Justice in the Age of Finance*

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The big news late in June 2017 was that the Serious Fraud Office (SFO) in the UK had charged four former senior executives of Barclays bank, including its former chief executive, John Varley, with fraud committed almost a decade earlier, during the global financial crisis of 2008. This is the first chief of an institution embroiled in the 2008 financial crisis who faces criminal (as opposed to civil) proceedings. How long the investigation will take and what the punishment will be is yet to be seen. But being the first criminal prosecution of a small number of the large group of financial chieftains who through their acts of commission and omission precipitated the crisis, the event has received substantial media attention.

Ten years have passed since the global financial crisis of 2007-08. While long-term, structural factors played a role in precipitating that crisis, early evidence showed that conscious actions by banks and leading investment banking firms which exploited the loopholes that financial deregulation offered were equally responsible. Moreover, compensation practices that linked salaries and bonuses to profits made, encouraged the pursuit of profit at the expense of all else. As a result, fraud was at the centre of the crisis that devastated ill-informed or wrongly tutored investors and borrowers, many of whom earned a minuscule fraction of what the functionaries of finance did, and had been persuaded into living beyond their means by accessing easily available debt. This could continue for long because the securitization that deregulation encouraged, allowed those who created credit assets by lending to transfer the risk to dispersed investors for a fee. The opaque instruments created to conceal the accumulating risk in the system were merely emblematic of the ubiquitous fraud.

This is what William Black, currently a Professor at the University of Missouri, Kansas City, and a lead official investigator of the circumstances that led to the Savings and Loans crisis in the 1980s in the US, calls "Control Fraud". In his words: "Control fraud is what happens when the person who controls a seemingly legitimate entity uses it as a weapon to defraud."

The results of such fraud in the lead up to the 2008 crisis it is now clear were devastating for large numbers of people who had little to do with the actions that precipitated the crisis. Besides those thrown out of homes because of foreclosures of mortgages that could not be serviced, many lost their savings because of the collapse of financial asset prices, and large numbers were left unemployed or saw their earnings reduced because of the ravages of a deep recession that still lingers in most countries.

At that time, President Obama who took power as the crisis unfolded promised to book those who were responsible for the large scale incidence of fraud, speculation and mismanagement that led to the devastation. Now, with hindsight, we know that little was done on that front. In all these years no top executives, under whose watch or at whose direction these instances of fraud occurred, have been prosecuted, let alone punished. On the other hand, large volumes of capital were poured into those banks not just to save them from bankruptcy but to return them to profit and ensure huge appreciation of their share values. Finance, everybody agrees, while the criminal, was also the main beneficiary of the rescue efforts that followed the crisis.

So the first signs of real justice has been received with some celebration. Better late than never, argue journalistic observers. But that argument misses out on a crucial feature of the prosecution: the nature of the ‘crime’ for committing which the Barclays Four have been charged. The charges against the four former executives relate to transactions conducted in June and November 2008, when Barclays, facing insolvency in the wake of the crisis,found a way of staying afloat without accepting capital infusion from the government. Such infusion could invite state intervention, that could hurt the “independence” of the bankers and bring into question the fairness of the large compensation they paid themselves—fears that subsequently proved unfounded. But driven by that fear, the top executives at Barclays struck a deal with two Qatari institutions (Qatar Holding LLc and Challenger Universal Ltd, the former a state-owned investment fund and the latter the investment vehicle of the then Qatari Prime Minister Sheikh Hamad bin Jassim bin Jabr al-Thani). As part of the deal, the Qatari investors provided Barclays, funds to the tune of £4.5 billion in June and £7.3 billion in November, in return for equity in June 2008 and high-yielding capital instruments, mandatory convertibles and equity warrants in October-November that year.This helped Barclays avoid accepting a government bailout plan of the kind that the Royal Bank of Scotland and the Lloyds Banking Group were forced to accept. At that time, the fact that Barclays could stay out of the bail-out, was seen as a victory for chief executive Varley.

Problems arose because of what seemed to be a quid pro quo. Barclays not only paid the Qatari investors involved commissions of around $320 million, ostensibly under an “advisory services agreement” to help Barclays develop its business in the Gulf, but also provided the State of Qatar a loan of £3 billion, which the SFO suspects was used to finance the investment by the Qatari Investment Agency in Barclays. These actions have led to a series of charges, initiated by the Financial Conduct Authority, and subsequently taken up and extended by the SFO. To start with, Barclays has been charged with violating the law that forbids a firm providing financial assistance to an investor in its own shares, as that involves propping up the values of shares under pressure, with those shares being the implicit collateral for the loan. The Barclays Four have also been charged with conspiracy to commit fraud by false representation. Partly because they made an offer of sale of equity to outside investors rather than giving existing shareholders priority, or the right of first refusal. Moreover, the equity held by existing shareholders may have lost value because of the dilution. Finally, the resources mobilised through the issue of about £3billion of special bonds, called “reserve capital instruments”, were expensive, involving a payout of 14 percent between October 2008 and June 2009, the deadline by which the loan had to be converted into equity to demonstrate solvency to the regulator, the Bank of England. That too would hurt returns earned by existing shareholders.

So the ‘crime’ that Barclays is seen to have committed was to deprive financial investors already exposed to it of the option of enhancing their holdings and their returns, even though circumstances were such in June and November 2008 that investors are unlikely to have exercised the option of enhancing their holding. In sum, Barclays is being brought to book because it cheated the community of ‘Finance’ that it belongs to. But those most adversely affected by the financial crisis and the Great

Recession that followed were outside this community—ordinary citizens, most often with not too well paying jobs, small sums saved and a modicum of housing equity. The tens and hundreds of banks, mortgage companies, investment banks, hedge funds and other financial firms that speculated in ways that took these people into a devastating crisis have been left relatively unscathed, except for a few fines imposed on and paid magnanimously by the 'criminals'. In fact, in a case unrelated to the crisis, Barclays was fined £280 million in 2012 for the much more serious misdemeanour of rigging the Libor, affecting in the process, the returns on a range of financial instruments. Its then chief executive, Bob Diamond was forced to resign as a result.

The failure to prosecute in cases stemming from the actions that led to the financial crisis is not because the perpetrators of fraud could not be easily nailed. It is because Finance has been able to stymie any effort to do so, by lobbying, through Congress and in the courts. According to William Black quoted earlier, at the peak of the investigation into the savings and loan cases in the 1980s, there were a thousand FBI agents involved, out of around 2300 FBI white collar specialists available. As opposed to this "in the current crisis, as recently as fiscal year 2007, there were a 120 FBI agents nationwide assigned to all cases of mortgage fraud."

In sum, the very limited Barclays prosecution comes in the wake of a half-hearted investigation effort, which has thus far completely let off all those who took the world economy to the verge of a crisis akin to the Great Depression. It is not clear if anything will finally come out of even this case, which is aimed at merely teaching a lesson to those who hurt a bunch of financial investors by violating insider rules. In fact, many of those investors have in the final analysis, lost little since bank share values have appreciated hugely since the crisis.

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