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THE TURNING POINT

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Francis
Kinsella**

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in the begining

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The Turning Point
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BANKSTERBOOKS

To Tilla, Selma, Eléonore, Noé, Xaver, Elyas, Adélé

Economics was invented in order to make astrology look respectable.

John Kenneth Galbraith

For a number of diseases, 20% of the population account for around 80% of the disease spread. The present financial epidemic has broadly mirrored those dynamics.

Epidemiology provides a second key lesson for financial policymakers – the importance of targeted vaccination of these 'super-spreaders' of financial contagion. Historically, financial regulation has tended not to heed that message.

Andy Haldane
Bank of England

The story of its ruin is simple and obvious; instead of enquiring why the Roman Empire was destroyed, we should be surprised it lasted so long.

Edward Gibbons

PROLOGUE

AFTER THE CHAMPAGNE AND FIREWORKS, the toasts and good wishes, came the almost inevitable hangover. The twenty first century got off to a bad start with the dotcom bust. Barely a year later the world was shaken by the events of September 11. The monstrous and unexpected attack on the World Trade Center, a senseless tragedy for so many Americans, saved George W. Bush from a trivial destiny, elevating him to the role of self-appointed saviour of the Western World, or the narrow world of the Midwest and its Bible-punchers.

Launching his war on terror, Bush galloped, accompanied by his faithful sidekick, Tony Blair, to create a different version of Bush the father's post-Soviet *New World Order*, where, in Winston Churchill's words: *the principles of justice and fair play...protect the weak against the strong* — or was it the other way around?

The widely hailed New World Order held a number of unexpected surprises in store for those who had acclaimed it. The neo-liberals had won the battle, through

deregulation and by abandoning state control and protectionism, allowing the world to continue its path towards the economic and political model preached by Reagan and Thatcher. Market forces replaced governments in determining economic direction, whilst the world, and more especially China, discovered that liberalization could exist without democratization. The consequence of these changes tilted the balance of economic power inexorably towards the East.

Under Bush and Blair interest rates were slashed and a loose monetary policy was pursued to compensate the loss of business confidence and weak share prices. This led to a global credit and property boom, signalling the start of an uncontrolled race for wealth by the world's investment bankers and financial institutions.

Unwittingly the leaders of the rich nations had started a count down to what was, by its very scale, the greatest financial crash in all history, the consequences of which led to a historical turning point, a momentous loss in the relative wealth and economic power of the nations that had ruled the world for more than a century, and more significantly that of Great Britain.

As the summer of 2007 approached its end anxious savers formed long queues outside Northern Rock branches all over the UK to withdraw their savings. What had commenced as a temporary liquidity crisis signalled the beginning of a long series of convulsions that announced a pivotal change, a catastrophic shift, which was to transform the lives of countless millions of people.

There would be winners and losers. One of the winners was China; the UK an also ran. The former appeared poised to claim the lion's share of the global economy, and the latter to finally admit the remains of the predominant global influence it had built over two centuries in industry and finance were gone — forever.

As this modern tragedy was played out certain actors congratulated themselves, perhaps prematurely, for having avoided the worse and even profited from the changes that had been forced upon their world.

Spurred on by the encouragement of the West's compelling leaders, many determined men had grasped the chance that destiny had unexpectedly thrust upon them. Michael Fitzwilliams was one of them, his dream was that of transforming his relatively modest bank into a global finance and investment institution, with quite naturally a deserving place in the adrenaline driven heart of the London's square mile.

2007

Spring

IT WAS THE END OF FEBRUARY when the first tremor was felt; the Shanghai Composite Index fell a massive

8.84%. In spite of this warning it would be months before the nascent economic crisis came to the attention of the world's political leaders. As winter passed markets recovered their brash self-assurance. Life continued with the same unabashed optimism people had become accustomed to in the glow of George Bush's New World Order and Tony Blair's Cool Britannia.

At a grass roots level prospective home owners continued their scramble to sign-up for mortgages, lured by the mouth watering terms offered from lenders across the USA and the UK. In their rush to get onto the property ladder, to upsize, or to drawdown on their accumulated property equity, normally sensible, and not so sensible citizens were stampeded into debt. They were engulfed by a psychos; the fear missing out on what seemed like a once in a lifetime opportunity of realizing their dreams.

