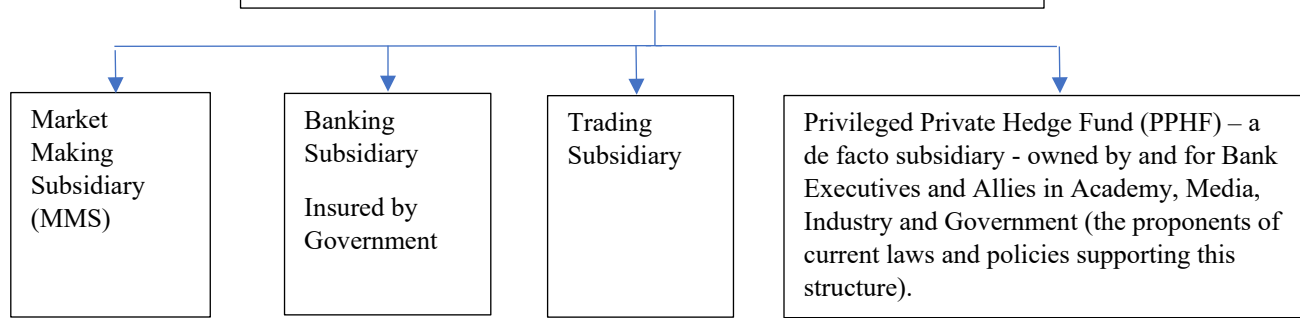


Current Structure of Banks and Financial Markets is centered around a **Mega Bank Holding Company** (a Member of Clearing House, LLC and Federal Reserve) with typically the following subsidiaries



Problem: Suppose that the Market Making Subsidiary (MMS) sees now (a) sell orders for 5 million shares of common stock of a company at \$12 per share from many unprivileged sellers like mutual funds, pension funds and hedge funds due to request for withdrawal from investors in these funds, (b) buy orders for 5 million shares at \$11 such unprivileged buyers. The MMS detects selling pressure from unprivileged funds.

Under the current law, the subsidiaries and parent company are legally firewalled. This means the information from one subsidiary to others, directly or indirectly through parent company, is not permitted legally. Under this law, the MMS cannot legally share real-time order flow information with anyone including its own parent company and other subsidiaries including the PPHF. By law, the MMS is supposed to match buy and sell orders to clear the trading orders efficiently. The MMS receives an appropriate commission from buyers and sellers. The MMS is, however, legally not permitted to trade with buyers and sellers for profits.

Suppose that the following are true:

- Government officials who are empowered to restrict information sharing between the MMS and its parent company and other BHC subsidiaries have (passively) invested in the PPHF managed and shared by the BHC executives.
- The salary and bonus of executives at MMS are controlled by the BHC-CEO. The MMS executives have also invested in the PPHF.
- To increase their salary, bonus and value of investment in the PPHF, MMS executives are incited to pass real-time order flow information, secretly, to their boss (BHC-CEO).
- To raise the value of investment in the PPHF, the BHC-CEO is incited to share order-flow information with the trading subsidiary and PPHF and to instruct the banking subsidiary to lend profusely to the trading subsidiary and PPHF. The banking subsidiary is protected by the Federal Reserve Act (1913) to receive cheap funds should it become bankrupt. This means, the banking subsidiaries of mega BHCs are privileged to never be bankrupt. Note that Prime Minister Gordon Brown of U.K. admitted in a column in Washington Post in October 2008 that the financial crisis was caused by irresponsible and undisclosed lending and lost his job soon afterwards.¹
- The current Security and Exchange Commission (SEC) rule allows selling of securities short. Dodd-Frank Act of 2010 prevented anyone from suing the SEC for promulgating such a short-selling rule. The SEC was created by the Glass-Steagall Act of 1933. But there is no act of Congress which directly permits selling of securities short. Acharya (2012) shows that short-selling under the current structure of banks and financial markets (as presented above)—that bestows unfettered privilege to a few including leaders in mega banks, government, academy, media and industry and keeps the rest unprivileged—is inefficient, unconstitutional, unanimously disagreeable and detrimental to stability and civilized coexistence of humanity.²

Q1: Will the MMS share real-time information with the parent company and subsidiaries of the BHC secretly?

Q2: Will those, passively invested in the PPHF, remain blackmailed to be muzzled about such secret information sharing?

Q3: How will the PPHF and trading subsidiary trade and how much profit will they make based on the trade order-flow information given above? What is the risk of such trading?

Q3: Is the current structure of banks and financial markets fundamentally unfair (which means unconstitutional)?

Q4: Will the BHC-CEO discretely persuade every leader in government, academy, media and industry—who is capable of publicly discouraging the existing structure of banking and financial markets as unfair—to be a passive investor in the PPHF?

Q5: If the elected officials know that *We the People* have discovered the unfairness (unconstitutionality) of the current structure of banks and financial markets, how will they act?

- <http://pro-prosperity.com/Public%20Financing%20of%20Private%20Hedge%20Funds%20is%20Unanimously%20Disagreeable.pdf>
- <http://pro-prosperity.com/Research/Sub-Optimality%20of%20Short%20Selling.pdf>

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