International Institute of
Certified Public Accountants

Incorporated under the laws of the State of Delaware

28 July 2012

Open letter to:

Mr. Mark Hoban, MP
Financial Secretary to the Treasury
1 Horse Guards Road
London, SW1A 2HQ
United Kingdom

And to

Prof. Sir Mervyn A. King
Governor of the Bank of England
Threadneedle Street
London EC2R 8AH
United Kingdom

Dear Mr. Hoban, dear Professor King:

Liquid Monay — The Final Thing.
Federal Reserve and Central Bank Accounts for Everyone

I thank Mr. Hoban for his letter of 29 June 2012, responding to my letter of 3 May 2012 to the Chancellor of the Exchequer, the Rt. Hon. George Osborne. (Copies attached for your read reference.)

Book sent to you under separate cover

I am sending you under separate cover my new publication, "Liquid Money – The Final Thing. Federal Reserve and Central Bank Accounts for Everyone." 134 pages, illustrated, ISBN 978-1478312239.

ICB's proposal of ring-fencing retail banks

I make the argument that ring-fending retails banks as recommended by Sir John Vicker's UK's Independent Commission on Banking is a step in the right direction by re-enacting the American Glass-Steagall Act of 1933, unwittingly repealed through the Gramm-:Leach-Bliley Act in 1999 under President Bill Clinton, although it had been said that Glass-Steagall was already a dead letter.

Accounting fraud

I argue that ring-fencing does not cure the principle fault of the banking system, namely, the monetary financial institutions (MFI's, the European Central Bank's name for the private commercial banks) continue to create demand deposits that are NOT money and can transfer only by way of offset in the daily payments clearing.

This quasi money is always unacceptable when businesses experience downturns, and ALWAYS over the past 80 years these money creating banks that — as Thomas Jefferson wrote to James

Madison on January 1, 1815, “I sincerely believe the banking institutions having the issuing power of money are more dangerous to liberty than standing armies” — fail at one time or another.

I accuse that banking supervisors are incompetent, perpetuating a system that was known to be flawed since Jefferson’s letters were published, since thousands of banks failed every few decades, and there is NO end in sight.

Money created by bookkeeping, debiting loans receivable, crediting demand deposits, is plain and simple accounting perversion (if not a “fraud”). I am a Certified Public Accountant in the State of Washington, and I am sticking my neck out, so to speak, making this accusation against the standard setters FASB and IASB, and against the accounting profession auditing the banks. I have corresponded with Board Member Jim Leisenring, but to no avail. The stakes are high, and admission of error would cause a tsunami, if misunderstood, although the process to cure the defect is simple. The entire argument is in my book which you are receiving.
Liquid Money

I make the further argument, saying that every person has the right to receive, hold, and to dispose of legal tender money issued by the central bank(s), but is barred, yeah openly discriminated against in violation of the equal treatment clauses in the constitutions and human rights conventions, from holding deposit balances at these central banks.

The discrimination, which in the case of Germany was imposed against the third largest insurer, Talanx AG, to open an account with the Bundesbank allowed under Art. 19 of the Bundesbankgesetz, not only protects the monopoly of private commercial banks to operate like private mints, but puts the entire monetary and payment system of the nation (and most of the world) constantly at an unexplained, unjustified risk.

I show in my booklet, “Liquid Money — The Final Thing,” that the process of tranferring private bank deposits to the central banks is so simple that the mind is repelled, does not increase a nation’s or currency area’s money supply, and is therefore completely sterile as to price inflation.

I am proposing three options, Option I being the most desirable, namely in a nut shell:

Central Bank Account for Everyone

1. Everyone, individual or juristic entity, is entitled to maintain a current account at the central bank (“central bank account” or “CBA”) or its branches to make deposits and withdrawals in any amount as well as payments by way of transfer, in accordance with the fee schedule published by the central bank.

2 The central bank may pay interest on deposits, or not pay interest.

For the UK, The Bank of England Act 1946 does not appear to contain any provisions preventing a person from opening a current account, although regulations may. Under Article 4, HM Treasury has the power to give instructions of public interest to the Bank of England. For Germany, Article 19 of the Bundesbankgesetz allows non-banks to have accounts at the German part of the Eurosystem.

