The Hegemony of Finance*

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Three parallel developments that caught media attention over the last month point to the restoration of the hegemony of Finance Capital in the years since the 2008 crisis. They also reveal the likely consequences of the neoconservative backlash, led by Finance, against post-crisis financial sector reform in the US and other developed countries.

One was the decision of the Financial Sector Protection Bureau (FSPB) of the US, an institution created after the 2008 crisis, to arrive at a settlement with Wells Fargo (WF) in an investigation relating to a rather shocking discovery. More than 5000 employees of the bank had, over the last five years, opened more than a million new banking accounts and another half a million or so credit card accounts in the names of its customers without their knowledge in order to meet sales targets.The customers were charged a fee before the accounts were closed. Thus, faking the outcomes of fraudulent “cross-selling”, or the selling new products to existing customers, employees met their targets and enhanced their incomes. The fraud was either missed or ignored by senior management for a very long time. The settlement for ending the investigation into these violations requires Wells Fargo to pay a combined fine of $185 million ($100m to the CFPB, $35m to the Office of the Comptroller of the Currency and $50m to the City and County of Los Angeles), the largest ever imposed by the FSPB. In addition, WF will also have to set aside $5million to compensate clients who were charged fees on accounts regarding the existence of which they had no knowledge. But relative to the net profits of more than $20 billion that WF is expected to record this year, the fine is not really much damage. On the other hand, while more than 5000 employees had lost their jobs on charges of fraud, the settlement waves fixing responsibility for the incident on the senior management.

The second development relates to a much delayed “conclusion” of an investigation into one of the many hundreds of violations that came to light at the time of the 2008 financial crisis. This investigation (among many others that have been completed or are ongoing) is into allegations that Deutsche Bank “mis-sold” (or sold without due diligence or under false pretences) mortgage backed securities to its clients in the years prior to the 2008 crisis. Here again, the US Department of Justice (DoJ) has decided to arrive at a “settlement” with the offender, Deutsche Bank (DB), on condition that the latter makes a $14 billion payment in return. Interestingly, the discussion has not been on the correctness of what Deutsche Bank did or did not do, leading up to allegations that warranted the investigation. Rather, the discussion is large on whether $14 billion is a fair figure for letting DB walk away without having to admit that it violated laws or committed any grievous error.

The debate is partly fanned by assessments, hotly denied by DB, that a $14 billion settlement could severely damage its balance sheet, and necessitate intervention by the German Chancellor Angela Merkel to bail out the bank. That would revive memories of the first phase of the 2008-09 crisis when tax payers’ money was used to bail out the banks that precipitated the crisis, even while those affected by the recession the crisis triggered were not helped or even forced to suffer the effects of austerity measures. Yet the debate goes on, with DB not agreeing to the DoJ’s demand, and reportedly nearing a much smaller $5.4 billion settlement. This should not surprise, given the fact that Goldman Sachs, which was slapped with an initial settlement claim of $15 billion for similar charges, managed to end investigations with a $5 billion payment in January 2016. Since then banks such as Royal Bank of Scotland, Credit Suisse, UBS and Barclays that are looking for similar settlements have been hoping to be let off lightly. Here too the experience is one in which a "settlement" rather than conviction and punishment is the direction being taken. What helps DB and its European and British peers, is that the claim on DB seems discriminatory given the magnitude of the final reduction of the Goldman Sachs settlement. Politically, this would look like discrimination against banks in Europe, which committed the same "mistakes" that Goldman did. The settlement itself is disputed and is likely to be reduced, and there is little focus on setting examples that ensure that the actions or behaviour concerned are less likely to be repeated.

The third development of import was news that a House committee of the US Congress had approved consideration of the Financial Choice Act 2016—a bill introduced by Republican Senator Jeb Hensarling from Texas. The bill seeks to dismantle even the diluted post-crisis regulatory reform introduced through the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010. In the words of the New York Times, Senator Hensarling's proposal would achieve much by way of doing away with Dodd-Frank. It calls for allowing big banks to exempt themselves from even minimal regulatory requirements like meeting capital and liquidity standards, so long as the ratio of their Tier 1 capital (equity and reserves) to their total assets (the'leverage ratio') is kept at 10 percent. It seeks to repeal the Volcker Rule, that went further than mere regulatory capital standards by requiring banks to stop using their own (as opposed to their clients') money to make risky bets in securities markets. It wants to prevent the Financial Stability Oversight Council from designating any non-bank financial institutions as "systemically important", since that would bring them under stricter regulation. "The Republican plan does not 'force' any bank to raise a dime of new capital," Senator Hensarling reportedly said. "Rather, it allows banks to opt into a regime that replaces Dodd-Frank's suffocating regulatory complexity and control with market discipline."

