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James Patrick in Interview with Claudio Grass

Claudio Grass in conversation with James Patrick, author of the documentary "Stop it! The Great Taking".

Claudio Grass

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As many of my clients, friends and regular readers know well, I've spent the better part of the last decade criticizing all the great evils and trespasses of the State and its crony capitalist accomplices. I've written extensive analyses and gave many speeches warning fellow citizens about the dangers that lie in government power grabs and authoritarian transgressions. The most important of these risks can, without fail, be found in monetary matters and in the banking system. After all, whoever controls the money, controls the world.

By now, those of us who have studied monetary history and who carefully observe how the current system operates, are fully aware of the fact that fiat currencies are devoid of any real value. Whatever perceived value they have is totally dependent on the State and even the very notion of ownership over one's savings is illusory. Savers can just wake up one day and find that they no longer have access to their bank accounts, as we saw in Canada, or even that part of their savings is simply gone, as we saw in Cyprus.

What might come as a much more disturbing surprise, however, is that this risk and this uncertainty over one's property rights extends to securities too. In the interview that follows, James Patrick talks about the subject of his new documentary, "STOP IT! The Great Taking", which shines a much-needed light on a little-known but deeply consequential transformation in global securities law. He exposes the shocking shift that occurred through a series of legislative changes in the US and the EU that very quietly transferred legal rights from investors to large financial institutions. This resulted in the legal redefinition of ownership rights over stocks, bonds, and other assets that investors believe they fully own, when they practically, effectively and legally don't.

Claudio Grass (CG): Nice speaking with you again James. Many people have heard of the term "The Great Taking" put forth by David Webb but could you briefly summarize the issue.

> James Patrick (JP): Sure. The story involves a fraudulent practice that developed within the financial services industry of surreptitiously using client securities as collateral on their own trades and lending them to other firms for use as collateral on speculative bets. This practice became widespread in the 1970s, but changes in law to legalize this fraud were established in the US in the 1990s and harmonized into EU law in the 2000s.

CG: So, whose securities are being used exactly? Is it the stocks and bonds that retail investors buy through their broker?

> JP: Unfortunately, this is being done to all securities in the market. All investors in securities, big and small, even sophisticated and institutional investors, are exposed to the risk of the failure of their brokers and the financial intermediaries above them in the system. Even when clients are told their accounts are "segregated," they in fact are not. All client securities are kept in pooled accounts, and from there are pledged as collateral. This is done over and over again in rehypothecated "collateral chains."

When any of these firms using client assets fail, clients are only entitled to "pro rata share" (a proportional share) of what is left over of the firm's assets, and have a subordinate legal claim to recover their property behind secured creditors of the contracts their securities were posted as collateral to.

CG: That is quite surprising. How is that even legal?

JP: In answer to your question, this is how it became legal. The fraudulent use of client collateral began as an illegal act and developed into a widespread industry practice. This led to a concerted multi-decade lobbying effort to make significant changes within securities and bankruptcy law to legalize the practice. These changes to law expose all holders of securities to total risk of loss should the firms using their securities go bankrupt.

The first big legal change made was in the US in the 1994 revision of Article 8 of the Uniform Commercial Code, which is the primary section dealing with securities. This UCC amendment introduced two novel legal concepts. The first was, direct title to a security was substituted with a contractual claim on a security called a "Securities Entitlement." The significance of this being a contractual claim is very weak in a bankruptcy proceeding.

The second novel legal concept was, in the event of bankruptcy, priority to the client's securities was given to the secured creditor of the derivatives contract using the client securities as collateral ahead of the client (entitlement holder). The 1994 revision of Article 8 was used as a model for harmonizing these changes into EU law between the years 2004 and 2014, as evidenced by documents between the "Legal Certainty Group", (the working group tasked with implementing these changes in securities law in the EU), and lawyers at Federal Reserve Bank of NY.

CG: So, clients are at risk of total loss at any time should the firms using their assets go bankrupt, correct? And who are the secured creditors exactly?

JP: Client securities are posted as initial margin on derivatives contracts and if the market moves against their positions, they have to put up more collateral or their initial margin gets wiped out. Each derivatives contract has a secured creditor, that takes control of the collateral pledged. The problem the industry faced, is that when client securities are posted as collateral many times, on multiple derivatives contracts, and these contracts fail, the secured creditors of those failed contracts get to take the collateral. But there is not just one, there are many and a priority contest ensues between multiple secured creditors.

Industry needed legal certainty that the secured creditors would come ahead of the clients. Client's claims to their property needed to be eliminated for the derivatives industry to function at such leveraged levels.

Another significant legal obstacle the industry faced was bankruptcy law. Prior to changes in bankruptcy law, if a client's securities were seized on the eve of bankruptcy, this would be constructive fraud or a fraudulent transfer. So, changes in bankruptcy law were enacted federally in the United States in 2005 and 2006, that amended the "Safe Harbor" provisions and established the 546(e) exemptions which specifically exempted fraud. They actually carved out exemptions for the very criteria of constructive fraud and fraudulent transfer. I know all this sounds fantastical, but it's true and in black and white in the law.