Result of Option I

If Option I is exercised, allowing the public — natural and legal persons — to open current accounts at the central bank of their country, drawing down their balances at these private commercial banks — if the banks did nothing by making deposits attractive enough for depositors to stay or redeposit their new central bank funds — then bankruptcy of the banks would be the result and very little would money would actually be transferred because the banks don't have the legal tender money.

Solution to Lack of Liquidity:
Central banks assume deposits held at commercial banks

At the request of the commercial bank's depositor to transfer his deposit to the central bank, the central bank would credit the person's account at the central by assuming the person's deposit balance(s) at the private commercial bank(s).

The commercial bank would be required to pay interest on the assumed deposit to the central bank at a rate of interest set by the central bank. The deposit of the central bank at the private commercial bank would be redeemable in central bank funds at any time the private commercial bank so chooses and can do so, or if tardy the central bank would put the private commercial bank on a realistic repayment schedule.

The balance sheets of the central bank and the commercial banks would reflect the transfers of deposit as follows:

Central Bank

Assets		Liabilities	
Due from Bank A	100,000	Deposit Customer 111	100,000
Due from Bank B	200,000	Deposit Customer 222	200,000
Due from Bank C	300,000	Deposit Customer 333	300,000
Etc.		Etc.	

Private Commercial Banks:

Bank A

Assets	Liabilities	
	Due to Central Bank	100,000
	Deposit Customer 111	0

Bank B

Assets	Liabilities	
	Due to Central Bank	200,000
	Deposit Customer 222	0

Bank C

Assets	Liabilities	
	Due to Central Bank	300,000
	Deposit Customer 333	0

Inflation sterile — No change in money supply

The money supply before the transfer of deposits to the central bank including deposits at the private commercial banks, and after the transfer of deposits to the central bank (now including the public's deposits at the central bank) is unchanged. The result is merely a switch in liabilities from the insolvency-ridden private commercial banks to the always solvent central bank(s).

Persons may redeposit central bank funds with private commercial banks

Private commercial banks may be interested in having their deposit customers retransfer their central bank deposits with them to gain high-power central bank money to bolster their liquidity. Such a depositor's private bank deposit would, of course, not be as safe and solvent as at the central bank, and the private bank would need to pay a risk premium in the form of a highly competitive interest rate, or deposit insurance if the FDIC were to continue its operations.

In fact, these redeposited funds, which should not be labeled deposits but "investments," would be the ones that can be lent out safely without risk of bringing down the banking system if the borrower defaulted, even if borrowers defaulted *en masse*. In case of borrower-default, the lending bank would become insolvent, the "investor's" at the private commercial bank "investment" would be impaired (or even lost) due to bankruptcy of the bank, but the money in circulation would be unaffected; would simply be in other peoples' pockets or accounts at banks' whose demand deposits are 100% covered by central bank funds, the same funds that the lender had initially deposited.. This is not the situation today before the reform, because 90% of the money supply is in the form of quasi money at individual banks and cannot transfer for lack of offset capability during business downturns.

Continued management of the loan by the private commercial banks

The private banks ought to remain liable for the deposits they have created and should continue to manage their loan account, paying interest to the central bank, and continue to be 'on the hook' until the CB's deposit is redeemed.

The threat to the banks posed by the public's ability to move their demand deposits to the central bank the very moment a bank had made a loan out of nothing by double entry bookkeeping, would drain the bank's liquidity and push the bank into bankruptcy.

The threat of a liquidity squeeze at commercial banks resulting from lending and creating quasi money is necessary to begin to reign in and contain the amount of risk-taking that has occurred in the past two hundred and fifty year, and to put an end to commercial banks' ability to create quasi money out of nothing. The ability of the public to bank at the central bank is enough of a threat to the private commercial banks to stop their old practice; no new law and regulations are needed to accomplish the desired effect.

Prudent liquidity-conscious banks, and they must all be, will expand and contract their loan portfolio in tandem with their savings deposit accounts, requiring notice of withdrawal which maturities aligned with the bank's realistic ability to call in loans for redemption. Or the bank would cease to be a deposit-taking institution all together and convert to a finance company.

As already mentioned, it would be important to amend the Federal Reserve Act, disallowing the Federal Reserve Banks to maintain accounts with private commercial banks. In the past this was desirable for the government as a way of acquiring and spending the private banks' quasi money resulting from the sale of government securities.

Quantitative easing:
Expansion of the money supply by interest-free borrowing and government-spending

The bank's being cautious in creating demand deposits without backing of central bank money, the nation's money supply may not increase sufficiently with central bank money (interest-free) to meet the demands for money in times of economic expansion, unless federal funds are created to be available.