Tom Barton, from his office in the City, sensed the coming crash. It loomed as large as a runaway double-decker bus hurtling down Leadenhall Street. His brokerage firm was inundated with a daily flood of mortgage demands — many of them with patently fraudulent declarations — from every kind of hopeful punter imaginable in their frenetic rush to jump onto the bandwagon before the music ground to a halt.

The warning lights flashed crimson when a taxi driver boasted about the profits he had made on his terraced house, 'Look mate,' Barton remembered the driver telling him, 'if some bloke at the bank tells yer the place you'd bought a couple of years back was now worth a couple of hundred grand, you'd feel a bit mean if you only borrowed

thirty, I mean with that kinda money you could pay for a new car and take your missus and the family on holiday to somewhere like the Coster Bravo, couldn't yer?'

Young and old, rich and poor, able-bodied and infirm, were getting into the stampede, overextending their fragile finances, many in the hope of an easy profit, buying rundown homes then after a quick renovation job flipping them to anxious first time buyers desperate to get their foot on the first rung of the property ladder.

Objectively, there were two distinctly different origins to the financial crisis that pushed the global economy towards an unparalleled slump. In the US the cause could be traced to sub-prime mortgage lending, and in the UK the demutualization of British building societies.

In the nineties British building societies demutualized and were transformed into banks, under the provisions of the Building Societies Act of 1986, which allowed them to become joint stock banking companies listed on the stock exchange as public limited companies. After 2000, these new banks through a policy of aggressive expansion built their business around home loans and company lending, both in the UK and abroad. One of the most important of these was the Halifax Building Society, the UK's largest mortgage lender, which merged in 2001 with the three century old Bank of Scotland — a commercial bank, to form HBOS.

During the same period, in the US, the sub-prime mortgage business rapidly expanded driven by investment banks and the securitization of mortgages at a time when interest rates were low following the dotcom crash and

September 11. House prices continued to rise, peaking in 2006, though vast numbers of buyers would continue to pile into the market afraid of missing out on the bonanza.

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The Federal Reserve Chairman, Alan Greenspan, although not alone, would be seen by many as being responsible for the sub-prime crisis. His monumental mistake had been to open the monetary floodgates following the dotcom debacle in 2000. In doing so he allowed the housing bubble to develop, pumped-up by his policy of low interest rates and his encouragement of sub-prime lending. Equally important was Greenspan's backing for the growth of derivatives, including the securitization of sub-prime mortgages.

In the UK, as Tony Blair waltzed across the world stage in the footsteps of George Bush, creating his version of Cool Britannia built on war, credit and ruinous short term economics, a smug Bank of England governor, Mervin King, reported growth at 3% and inflation at 1.3%, without the least explanation as to the whys and wherefores of those serendipitous figures.

By encouraging such disastrous policies Britain's leaders ran the risk of transforming the City of London's financial services sector into an urban version of country's industrial rust belt. During the sixties and seventies successive governments had looked on indifferently as the country's iron and steel industries collapsed, coal mines

were shut down and the automobile industry's slid into its long and painful decline.

The rust belt was formed by the crumbling remains of Britain's once glorious manufacturing industries — the heart of a now forgotten empire, running from Birmingham to Liverpool, Liverpool to Newcastle, and Newcastle to Derby. Bad business decisions and political mismanagement had condemned large swaths of British industry to oblivion whilst in Japan and Germany the same industries were reinforced to form a solid base for the future.

Tom Barton remembered his father's Wolseley and Humber cars, built in the sixties by once famous automobile manufacturers, companies now forgotten, swallowed-up by the failed British Motor Corporation and its defunct successor: British Leyland. Britain had even abandoned control of its luxury car sector, now in the hands of Germany and more incredibly India's Tata Motors. Incredible it was if one looked back to the UK of the sixties and compared it with the then struggling and impoverished newly independent state of India.

Airbus had succeeded after once illustrious British companies, including De Havilland, Hawker Siddeley and Vickers, became forgotten names. Ariane thrived after a whole series of able British rocket builders were condemned to fail; the end result of political squabbling and indecision. The Nuclear industry was left to the French. The computer industry to the Americans and Japanese. Hanging on to the coat tails of the US, Britain had abandoned more than a century of industrial tradition.