These changes to law have led to wild speculation in the derivatives market, which is now estimated to be valued at around 2 quadrillion dollars. The underlying value of all securities held at the Depository Trust and Clearing Corporation (DTCC) in NY and at Euroclear in Belgium are around 130T. Given not all the 130T are being used as collateral, we are talking about a system wide leverage rate of over 20X, with US treasury bonds sometimes exceeding 150X leverage.

CG: How come the average investor is totally in the dark about this issue? Even seasoned professionals are most likely not entirely aware of the risk they are exposed to in the markets. How did such incredibly important and game-changing legal shifts occur without any public disclosure, let alone debate?

JP: These changes were snuck in under the radar but in plain sight. Although the broader banking, repo, and derivatives industry benefitted from them, very few people within the industry understand the big picture and broader risks this created... And big institutional investors have no idea, let alone a retail customer, even if he has hundreds of millions of dollars in the markets.

Alongside these changes, the repo market, that was really cultivated by JPMorgan, has become the primary money market between banks. These repurchase agreement contracts are inherently prone to cause systemic illiquidity should there be downturns in the market. The BIS has written many reports warning of "margin spirals" in such a scenario.

CG: Wow, so what can be done about this?

JP: Well, within the EU not much to be honest, as a lot of this has been enacted in EU code that supersedes national governments. So, short of dismantling the EU itself, I don't see a clear legal strategy to change any of that. National governments within the EU need to assert their sovereignty, exit the EU and protect their citizens.

But in the US, because the foundational legal change was enacted on the state level and can be undone on the state level by striking a few exceptions in 1994 Article 8 revision. This would unravel the legal structure industry put in place to encumber client securities. If these bills to amend Article 8 are passed in any one state, that would allow large firms to rewrite their custodial contracts to be under that state's laws, giving them priority to their securities if their broker or other financial intermediaries pledging their securities went bankrupt.

If we don't make these changes, we will own nothing and be unhappy.

CG: Can you elaborate a bit more on that last point? If nothing changes, what do you anticipate will happen next? How would you expect the worst-case scenario to play out and what "dominoes" would have to fall to get there?

JP: In the worst-case scenario, we see a decline in prices within the derivatives market that causes a cascade of collateral calls. As this occurs collateral gets sold, irregardless of the price fetched on the market, and the entire collateral market freezes up and everyone's securities get transformed to US treasuries and taken by secured creditors.

In the end, this would end up being the "too big to fail" banks that suck up all the collateral. Everyone would lose their savings and the wealth of society would be transferred into the hands of the few and no one would legally be able to dispute it, short of an armed revolution. We would then live in a much poorer world outlined by UN initiatives such as the C40.org where meat and dairy, long distance travel and cars would be out of reach of common people who would live in "15 minutes cities."

CG: How did you get involved with this issue?

JP: Well, I'm from Washington, DC… don't hold that against me… and I was always researching who is really in control of our 'out of control' government. I concluded the banking interests behind the Federal Reserve were really the ones in charge. So, I searched for best analysis of how the Fed works and this led me to Austrian economics. They provided the best analysis of the business cycle and the problems arising from fractional reserve banking. The 300-year-old practice of banks lending out their client's deposits as loans, with the interest on those loans being profit of the bank, is a strikingly similar to the current industry practice of pledging and lending out client's securities, with the return from those trades being the profit of the firm.

I was finishing up a doctorate on monetary and banking reform and the threat of CBDCs to civil liberties when the covid episode began. This widespread violation of our civil rights angered me so I decided to do something about it and embarked on the largest international documentary on the subject called Planet Lockdown, which you contributed greatly too Claudio. 18 months ago, I met David Webb at a conference in Sweden we were both speaking at. I approached him about making a film on the issue and we decided to make a documentary. He and several other bankers, some of whom worked in the Eurodollar market, helped me to understand this securities issue and bring my understanding of the financial markets up to date from where Austrian analysis left off. Within 3 months of starting the film, some lawyers who read his book in South Dakota began introducing laws at the state level to amend Article 8 of the UCC that would restore priority to clients to their own securities, ahead of the secured creditors. We were interviewing G Edward Griffin when David and I first heard about these efforts and the film quickly became about the legislative efforts of 2024 to amend article 8, and the rest is history. G Edward Griffin was the one who suggested the film be titled "STOP IT!". The film came out in late January and can be seen for free at TheGreatTakingReport.com.

CG: Can you talk a bit about your experience making the film? And did you encounter any pushback during the production or after its release?

JP: If you mean harassment, no I did not. Still very few people know about this issue and those that do know parts of it do not understand the broader implications. It's because of interviews like this one that more can find out about it and put pressure on their legislators to strike these laws legalizing theft and fraud.

CG: Quite the story. Is there anything else you'd like to end with?

JP: Everyone can see the film at TheGreatTakingReport.com. I am publishing a technical report for sophisticated investors and fund managers to better understand the inherent risks in the securities market. My report reviews the relevant changes in law in US and EU that have undermined property rights to securities and outline the unrecognized risk faced by all investors.

I would also like to encourage any US citizens to contact their state legislators to amend article 8. This is a realistic goal and the first step to restoring our property rights and peacefully deflating a 2 quadrillion dollar derivatives bubble that threatens to bring down the world economy.

ARTICLE TAGS:

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Depository Trust and Clearing Corporation, DTCC BIS