The notions ‘too big to jail’ and ‘too big to fail’ mean we’re never too far from another crisis

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WALL Street is trading in record territory, the US economy is showing sustainable signs of life and yet five years after the global financial crisis sent the world economy to its lowest ebb since the Depression, not one banker has faced criminal charges in the US or Britain, despite what many would describe as questionable, if not culpable, behaviour that sparked the crisis.

Last week in Sydney, Judge Jed Rakoff from the US District Court outlined his views on just how Wall Street got away with it. He also pointed to the danger signs ahead.

Rakoff was speaking at a conference organised by Justin O’Brien from the UNSW Centre for Law, Markets and Regulation, having in the past couple of years shaken the US legal system by refusing to rubber-stamp a settlement between the US Securities and Exchange Commission and Bank of America because it didn’t go hard enough.

The same judge was criticised for being too lenient on the sentence he handed to former Goldman Sachs director Rajat Gupta last year, and also presided over one of the settlements flowing from the Bernard Madoff Ponzi scheme case.

Some would argue that criminal convictions are not the only answer and maybe there is nothing regulators can do to stop basic greed and moral breakdowns. However, the question certainly needs to be raised: why did the world seem to embark on the same wild ride once more?

In the same conference last week, Australian Securities & Investments Commission deputy Peter Kell underlined the warnings given by his boss, Greg Medcraft, against “complex products being sold during periods when people are searching for yield”.

not individuals, was lazy and would allow perpetrators to escape unscathed — as, arguably, they did at Bear Stearns, Lehman Brothers, Goldman Sachs et al. Enforceable undertakings and early plea bargains championed by ASIC are cost-efficient because they avoid the cost of long investigations and trials. But it is questionable whether they have the same impact and deterrence effect as a full-scale prosecution.

Not so many years ago, the US had 1000 investigators chasing the savings and loan fraudsters, from Charles Keating down. The junk bond scandals of the 1980s were happily prosecuted, with Michael Milken, Ivan Boesky and others doing time.

Rakoff notes that there is an immorality about the notion “too big to fall” and “too big to jail”. He went through the reasons advanced for the lack of prosecutions, such as no immediate victims, which seemed to ignore the 26 million unemployed in the US. He said the doctrine of willful blindness was well established in the US, and was used against Jeffrey Skilling at Enron and Bernie Ebbers at WorldCom, who are both in jail today despite using the defence that the prosecution could not prove they were personally involved in the crimes.

“It is a little surprising that the Justice Department has said the evidence was an issue, when that never stopped it before,” Rakoff said.

The white-collar taskforce was diverted to the terror attacks after 9/11, which was obvious priority. Arguably, the US government itself was at fault in the GFC because it encouraged the creative forces that were making home loans available to anyone who could spell the words.

Then, when the GFC hit, the US Treasury was putting the pieces together, persuading Bank of America to rescue Merrill Lynch, among other deals, to “save” the global economy which would make a prosecution difficult to run against the very same perpetrators. The statute of limitations has now run its course and Wall Street and the City of London are free from prosecution.

However, it is easy to argue that the same morality — or lack of it — is alive and well, which will result in more financial ruin for the same sad breasts.

The promised global co-operation is alive among corporate cops, but it has long been dead when it comes to banking regulation. This begs the question: how long will it be until the next snafu?

Protest vote

In case you didn’t know, Spain-based ACS controls 54 per cent of Leighton Holdings. So, in the scheme of things, the 14 per cent protest vote against the appointment of ACS-owned Hochtief boss Marcelino Fernandez Verdes to the board merely underlined that point.

The best news was that the company’s guidance was reaffirmed, which helped the stock to climb 3.7 per cent to $18.67. Leighton shareholders would be pleased to know that Fernandez Verdes’s Spanish pay is reduced by the $90,000 he collects as a Leighton director, so the Australian company is, in effect, subsidising his salary.

Local chairman Robert Humphris and lead independent director Paula Dewar are commendably finding more people to replace the last local walkout, but as they say in football, when there is an argument, look at the scoreboard. In this case it reads ACS 54 per cent, which means it gets to call the shots. The next saga at Leighton will come with the proceeds from NextGen, which are meant to stay here to reduce debt.

Low bar, high pay

One of the great potential risks in executive pay allows management to low-ball budget forecasts to lower performance hurdles and maximise potential bonus payments.

Adelaide Brighton is one of the better market performers, with a return on assets of 10 per cent last year and a return on equity of 15.7 per cent. The question, then, is why in three of the past four years was Adelaide Brighton’s budget based on a decline in earnings, 7.8 per cent in the past year?

As luck — or performance — would have it the targets were easily reached. Under the 2012 financial year bonus plan, the executives would have collected if profits fell by 17 per cent when, of course, they actually increased.

Colin Carter, head of the Seek remuneration committee, has noted that if you don’t pay short-term bonuses, then budget talks take on a whole new meaning because executive pay hurdles are not part of the equation.

It would seem that Adelaide Brighton chairman Les Hosking might care to look at adopting the same practice.

Chief executive Mark Chellew collected fixed pay this year of $1.7 million and a bonus $1.6m, or 95 per cent of fixed pay.

Ownership Matters is recommending a vote against the remuneration report because of the way the budget forecasts appear weighted towards higher executive bonuses.

A protest vote could be expected at tomorrow’s meeting, but if Seek’s Carter has his way, no companies will follow his lead in making remuneration reports simpler by cutting out short-term bonuses and simply working out with management what they think a fair wage would be, any keeping bonuses as long-term affairs based on shareholding returns.

That system negates all the nonsense of special handouts to reward executives for competing tasks for which they are paid in any case.

Carter is also a champion of annual board votes, which means the whole slate is up for re-election and, in the process, the two-strike policy would in effect be void.