The massive losses by big Wall Street firms, now topping those of the Great Depression in relative terms, have yet to be adequately explained. Wall Street power players are obfuscating and Congress is too embarrassed or frightened to ask, preferring to just throw money at the problem and hope it goes away. But as job losses and foreclosures mount and pensions and 401(k)s shrink, public policy measures to address the economic stresses require a full set of unembellished facts.

The proof that Wall Street is giving mainstream media a stage-managed version of what went wrong begins with a strange revelation by Gary Crittenden, CFO of Citigroup, on the November 5, 2007 conference call where he discusses what have now become the largest losses in the firm's 196-year history. Mr. Crittenden is asked by an analyst why the firm didn't hedge its risk. Here's his response:

> "I mean I think it is a very fair question ... we are the largest player in this [collateralized debt obligation; CDO] business and given that we are the largest player in the business, reducing the book by half and then putting on what at the time was three times more hedges than we had ever had at least in our recent history, seemed to be very aggressive actions given that we were a major manufacturer of this product ... once this [decline in values] process started ... the size was simply not there. The market is simply not there to do it in size in any way and it would have been uneconomic to do it."

What Mr. Crittenden really seems to be saying is that Wall Street, with Citigroup leading the pack, built a vast market of complex securities but neglected to put in place a liquid and efficient marketplace for hedging this risk. Say, for example, big, liquid, exchange traded indices and futures contracts that are routinely used to hedge everything from stocks to soy beans to crude oil by as diverse a group as Iowa farmers to Saudi princes.

In fact, the unabridged story is breathtaking in its callous disregard for the economic well being of this nation and its people. Exchange traded products did not emerge to hedge this risk because, behind the scenes, Citigroup, along with 12 other big banks and securities firms were funding a private company to gobble up all the necessary components to keep this burgeoning cash cow to themselves in the opaque, unregulated, over-the-counter (OTC) market, despite the fact that they knew it was dysfunctional.

The private company that would become Wall Street's ticker tape for pricing exotic credit instruments (derivatives on subprime mortgages and credit default swaps) started out as Mark-it Partners in 2001, the brain child of Lance Uggla while he was working for a division of Toronto Dominion Bank, TD Securities.

The official story goes like this: Mark-it Partners needed big broker dealers to submit daily price data. As an incentive, it offered 13 large security dealers options to buy shares in the company providing they would be regular providers of pricing data: ABN AMRO, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, Dresdner Kleinwort Wasserstein, Goldman Sachs, JPMorgan, Lehman Brothers, Merrill Lynch, Morgan Stanley, TD Securities, UBS. By 2004, according to an archived company press release, all of the companies had kicked in capital. *The Financial Times* would later report that these banks and brokerage firms held a majority interest of approximately 67%, hedge funds owned 13%, and employees 20%. The firm's web site currently says it has 16 banks as shareholders, without naming the banks.
Deutsche Bank, Goldman Sachs and JPMorgan were reportedly the first three firms to take an equity stake in Mark-it on or around August 29, 2003 when the three firms sold a proprietary database of credit derivative information to Mark-it. Since Mark-it is a private firm, financial terms have not been disclosed.
What would have been the incentive for three big Wall Street players to build a proprietary database and then, in a magnanimous gesture completely uncharacteristic of Wall Street greed, hand it over to be shared with their largest competitors?

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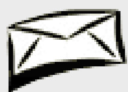

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One likely answer is that around this time regulators with a fetish for orderly paper trails (but myopic to the rapidly escalating financial hazard of this unregulated market) had stumbled upon the fact that there was a growing backlog of credit derivative trades that were never officially confirmed between the parties, reaching a peak of 153,860 unconfirmed trades by September 2005. Of this, 97,650 trades were more than 30 days overdue; 63,322 trades were a stunning 90 days past due according to a Government Accountability Office (GAO) report. (Although regulators knew about this spiraling trading nightmare as earlier as 2003, the GAO report did not come out until we were deep into the credit crisis in June 2007.) It was during this time that regulators got an agreement from the major dealers

that Mark-it Partners would begin collecting and aggregating the data on unconfirmed trades, keeping individual dealer data confidential from other dealers and preparing a monthly report of aggregated data for regulators.
Who were the banks and brokerage houses responsible for this unmitigated mess? With only a few exceptions, the exact same firms with a majority ownership in Mark-it Partners.

To grasp the magnitude of this wild west world of trading, one needs to understand that we are not talking about a market of a few billion dollars. According to the International Swaps and Derivatives Association, the credit derivatives market has grown from an estimated total notional amount of nearly $1 trillion outstanding at year-end 2001 to over $34 trillion at year-end 2006.

