

IN THE NEWS

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Economic News

We need to start with a bit of good news; oil prices are falling [1]. And, the Fed cut the funds rate down 1/2% to 1.5% [2]. However, the markets are still under stress and we examine some of the news. In July, the SEC declared war on false rumors at a time when Fannie Mae and Freddie Mac were getting clobbered by short sellers [3]. The recent case of a citizen reporter, Johntw posted a bogus story that Steve Jobs had a heart attack; consequently Apple stock lost \$9 billion in value before the rumor was denied [4]. The blame game, starting with the Lehman Brothers collapse has started in earnest. In his testimony before the House Government Oversight Committee, Lehman Brothers Holdings CEO Richard Fuld blamed the collapse of his company on false rumors, short-selling, and a general lack of confidence on Wall Street [5]. Before his committee, Henry Waxman stated regulators failed miserably to prevent the Lehman Brothers collapse [6]. It has been suggested that Mr. Fuld blamed other factors, including an extraordinary run on the banks, but didn't blame himself [7]. Furthermore, lawmakers before Mr. Waxman's committee criticized the nearly \$350 million Mr. Fuld received and one Congressman wondered aloud how Mr. Fuld could sleep at night [8]. It is very seductive to point to someone better off and blame them for the crisis. But what if Mr. Fuld is correct and he didn't see the problem coming? Today, interconnected computers have enabled an environment where companies can collapse in a fraction of the time anticipated. If the total time it takes a company to go from healthy to collapse is measured in hours, any meaningful control must be applied during that time. Once the company is gone, it is too late to correct the problem.

It seems the FDIC Wachovia brokered deal was very valuable Citigroup. Citigroup is suing Wachovia and Well Fargo for \$20 billion in compensatory and \$40 billion in punitive damages [9]. Citi announced that their deal to purchase Wachovia was off and they would no longer seek an injunction, but the law suites remain [10]. It remains to be seen what the impact to banks will be because of this litigation. The Deal engineered by the FDIC included a provision for the FDIC to assume all losses above \$42 billion on Wachovia's riskier assets, in return for \$12 billion of Citi preferred stock [11]. Fortunately, once Citi backed down, Standard & Poor's upgraded its counterparty credit rating on Wachovia Corp [12].

To look at a microcosm of what's happening consider Morgan Stanly (MS). Shares of MS have been heading south and now Moody's is considering downgrading MS's credit rating [13]. This bad news in turn is feeding the free-fall of the stock. Similarly, Moody's placed a negative outlook on Goldman Sachs' (GS) long term rating [14]. On Friday, GS fell over 12% in value. It

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IT Security

One of the most effective methods in maintaining security is ensuring the current vendor patches are applied. For example, on October 14, Microsoft plans to release patches to fix 11 security problems, four of which are critical [1]. Seven of the patches address vulnerabilities that allow remote

code execution [2]. Additionally, Apple released security patches for their OS X and Opera web Browser [3]. The Apple patches are supposed to correct 20 security vulnerabilities [4]. Additionally, there is an updated plug in for Mozilla's Firefox Web Browser that protects against clickjacking [5].

Other approaches to maintain security include using cryptographic controls to reduce tampering and maintaining integrity. For example, The government is looking at Domain Name and Addressing System Security Extensions (DNSSC), that includes digital signatures for improving the Internet

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Special points of interest:

- Retirement accounts lost \$2 trillion during past 15 months
- Regulators shutter Meridian Bank and Main Street Bank
- September 26 silent run on Wachovia - Accounts greater than \$100K withdrew \$5 billion



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seems the crisis is also impacting retirement accounts to the tune of \$2 trillion over the past 15 months [15]. Meanwhile, bring to a total of 15 for the year; regulators closed two more banks; the Meridian Bank in Illinois and Main Street Bank in Michigan [16]. In other news, the total cost of the Lehman bankruptcy is still being calculated. Companies that effectively wrote insurance policies on Lehman debts could lose \$365 billion [17].

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16. Vekshin, Alison, and Katz, Ian, *Bloomberg*, *Illinois, Michigan Banks Shut by Regulators; Toll Climbs to 15*, October 11, 2008.
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You can't fake quality any more than you can fake a good meal—William S. Burroughs

(Continued from page 1)

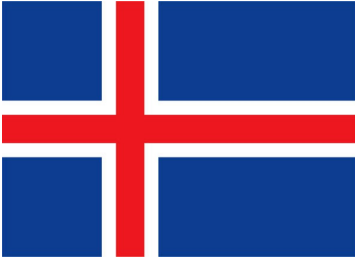
addressing [6]. In Germany, an error placed 30 million users' confidential information on the Internet [7].

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2. Keizer, Gregg, *Computer world*, *Microsoft promises huge patch day next week*,

October 9, 2008.