Britons were lulled into complacency by the glitz and glamour of celebrities, thrust upon them, as models, by trash media. The term 'celebrity' once referred to cinema idols, up and coming starlet's, football and cricket players. All that changed when high definition colour television thrust life-like images of the country's leaders, tutored by public relations specialists and revamped by my makeup artists, into the intimacy of Britons' living rooms, carrying their persuasive messages of spend and prosper, as if tomorrow did not matter. The same television encouraged viewers to emulate the life styles of the so called celebrities; aping their supposed elegant living: flashy homes, trendy shopping, loud entertainment, showy fashions, sporting styles, clubbing and pubbing, living on credit and paying scant attention to the consequences of frivolous living.

In that well Hackneyed comparison, Britons were not unlike the Titanic's passengers on the night of 15 April 1912, oblivious to impending disaster; the rich wined, dined and danced, the poor huddled in their cramped quarters below decks, as the nation sailed towards doom captained by a helmsman who had not understood the dangers of the perilous course he had chosen.

The creation of Britain's modern financial sector could be traced back to Margaret Thatcher; architect of the legislation that transformed British economy. The Iron Lady lived up to her name, instead of seeking a cure for the chronically sick coal, steel and automobiles industries, she simply killed them off. It was Thatcher who initiated the deregulation of the country's financial services industry,

opening the City of London to American investment banking methods.

The Iron Lady's changes transformed the City of London into the financial capital of the world, where vast riches were created, riches that in the long run were to prove ephemeral. Wealthy foreigners poured in encouraged by laws that exempted them from British taxes on their non UK income: Americans, Europeans, Russians, Indians and Middle Easterners. Twenty years after the Iron Lady's Financial Services Act, London had become an international financial Mecca where bankers, traders, hedge fund managers and financial adventurers of every ilk rubbed shoulders and became rich.

When the party came to an end, as it inevitably did, the British taxpayer was presented with a horrendous bill with the country's hobbled financial sector forced to live on handouts from public funds. Policy makers who had imposed the financial sector as Britain's economic locomotive would wake-up to find themselves in charge of a hugely indebted nation, a crisis stricken banking sector and a greatly diminished manufacturing industry.

Successive governments, driven by powerful financial interests seeking short-term gains, had wittingly or unwittingly presided over the massive deindustrialization of the nation, exporting jobs and industries to China or India, with little or no thought for the future consequences of their acts.

Summer

The City of London

MICHAEL FITZWILLIAMS GAZED OUT at the clear blue summer sky and breathed in deeply. He had never felt so good. The sensation of wellbeing had little to do with the air, which was anything but fresh; endlessly recycled through a vast and complex system of ducts, filters and cooling machines, pumped by huge fans to the gleaming glass dome from a powerful air-conditioning plant that functioned non-stop, twenty four hours a day, noiselessly, many floors beneath the banker's expensively shod feet.

Four years had passed since his decision to move the corporate headquarters of the Irish Netherlands Bank Ltd to the futuristic tower that dominated the City of London's skyline. Four years during which the fortunes of what was in effect an Anglo-Dutch banking group had progressed in leaps and bounds, assuring its place as a player to be counted with in the City's square mile. Four years that had seen the bank's profits rise to heights unimagined by Fitzwilliams' predecessors, and four years of continuous expansion.

Wags were heard call the bank's prominent headquarters Fitzwilliams' member. They were probably not far off the mark; the banker had grown so used to success he felt invulnerable, unstoppable. His eyrie, perched on the glinting peak, was his proud symbol of success, visible for the less well endowed to look up to and envy.

That summer morning it seemed as though nothing could stop the progress of the bank; profit forecasts from its three geographical poles: London, Dublin and Amsterdam, were glowing and the future looked assured. It was a little more than a decade since Fitzwilliams' uncle, David Castlemain, had dispatched his promising nephew to England to take over the development of UK mortgage activities. Then when fate unexpectedly intervened Fitzwilliams was thrust to the top and under his guiding hand the once modest Irish bank underwent a stunning transformation.

It was Friday, July 27, and schools were breaking up for the summer holidays. On the business front the silly season was about to start. Not much ever happened during the holidays and Fitzwilliams saw little to prevent him from heading down to Poole, as planned, for a week's break on his yacht, the *Marie Gallant II*.

