

The Financial Crisis and White Collar Crime

by

Professor Nicholas Ryder

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First thoughts

This mighty book by Professor Nicholas Ryder² of the University of the West of England, United Kingdom is a tome of a monograph, with its 334 pages of which over 100 pages consist of its extensive bibliography,³ evidence of the huge impact that the financial crisis has had, warranting this plethora of news, official reports, caselaw, new government policies, new regulatory agencies, television documentaries and statutory changes in many countries.⁴



Professor Nicholas Ryder: Google

A global financial crisis

The whole world is aware of this latest global financial crisis⁵ some to a deeper extent than others, but everybody has felt its negative effects and it can safely be said that all countries throughout the world have suffered to a greater or lesser extent because of this recent financial crisis caused in part by modern electronic global systems which acted when the collapse came, much like a tsunami of financial distress around the world. Despite attempts by many governments of the major countries to placate their people and persuade them that this crisis is over, there are

² Nicholas Ryder is also author of several other law books including *Financial crime in the 21st century*, Edward Elgar (2010).

³ Robert Bryce, "Millions of words have been written about the ongoing financial disaster largely caused by the ongoing subprime mortgage mess", *Texas Observer*, March 2008. See Morris, C.R., (2008) *The two trillion dollar meltdown: easy money, high rollers and the great credit crash*, New York: Perseus Books Group.

⁴ Germany's Penal Code; France's anti-terrorism laws; UK already had the Prevention of Terrorism Act 1974; the Anti-terrorism, Crime and Security Act 2001 and Counterterrorism Act 2008 and Crime and Security Act 2010.

⁵ There are thousands of media and web sources on the global financial crisis. These are important sources of information about crime mainly because, although not deep in detail, law or finance, they are the dominant source of public information about crime. Finch, E. and Fafinski, S. (2012) *Criminology*, Oxford: Oxford University Press, pages 78-102.

repercussions yet to be experienced by millions of people through their investments in pensions and other plans, not to mention war disruption and terrorist outrages such as had occurred in the past - the “9/11 terror attacks” on New York’s 110-storey World Trade Centre twin buildings, the symbol of American financial prowess.⁶ The insurance industry had to deal with insurance claims totaling \$50 Billion relating to property losses, injured people and other claims. As a consequence, the insurance industry capped potential future damages and increased insurance premiums in order to lessen any costs of future terrorist attacks.⁷



World Trade Centre Twin Towers, New York: Google.

As regards terrorism, financial institutions are a key target especially those involved in government-based work often against terrorists themselves. Also, terrorists have used bogus financial instruments and have undertaken financial crime to fund their activities. In July 2002, as an instance, a Mr Omar Shishani, a U.S citizen, was arrested by the U.S. Custom Service, on his arrival by aeroplane from Indonesia to Detroit. He was carrying nine counterfeit cheques totaling \$12 Million. They were

⁶ Hundreds of billions of dollars had to be spent in direct and indirect costs, notwithstanding the necessary emergency legal enforcement, political, social, legal, and military responses to terrorism. Alexander, D.C. (2004) *Business confronts terrorism: Risks and Response*, US: University of Wisconsin Press, pages 21-44.

⁷ Ibid 5. See pages 90-103.

discovered to be very sophisticated fake cheques purporting to have been issued by the Pomona, California, branch of West America Bank.⁸ The impact of “9/11” on the world economy was negative, especially in Japan and Europe because Japan and Europe had been, before “9/11” experiencing recessions. Mexico and Canada suffered subsequent economic downturn in their aviation, tourism, and hospitality economic sectors.

Corporate and executive greed and intense secrecy

Much of this crisis was due to greed; secrecy; tight networks; short sightedness; reckless and unregulated decision making; lack of proper corporate governance; electronic fraud⁹; accounting fraud; perjury; bribery; corruption; theft and other criminal and regulatory offences, and hedge fund frauds. Interestingly, at the time of the financial crisis, there was no legal definition of the term ‘hedge fund’¹⁰ in the United States federal securities laws because Congress had not defined it. However they were commonly termed in the media as ‘lightly regulated private investment vehicles’. Then came the ‘hedge fund bubble’. Yet, even today investors do not really understand the strategies used by hedge funds, much less the complex models that underlie them. However, there still are as many types of hedge funds today as the imagination can think of.¹¹ There are domestic hedge funds, offshore hedge funds, master-feeder hedge fund structures, incubator hedge funds and much more.

⁸ The bank did not have a Pomona branch. Ibid 5. See page

⁹ Fraud is defined in the Oxford English Dictionary as "the quality of being deceitful; criminal deception; the using of false representations to obtain an unjust advantage or to injure the rights or interests of another; a dishonest trick".