3. Krebs, Brian, *The Washington Post*, *Apple, Opera Ship Security Updates*, October 10, 2008.
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5. LeClaire, Jennifer, *Sci-Tech Today*, *Firefox Plug-In Updated To Fight Clickjacking Attacks*, October 10, 2008.
6. Kirk, Jeremy, *IDG News Service*, *U.S. gov't proposes digital signing of DNS root zone file*, October 10, 2008.
7. AFP, *Error puts data on 30 million German phone users on Internet*, October 11, 2008.

Where is the Money Going?



For years, Iceland has been rapidly expanding its banking industry. The global financial crisis has hit Iceland hard. For example, Iceland nationalized their remaining large bank, Kaupthing, following a run on the bank from foreign depositors in the U.K. and elsewhere [1]. Now the island country is searching for money to pay the depositors in other countries and they may have to ask the International Monetary Fund for help [2]. A question here is what would the U.S. do if the foreign investors did an Iceland on us? In the case of silent runs, money is moved out of the bank electronically, typically from one bank account to another. So where are the transfers going? In such times of financial angst, it is easier to hide nefarious activities. Even a small increase in fraudulent transactions could mean the difference between solvency and collapse. Financial institutions that could tolerate such losses in the past are now at an impasse. Consider in the United Arab Emirates (UAE) where in September there was a sudden rash of card fraud transactions and the cost to banks and account holders is still not known [3]. There are plenty of stories where money just disappears from a depositor's account. For example, outside of the US, a lady discovered

£1,000 had been mysteriously transferred to a stranger's credit card [4].

So why discuss activities in countries outside of the U.S.? Consider the interdependencies. For example, when Citigroup needed to raise cash, a 4.9% equity stake in the company was sold to the Abu Dhabi Investment Authority for \$7.5 billion [5]. Just like the U.K. bank runs on Iceland's banks, the world financial institutions are tightly interconnected. Moreover, actions taken overseas can have a direct impact on U.S. financial institutions. For example, a Romanian national pleaded guilty to causing approximately \$700,000 in identity theft losses in the U.S. [6]. So \$700,000 transferred out of the U.S. and is likely gone for good. Who pays for this loss?

Consider the impact of silent runs and ask where the money went (to other banks?). Immediately following the collapse of Washington Mutual, on September 26, \$5 billion in deposits was pulled from Wachovia in a silent run [7]. Starting on the Friday morning following the WaMu collapse, Wachovia accounts with over \$100,000 withdrew deposits to just under the FDIC insurance level [8]. This is another bank failure that could have been delayed or averted had the deposit insurance level been higher. The question here is should the limit be increased beyond \$250,000 or should we hope no more silent runs take place? One possible approach is to use the new FDIC rules that allows trusts to be set up with extend coverage into the \$millions [9]. Another option is to consider that Ger-

many has opted to guarantee all bank savings [10].

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3. Reuters (Dubai), *UAE banks step up security after card fraud spree*, September 11, 2008.
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*Honesty is for the most part
less profitable than
dishonesty—Plato*

Asia

The financial problems in the US are finding their way overseas. The Japanese Nikkei down 24 percent for the week [1]. This was the largest fall in the 50 year history of the Nikkei [2]. Meanwhile, the Japanese Yamato Life Insurance Company files for bankruptcy causing additional angst [3]. China's central bank has pledged to help the global crisis [4]. This is good news given China's large currency reserve.

The Census released the Au-

gust trade figures and the deficit with china grew to \$25.3335 billion. At the same time, the deficit with Japan fell to \$2.47659 billion. In addition to the mounting debt, the US is falling behind Asia in R&D [5].

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Crime

In Texas five people were indicted in a \$17 million mortgage fraud scheme [1]. In New Jersey, a man with a long criminal background was charged with defrauding investors of \$800,000 [2]. In Florida, two people pleaded guilty in a foreign investment scheme that evaded \$2 million in taxes [3]. Elsewhere in Florida, a man got a 9 year sentence for \$13 million in mortgage fraud [4]. In Maryland, a man was sentenced to 10 years in prison for a \$2.3 million fraud scheme [5]. In Georgia, a man got 14 year in prison sentence for an \$11.2 million mortgage fraud scheme [6]. In Kansas a real estate agent a mortgage fraud scheme that bilked lenders for more than \$12 million in home loans [7]. In efforts to fight crime, some people are finding some security solutions onerous. For example, in Massachusetts, a Bank of America required anti-fraud feature required capturing a fingerprint before a

check could be cashed [8]. In other news, Wachovia agreed to pay almost \$200 million to settle lawsuits that it profited by ignoring fraudulent telemarketers using the bank to help them steal from consumers [9]. In another legal battle, Country-wide (purchased by Bank of America) will settle fraud complaints in 11 states for \$8.4 billion [10].

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Those who create and issue money and credit direct the policies of government and hold in the hollow of their hands the destiny of the people—Reginald McKenna, former Chancellor of Exchequer, England
