and strive to increase their assets – an opportunity not available to those without assets. Those without acceptable or sufficient assets have always found it difficult to borrow. The latter then suffer the ravages of the inflation produced by the newly created money and, as they say, 'the rich get richer and the poor get poorer'. It is all a product of the existing faulty banking system.

There are ways of raising money other than borrowing. People and businesses need money for a variety of reasons. If a business regularly needs to borrow to meet its day to day obligations, it is clearly under-financed and should raise more capital. The owners can maintain their control by issuing non-voting preference shares. If someone wants to buy a house, they can do so through shared-ownership financing. Shared-ownership vehicles can be set up which can purchase the house and from which they can buy the portion they can afford. They will then rent from that vehicle the portion they don't own and can purchase more whenever they can afford to. Those who need to borrow to live are, too often living beyond their means and need to rein back. Purchasing by making payments for an item set aside until it was fully paid for used to be an option. There are and always were many practical ways to avoid the terrible burden of debt.

We have all become conditioned to rely on banks whenever we need money. This has allowed bankers to argue successfully for the same faulty system to continue. Each time a new plaster has been applied, the system has been allowed to continue so that the banks could **continue to profit by 'creating new money'**, upon which they earned income and to which they became entitled when it was repaid. Eventually the increase in the supply of money and the increase in the level of debt would cause the plaster to stretch beyond its breaking point. The next generation would then have to pick up the pieces. We have now reached another breaking point. So, let us fix it properly this time.

Now, let us fix the banking system, once and for all and in a way that will simultaneously remove the destructive force of inflation and the burden of debt from our society. Let us

now start learning how to live within our means and within a sound and secure financial system.

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