¹⁰ Editor, ‘Hedge funds: an emerging force in the global credit markets’, *Fitch Ratings Special Report*, 18 July 2005. Editor, ‘U.S financing gap: long-term gloom, not short-term stresses’, *J.P.Morgan Chase*, 21.9.2007.

¹¹ Gary Parkinson, ‘Bruised by Shire, hedge funds seek other targets’, *The Times Newspaper*, Saturday, 18 October, 2014, at page 52.

Collapse of gigantic corporations in the United States of America

As Professor Nicholas Ryder says in this book published by the most competent, contemporary and highly regarded of leading international publishers of academic books and journals in economics, finance, business and management, law, environment, public and social policy, Edward Elgar, we have seen news ricochet around the world and financial and economic damage to many countries due to the collapse of gigantic American corporations such as Worldcom¹², Enron¹³, Adelphia¹⁴, Bear Stearns & Co¹⁵, Fannie Mae¹⁶, Freddie Mac¹⁷, and Wall Street's Bernard L Madoff Investment Securities LLC¹⁸ among others. Lawyers worldwide used to be encouraged to "stick to the knitting", i.e. to specialise in a particular area of law. Whilst this is still necessary, lawyers must now think "holistically" at the same time and the Money Laundering law certainly has forced many to think again. After all,

¹² Worldcom's bankruptcy proceedings revealed high profile corporate governance failures and highlights the general counsel's primary duty as being to the company rather than to the chief executive officer ("CEO"). An analysis of this caselaw highlighted the need for general counsel to ensure that corporate governance practices are not breached by the dominant personality of the CEO. Giant companies, as do all companies, need robust and transparent reporting structures. Michael J. Missal, 'Corporate governance: in-house lawyers', *Practical Law Companies P.L.C.* (2006) Vol.17 No.2 Supp (Law Department Quarterly), pages 9-10.

¹³ Enron used securitisation which avoids the mark-up charged by an intermediary of hedge funds ('the shock absorbers of the financial markets) thus enabling a company to raise funds cheaply based on an allocation of risks that are assessed by parties having the most expertise. Enron had high risk that share prices could fall and that its asset values could fall. The difference between normal securitisation and Enron's manipulation of SPEs is that Enron had high risk that share prices could fall and that its asset values could fall. So, the structured transactions had dubious economic value whereas in most securitisation deals, the receivables are sold to SPEs with minimal recourse, so the SPE and its investor take the economic risks of collection and once the deal is closed nothing can happen to cause the risk allocation to be subsequently reversed.

¹⁴ When Adelphia Communications collapsed, John Rigas, CEO, resigned. However he was charged with 22 counts of fraud, one of which was a \$2 billion Adelphia guaranteed loan to John Rigas and his sons. Hidden in the company's accounts were debts of \$2.3 billion.

¹⁵ Bear Stearns in New York was ordered to pay US\$125million plus interest to the estate of Manhattan Investment Fund ("MIF") because Bear Stearns ignored clear signs that the MIF manager was defrauding investors.

¹⁶ Even after the stupendous fraud, manipulations and deceptions revealed at Fannie Mae, disconcerting findings concerning use of lawyers to lobby government came to light. Editor, 'Senior advisers Steve Schmidt and Mark McKinnon work for firms that have lobbied for Land O' Lakes, UST Public Affairs, Dell and Fannie Mae', *Washington Post*, 22 February 2008.

¹⁷ Fannie Mae was, until its demise on 6 September 2008, a publicly held company, the biggest corporation in the United States' \$3 trillion mortgage investment market and held one quarter of this secondary mortgage market for U.S. home loans. It is the second -largest issuer of debt in the U.S. after the federal government. Sally Ramage, 'Fannie Mae – A United States Government Sponsored Enterprise and a Complex, Securitised, Unregulated Bank', *Mondaq Legal Newsletter*, 25 February 2005, at <http://www.mondaq.com/article.asp?articleid=31149&hotopic=1>. See also Sally Ramage, 'Fannie Mae and Freddie Mac in Administration', *Social Science Research Network*, 1 September 2008 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1264786.

¹⁸ For 20 years committed securities fraud, mail fraud, wire fraud, money laundering, making false statements, perjury and theft to the tune of \$65 billion by running a major Ponzi scheme. Arvedlund.E. (2009), *Madoff: the man who stole \$65 billion*, London: Penguin Books. He was convicted and sentenced to 150 years in prison where he will die for his evil deeds of ruining thousands of lives.

the contracts devised in the Enron major scam were drafted in London by English lawyers. It is not only major scams, swindles and fraud that are the result of slack work in the legal and audit profession, but one's work may be aiding and abetting terrorism. We need to switch on our antennae not to police the world but to gain the experience that is needed to "smell a rat", so to speak. We need to also take the teaching of business ethics much more seriously. Corrupt professionals must be struck off with speed.