The Act which wants to achieve all this and more is unlikely to be legislated into law this year or in the near future. But it would serve the purpose of shifting the terrain of debate away from the regulatory measures and reform requirements that the 2008 crisis signalled as being imperative. This it seeks to do despite the signals regarding the dangers of deregulation coming from Wells Fargo, Deutsche Bank and their peers. Thus, the message that comes out of these three related but seemingly disparate developments is that Finance has been able to successfully stall reforms that the 2008-09 crisis had established as being urgent and imperative, and that the consequences are bound to be damaging.

The nature of those consequences came through clearly in the Wells Fargo case that occurred much after the crisis. It is true that the "scale" of the fraud was by no means large going by the standards of the financial sector in general and banking in particular. Fees generated from the fraudulent transactions involved amounted to just $2.6 million. Large perhaps for some clients, but definitely small for the bank. Yet, there are three features of the Wells Fargo case that make it noteworthy. First, this was a case of widespread internal fraud that was occurring under the noses of the management and senior staff in a manner that should not be difficult to detect. This has led up to the suspicion that either the management chose to ignore the phenomenon or that there was a huge governance deficit at the bank. Yet, a second feature was that, while many of the employees involved were given the pink slip, top management excepting for the head of the retail division, Carrie Tolstedt, were initially not held responsible. In fact, Tolstedt, drew benefits, including the value of her accumulated shares and option, of $125 million when she exited the firm, much to the chagrin of those like Senator Elizabeth Warren who have been vocal advocates of strong regulation of finance after the crisis. It was only after the matter became an issue of public debate that some effort at a “clawback” of a part of the “rewards” of an over-paid senior management to settle claims became a possibility. The experience during the 2008 crisis too was one where senior employees who had earned huge salaries and bonuses in financial firms while resorting to speculation of a magnitude that precipitated the crisis went scot free.

What is surprising about the development at Wells Fargo was that the fraud occurred in a bank that had abjured the practice of raking in fee incomes by floating products such as mortgage-backed securities, collateralised debt obligations and credit default swaps, that allowed for the proliferation of risks before 2008 that were hidden till it was too late. As a result Wells Fargo was not affected adversely by the crisis and in fact gained from it as it could acquire a distressed financial services firm, Wachovia, on favourable terms and expand its network and business hugely in the aftermath of the crisis.

This focuses on the third feature of the Wells Fargo crisis, which is the visible link between compensation strategies that provided bonuses for enhancing business or inflating profits, and the escalation in speculative and/or fraudulent activity. Such compensation practices had come under sharp criticism immediately after the crisis and led to demands to reform those practices. But the effort was stymied on the grounds that it would drive ‘talent’ out of the industry. That failure has encouraged similar talent to defraud Wells Fargo’s depositors.The demand that those responsible are at least minimally punished and penalised with a “claw back” to recover the huge sums that were paid to them for committing the offences they did is small recompense for all that was forgiven in 2009 and after. It amounts to a recognition of the need for regulation to prevent speculation and fraud and a system that penalises rather than rewards speculation and fraud.

But what the Deutsche Bank (DB) “settlement” claim indicates is that taking this forward is not going to be easy. Almost a decade after the 2008 crisis broke it is clear that organisations whose employees “mis-sold” (read acted in bad faith while speculating, leading to fraud) mortgage-backed securities and many other derivative assets bordering on the opaque, were not only bailed out but were not penalised for their actions, and allowed to walk out without admitting to guilt by paying sums that ensured a “settlement”. And if a large penalty is imposed at all, governments like Germany’s would be under pressure to put up the sum need to finance an equity expansion that would render the bank fully solvent after the pay-out. But that once again amounts to using tax payers’ money to resolve a crisis that was a creation of the banks themselves.

Instances like Wells Fargo and DB either remind the world once more of the tasks set by the 2008-09 crisis that remain unresolved or of the unlearned lessons taught by that crisis. In sum, the severity of the 2008-09 crisis and the persistence of its aftereffects also resulted in a near-consensus on the need to re-regulate finance, though there were significant differences both on ‘what kind of regulation is feasible and appropriate?’ and on ‘how much needs to be done?’ However, while the crisis did yield an exercise that led up to the Dodd-Frank Act, the substance of that Act was considerably diluted while it was being negotiated and then further whittled down when implementation rules were being framed. With Finance having been successful in that venture, it now wants to go the whole hog. That explains the need for and contents of the Financial Choice Act of 2016, which was approved by the House Committee on Finance in mid-September 2016.

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