According to the U.S. Office of the Comptroller of the Currency (OCC), JPMorgan, Citigroup and Bank of America handled about 90 percent of this trading among U.S. commercial banks in the fourth quarter of 2006. (These are the same three banks that were backing the scheme last year with the U.S. Treasury to create a $100 Billion bailout fund for exotic instruments that also had never seen the light of day of exchange trading. That plan failed when it appeared to be a thinly disguised artificial pricing mechanism to inflate values for the worst hit firms on Wall Street: namely, Citigroup.)

According to the GAO report, significant progress was achieved for a period in bringing down these unconfirmed trades but by November 2006, the numbers had climbed again: there were over 81,000 unconfirmed trades with around 31,000, or 54 percent, remaining unconfirmed for over 30 days. Raising images of the early 1900s curb market in lower Manhattan where traders posted securities for sale on lampposts, the report notes that this vast market is being handled manually to a significant extent. (Our nation has apparently devolved not only on torture and constitutional rights and habeas corpus and election integrity but we now seem to have wiped out 100 years of trading advances.)

The obvious solution, a transparent, regulated, automated, exchange traded model does not seem to have occurred to the Masters of the Universe or their timid regulators.

It did, however, occur to four Exchanges: Eurex, the Chicago Mercantile Exchange (Merc), the Chicago Board of Exchange (CBOE) and the Chicago Board of Trade (CBOT). In 2007, all four created exchange traded instruments to hedge the risk of credit defaults. Some traders call the response from the Wall Street firms a boycott; others call it a cabal that circled the wagons. According to a Bloomberg article in April 2007, "Banks and securities firms are keeping a stranglehold on the market, which has swelled to cover debt sold by more than 3,000 companies, governments and industries." A call to the CBOT on January 18, 2008 confirmed that they are still not seeing any business from the big Wall Street firms in their credit default product.

The track for this train wreck was put in place in December 2000 when Congress passed the Commodity Futures Modernization Act giving a free pass on regulation to the over-the-counter trading between sophisticated individuals and institutions. Brooksley Born, then Chairperson of the regulatory body, the Commodities Futures Trading Commission (CFTC), literally begged Congress to slow down the train and carefully consider the future ramifications of this legislation. Speaking before the House Committee on Banking and Financial Services on July 24, 1998, Ms. Born said:

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"The CFTC or its predecessor agency, the Commodity Exchange Authority, has regulated derivative instruments for almost three-quarters of a century. Its authority is contained in the Commodity Exchange Act ("CEA" or "Act"), which is the primary federal law governing regulation of derivative transactions. The CEA vests the CFTC with exclusive jurisdiction over futures and commodity option transactions whether they occur on an exchange or over the counter. The Act generally contemplates that, unless exempted, futures and commodity options are to be sold through Commission-regulated exchanges which provide the safeguards of open and competitive trading, a continuous market, price

> discovery and dissemination, and protection against counterparty risk."

Alan Greenspan, Chair of the Federal Reserve Board at the time, testified before Congress in favor of this legislation and asked that it be "expedited." Last week, Mr. Greenspan joined the payroll of the hedge fund, Paulson & Company, which last year made $15 billion in profits betting that poor people's homes would be foreclosed on while using the unregulated over-the-counter contracts that Mr. Greenspan assisted in making possible.

The counter-party risk that Ms. Born highlighted in her testimony is now set to take center stage in 2008. As it turns out, this non-exchange based market of darkness totaling $34 trillion has done business with some parties that are unable to pay up or are teetering on a death spiral due to looming ratings downgrades. Last week, Merrill Lynch announced it was writing down over $3 Billion as a result of problems with its counter-parties.

As the threat of some antiseptic sunshine and competition from the exchanges reached the big Wall Street players late last year, Mark-it Partners, now known as Markit Group Ltd., had yet another amazing burst of good fortune. In November 2007, two consortiums owned by essentially the same group of banks and brokerage firms that were early investors in Mark-it Partners, who conveniently also owned the major credit default indices, CDS IndexCo and International Index Co., up and sold themselves to little Markit Group Ltd. Included in the deal by CDS IndexCo were the two subprime indices, ABX and TABX, along with the prominent CDX index which acquired much of its respectability by previously having the name Dow Jones in front of its three letters.

ABX and TABX were the indices Citigroup should have been able to hedge itself with if this over-the-counter market was liquid, functional and able to handle pesky details like proof the trade happened. Instead, 401(k) plans, endowments, public pensions and Citigroup employees' deferred compensation plans, loaded up to their eyeballs in Citigroup's bizarrely large float of 5 billion shares, have watched the stock value decline by 53% over the past 12 months as toxic debt that was never hedged comes home from holiday in the Caymans to blow up on Citigroup's books.

It was four years after the crash of 1929 before the major titans of Wall Street were forced to give testimony under oath to Congress and the full magnitude of the fraud emerged. That delay may well have contributed to the depth and duration of the Great Depression. The modern-day Wall Street corruption hearings in Congress were cut short by the tragedy of 9/11. They must now resume in earnest and with sworn testimony if we are to escape a similar fate.

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