The CEO returned to his desk and thumbed through the activity reports his secretary had placed ready for his perusal. His thoughts were still fixed on his plans for the coming week when he stopped to glance at the interim report from the Northern Rock; market leader and one of his competitors in the mortgage sector. They announced upbeat trading results with a positive business outlook for the second half.

Northern Rock reported mortgages up almost fifty percent compared to the same period the previous year. That was equivalent to nearly twenty percent of all new mortgage policies sold in the UK. The mortgage lender promised shareholders it would boost its dividends by thirty

percent, and reported residential lending remained low risk while sales growth from its core mortgage business was good.

The only slightly negative note concerned the signs of an upward movement in money market borrowing rates, which could be somewhat bothersome and possibly weigh on year end profits if the trend continued. He put the report to one side for his secretary to file away, then looking at his watch he picked up his phone and called Pat Kennedy, the bank's number two.

'Pat! All set?'

'Already?'

'George will be outside to pick us up at eleven.'

'It's a pity our roof isn't flat. The helicopter could pick us up without our having to fight our way through all the traffic.'

'Stop moaning Pat. We'll be in Poole for lunch.'

George Pike, their driver, made good time to the Battersea Heliport in spite of the struggle through London's late morning traffic tangle. Not that the time made any great difference, Fitzwilliams had called ahead so that the pilot would be cleared for take off as soon as they arrived.

Battersea Heliport and the City Airport were near at hand ensuring Fitzwilliams and his key staff rapid hassle-free transport to any UK or European destination. The bank's Gulfstream executive jet and Agusta helicopter provided a daily standby service, linking the bank's key business centres and more important regional offices together.

Pike dropped them off and then headed for Putney and the M3. He with the Bentley would be on call during the week in Poole, ferrying Fitzwilliams' friends to and from the airport and for their shopping trips into Bournemouth.

The flight took less than an hour and once landed the ground hostess handed Fitzwilliams the keys to his Porsche, which was waiting outside of the private terminal. Twenty minutes later they were at the banker's waterfront home in Sandybanks.

They quickly dropped off their affairs with housekeeper and shed their bespoke City uniforms for weekend casual attire, then the transformed bankers strolled over to the boat pier where a semi-rigid was waiting to shuttle them out to the *Marie Gallant II*. Their week's holiday was all set to go, starting with a deck party that evening on the luxury yacht. The weather was great and the five day forecast announced an anticyclone over southern England with clear skies and temperatures in the mid to upper twenties.

The Basque Country

JACK REAGAN SIPPED A COLD BEER as he admired the view from his vacation home in the small border town of Hendaye, on the Basque Coast, in the south-west of France. The weather was unusually hot; just over 37°C, one of the highest temperatures ever recorded in a region known for its mild and often wet temperate Atlantic climate. Every year he and his wife spent a couple of pleasurable months

there, relaxing by the sea, walking in the foothills of the Pyrenees, enjoying the local gastronomy: piperade, tapas, jamon Iberico, and drinking Rioja and Irouleguay wines.

To the south side of the border lay the *País Vasco* or *Euskual Herri*, an autonomous region of Spain. To the French side, the *Pays Basque* had no political status, to the great chagrin of the few remaining real Basques, other than through its long history and traditions.

In the background a twenty-four hour TV news channel was reporting alarming news from the Lebanon, which, perhaps understandably, seemed unimportant to the tens of thousands of carefree holiday makers sunning themselves on the town's long sandy beaches. Yet another Middle East crisis had pushed the price of gasoline to new heights; the equivalent of almost eight dollars a gallon at the pump, a figure that would have caused a revolution in the US.

The population of Hendaye, as every summer, had jumped from its normal fifteen thousand to almost eighty thousand with the annual influx of holidaymakers and day-trippers. There was nothing unusual about that. What had changed were property prices. Inexplicably these had gone through the roof, rivalling those of Paris, eight hundred kilometres to the north, and Madrid, five hundred kilometres to the south.

Reagan could not help wondering why property prices in Hendaye, a small, almost insignificant, town tucked away in a relatively quiet corner of France, had suddenly rocketed. Part of the answer perhaps lay in the disappearance of borders within the European Union. Hendaye had become an attractive residential area for a

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