This is a an opportunity for the government to fund itself in a closed operation interest-free by depositing its securities at to the central bank, which credits the Treasury with the proceeds to spend into circulation as needed for defense, medical care, transportation, education, housing, and so on, increasing the money supply sufficiently to avoid price deflation without creating price inflation, a coordinated function that was previously a more uncoordinated one of the private commercial banks supported by central bank open-market-operations.

In the alternative, the central bank can monetize existing national debt securities held by the private sector by calling the securities for redemption or buying them outright in the market place, increasing the money supply while decreasing the national debt.

Other benefits to the public and the national debt

With banks' ability to manufacture quasi money curtailed, the money supply can be increased by public spending, the central bank buying government debt certificates, and the government treasury departments spending the proceeds into circulation, the times for the federal government's need to borrow in the capital markets should be over.

Deposit insurance

Under this Option I, deposit insurance is no longer needed to attract depositors' funds for deposit, because deposits at the central bank are always solvent. If persons choose to deposit their funds at private commercial banks as "investments", they will do so at their own risk. As shown above, should a private commercial bank fail, the central bank money on deposit will not be affected, and the national payment system will not be at risk from a bank failure.

The FDIC may continue to guarantee "investment accounts" up to the present limit of $250,000 per customer per bank, but there is no systemic need to do so once investors understand that interest paid by private commercial banks includes the premium for the risk of default. Those who cannot learn may loose.

Basel III
The misconception of equity capital and its irrelevance for banking institutions

Letters to
Mr. Mark Hoban, MP HM Treas. and to
Prof. Mervyn A. King, Govenor BoE
28 July 2012

The rare but good banking news these days come from the United Kingdom and Governor King's continuing support of Sir Vicker's recommendations. Even Sandy Weill ex-CEO of Citibank is accepting. But it is not enough. Although Basel III finally adopts liquidity standards, it upholds the misconceived capital adequacy standard, difficult to comply with, needless, ineffective, miscoceived and insulting to the intellect.

With all the great financial men that England and Scotland have produced (even considering John Law's debacle at the Banque Royal in France and what was learned), I am still ashamed of the ignorance of the world's learned and distinguished academic people, in particular of many economists who are hired to run our central banks, and also private Deutsche Bank by Prof. Josef Ackarmann; their ignorance not in Keynesian theories how money creation and distribution benefits economic growth, but ignorance about the mechanics of the banking system which is based on accounting (transaction recognition, measurement, and reporting) and nothing else.

Unlike the London goldsmith bankers of old, our banks today are glorified accounting offices, and that function should be completely understood before policies are thought out, pronounced and adopted, including the misconception of equity capital to protect deposits. They never have, because capital is a measure, an abstract, difference between assets and liabilties, not an account from which one can draw anything out and pay off depositors. Still Basel III is hailed as the grail of bank stability… as if a bank were an industrial concern, which it is not.

A bank is effectively a service provider like a law firm, an accounting office keeping records, without power of construction, but the ever present risk of destruction from malpractice.

With all best wishes,

signed

Michael Schemmann
Director of the IICPA

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FINANCIAL SECRETARY TO THE TREASURY

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Michael Schemmann
Director
International Institute of Certified Public Accountants
Box 9 Pak Thong Chai
Nakhon Ratchasima 30150
THAILAND

29 June 2012

Dr M Schemmann

Thank you for your letter of 3 May to the Chancellor of the Exchequer about banking. I am replying as Minister responsible for this policy area.

It is crucial that those areas of prudential regulation that proved deficient during the recent financial crisis are repaired in order to provide a more robust framework for the banking sector going forward. The Government considers the agreement reached by the Basel Committee on Basel 3 as one of the most important aspects of the internationally agreed response to the financial crisis, with the agreement reached addressing many of the deficiencies of the financial system. This is why the Government has consistently argued in favour of a full and faithful implementation of Basel 3.

Basel 3 will increase the reliance of the banking system because it increases amount of loss absorbent capital banks hold and the amount of liquidity banks are required to hold. Both of these are necessary. Enhanced capital requirements ensure that if banks incur losses these do not jeopardise the solvency of the institution. The experience of the financial crisis was that banks were not holding enough loss absorbent capital, and as such when losses were incurred tax payers were required to give support to these banks to enable them to remain solvent. That is why the Chancellor has argued in favour of increased capital standards.

