What Will Reform Wall Street?

It's time to actually hold bank CEOs accountable for financial fraud

By Jeffrey Sachs | TIME | November 28, 2011

The SEC recently fined Citigroup for $285 million for selling CDOs (collateralized debt obligations) tied to bad mortgages. Goldman Sachs and JP Morgan have both recently paid large fines ($500 million and $154 million) to the SEC for similar misbehavior, in each case teaming up with a hedge fund to create securities designed to fail, in order to defraud unsuspecting purchasers while the hedge fund bets against the securities. The hedge fund makes a large profit; the Wall Street firm earns a large fee; and the unsuspecting purchasers incur great losses. While the fines seem tough, they are merely a slap on the wrist. Citigroup, for example, made an estimated $160 million on the transactions, while investors lost $700 million. The firms do not even have to admit wrongdoing, which is why Federal Judge Jed Rakoff recently rejected the Citigroup settlement, writing, “In any case like this that touches on the transparency of the financial markets whose gyrations have so depressed the economy and debilitated our lives, there is an overriding public interest in knowing the truth.”

Moreover, the Wall Street CEOs who were the architects of this illegal behavior have pocketed vast personal riches in recent years and have lost nothing themselves from the SEC fines, which are basically passed down to the shareholders as the companies as a whole foot the bill. What is worse is that CEOs who were in charge while these deals were cooked in the first place are still in charge today.

If we want to truly reform Wall Street, we must hold these leaders accountable. When companies commit financial fraud, the responsible senior management team should step aside, accepting responsibility for the serious misdeeds of their companies and apologizing to the American people for the heavy costs they and their colleagues have imposed on the entire economy. If they do not voluntarily step down, and if the shareholders do not remove them, then the government should remove them. Bankers are required to exercise probity and responsibility vis-à-vis the markets as well as their shareholders. It is the job of bank regulators to ensure that top bankers measure up to these basic standards.

Bizarrely, the hedge funds that teamed up with the investment banks have paid no price at all for their behavior. The theory seems to be that these hedge funds are innocent bystanders when the banks peddle the toxic securities to the investors. This is a doubtful proposition. They have knowingly assisted the banks in violating financial laws.

In addition to the quick and hopefully voluntary departure of errant CEOs, the Justice Department should undertake an investigation into the legal responsibilities of the CEOs, senior managers and the corporate boards to see if criminal charges or other civil charges should be brought. It seems preposterous that the Justice Department has been almost mute on a calamitous storm of illegal behavior on Wall Street. An investigation into Wall Street’s behavior in the lead-up to 2008 should be launched immediately, perhaps best led by an apolitical special prosecutor.
Wall Street and much of the mainstream media have claimed not to understand the Occupy Wall Street protests, often stating that the young people in Liberty Plaza are simply acting out their envy. This is false. They are expressing their dismay at the impunity, lawlessness and arrogance displayed by Wall Street’s leading financial institutions, even after those institutions have nearly brought down the world economy. They are looking for justice and the rule of law, recognizing that unless serious financial malfeasance is punished the odds are that it will quickly reappear, as will a more general contagion of cynicism and violating the law. And in this regard, they have more foresight than our highest statesmen and wisest government economists.

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