In your letter you rightly state that enhanced liquidity requirements are an important part of effective banking regulation. As part of the Basel 3 agreement, the Basel Committee agreed international framework for liquidity with the intention of strengthening liquidity regulation in order to promote a more resilient banking sector. This framework includes the introduction of two liquidity metrics. Firstly, a liquidity coverage ratio (LCR) to support short-term resilience of liquidity shocks. This will require banks to hold sufficient high-quality liquid assets to withstand a 30 day stressed scenario.

Secondly, a net stable funding ratio (NSFR) to promote longer-term resilience by ensuring that long-term assets are sufficiently funded from stable long-term sources in relation to their liquidity risk profiles. Both the LCR and the NSFR are currently subject to an observation period before they are due to be fully implemented by 1 January 2015 and 1 January 2018, respectively.

In the EU, the Basel 3 agreement will be implemented through legislative proposal on prudential requirements for credit institutions and investment firms (often known as the Capital Requirements Regulation and Directive 4), which the Commission adopted proposals for on 20 July 2011. The agreement reached on CRR/D 4 will therefore shape EU liquidity regulation going forward. The Government believes that in order to protect financial stability, it is vital that the EU builds upon the G20 agreement to fully and faithfully implement the Basel 3 agreement through CRR/D4. This includes the implementation of strong liquidity standards that will benefit the real economy through reducing both the probability and severity of future banking crises.

Furthermore the Chancellor has accepted the ICB's recommendations and has set out the Government's plans for implementing them. Banks will be required to ring-fence banking services essential to the real economy – in particular, the taking of retail deposits –from investment banking activities and conduct them in separate legal entities, capitalised on a standalone basis. Large ring-fenced banks will be required to hold larger capital buffers and banks' wholesale debt should be loss-absorbing so that investors, not taxpayers, bear losses. Competition in the UK banking sector will be increased by reducing barriers to entry, improving current account switching, enhancing transparency, and securing pro-competitive financial regulation. These reforms will reduce the risk of financial crises and taxpayer bail-outs, leading to a more stable and competitive UK banking sector.

The Chancellor has confirmed that the Government will implement the proposals according to the ICB's recommended timetable. Legislation to implement the ICB's competition recommendations will be introduced this year. Primary and secondary legislation related to ring-fencing will be completed by the end of this Parliament in May 2015 and banks will be expected to be compliant as soon as practically possible thereafter. Other areas of the ICB's recommendations, in particular the introduction of a statutory bail-in power, will be influenced by developing EU legislation, including the forthcoming proposal for an EU Crisis Management Framework. The Government will actively work with our EU partners in these areas, and will take forward the ICB's recommendations in this European context. The final deadline for banks to be fully compliant with these will be 2019, as recommended by the ICB.

Thank you for taking the trouble to make us aware of these concerns.

Y sincerely
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MARK HOBAN

International Institute of Certified Public Accountants

Incorporated under the laws of the State of Delaware

3 May 2012

The Rt. Hon. George Osborne
Chancellor of the Exchequer
11 Downing Street
Westminster
London SW1A 2
England

Dear Mr. Osborne,

Capital requirements are the misconception of the Basel Capital Accords to keep international active banks solvent. You do not "look like an idiot" as you said on May 2, 2012 ("Britain's Osborne hits out as EU bank capital talks stall" – Reuters), because many politicians of your rank are embracing the same misconception.

For your information from an accounting point of view, and as a banker, I wish to explain that capital is only the difference between assets and liabilities, an abstract, not an account that one can draw on to pay depositors if there's a run on the bank. Liquidity -- to be precise legal tender, central bank money -- is needed to pay off depositors and creditors; the bank's self-created surrogate money does not suffice.

I have outlined all this in my publication (2012) "Accounting Perversion in Bank Financial Statements. Root Cause of the Ongoing Global Financial Crisis", available at Amazon.co.uk, both as a paperback and as an eBook.

Another booklet of mine (2011), "The Euro is Still the Strongest Currency Around" is worth reading for someone as yourself, who is not an economist or a banker by education and training. I believe your Governor of the Bank of England, Prof. Mervyn A. King, would be an experienced professional to consult on this matter before you keep on spreading your misconceptions.

Kind regards,

signed

Michael Schemmann, PhD, CPA, CMA
Director