Terrorism

Terrorism can undermine public and market confidence and E-commerce and so banks must still make global continuity plans and in case of terrorists' bombs in banks, continue to promote Internet¹⁹ banking although that in itself is plagued with other threats such as electronic frauds. Terrorism as per UK law was defined in section 20 of the UK Terrorism (Temporary Provisions) Act 1989 which says that terrorism is the 'use of violence for political ends.' Then section 1 of the terrorism

Act 2000:

'(1)...the use of threat of action where-

Where the action falls within subsection (2),

*The use of threat is designed to influence the government or an international government organization or to intimidate the public or a section of the public, and
The use of threat is made for the purpose of advancing a political, religious, racial or ideological cause.*

(2) Action falls within this subsection if it-

(a) involves serious violence against a person,

(b) involves serious damage to property,

(c) endangers a person's life, other than that of the person committing the action, creates a serious risk to the health and safety of the public or a section of the public, or is designed seriously to interfere with or seriously to disrupt an

¹⁹ The problem still exists of hackers intercepting a person's banking transaction to obtain banking details. This is in part due to the massive increase of mobile technology. There were 195 million cellular subscribers in the year 2005 (Matt Richtel, 'Live tracking of mobile phones prompts court fights on privacy', *New York Times*, 10.12.2005).

electronic system.'

Many scholars have argued that both the above definitions are flawed,²⁰ however as far as financial crisis is concerned, the concern is regarding financial support in terrorism, and under English law, there is a procedure, under the Proceeds of Crime Act 2002, for forfeiture of terrorist property following a conviction. The purpose of such a procedure is not to prevent people from enjoying their property but to disrupt terrorist activity.



Jeff Skilling: Unscrupulous manipulator of Private Equity investments at Enron.



Andrew Fastow: Mastermind of Enron's Illegal financial products cynically given names such as SIV (simian immunodeficiency virus).

Banks collapsed in the US, Europe and Asia and elsewhere

We have also seen similar collapses of giant corporations around the world, not only in rich, developed countries like Germany, France, and the United Kingdom, but also in developing countries in Asia²¹ and elsewhere.

²⁰ One instance is in Stone, R. (2014) *Civil Liberties and Human Rights*, Oxford: Oxford University Press.

²¹ Asia was affected because the Bank of China was the fifth largest bank in the world (by market capitalization) in February 2008.

Financial crisis linked to white collar crime

What is the link between financial crisis and white collar crime? Readers of this review will need to read Nicholas Ryder's very readable and engaging book to find out. However one factor that looms large was the London Interbank Offered Rate ("LIBOR") which was known to have been consistently manipulated for decades, but which criminal acts only came to light when the whole system collapsed. Other factors among those that Professor Ryder has included in his book, are accounting fraud and mortgage fraud, propping up reckless lending, hundreds of billions of dollars of bridging loans; deal financing and securitisation and re-securitisation, which all affected the British hedge fund manager Caliber²², the Northern Rock Building Society, the Royal Bank of Scotland Group plc, Lehman Bros, Credit Suisse bank, Deutchebank, BNP Paribas bank, Commerzbank, IKB Deutsche Industrie bank, Australian banks and many others. Other banks committed criminal fraud and conspiracy to defraud, misrepresentation, false accounting²³ and much more.



²² The hedge fund is one method of facilitating cross-border frauds, primarily due to the intense secrecy in the global hedge industry.

²³ Relating to the UK, the Fraud Act 2006 repealed the Theft Act 1968, section 17 (as from January 15, 2007) false accounting offence. False accounting is today a serious criminal offence under the Companies Act 2006. Transitional provisions in relation to any liability, investigation, legal proceedings or penalty for, or in respect of, any offence partly committed before that date are as per Schedule 2, para.3 of the Companies Act 2006. In 2014, in the UK, false accounting charges are being dealt with through "Deferred Prosecution Agreements"; "Serious Crime Prevention Orders" and other means where possible.

Inter-company short-term borrowings between the top banks took place in massive amounts of money at miniscule interest rates. Because of the billions borrowed at a time, this was risky, extreme leverage. When suddenly, the interest rate spiked in September 2008 by 20% from 5 to 6%, catching them all by surprise, a shadow-market²⁴ was also revealed of unrecorded shadow re-borrowing to the sums of trillions.²⁵ In Europe many SIVs were liquidized. Citi and Merrill Lynch banks held over \$20 billion of this paper, of which there were \$900 billion out there. Citi and Merrill Lynch were doomed and the government of Abu Dhabi lent them \$7.5 billion, but at 11% interest coupon. All of this was basically very reckless high-risk gambling. All the while banking executives were left unhurt, many receiving the handsome financial packages they were contractually entitled to when they left.

²⁴ This is what is known as lending from capital markets: investment banks, etc, when credit vigilance is suspended, instead of being tightly controlled. Morris, C.R. *(2008) *The two trillion dollar meltdown*, New York: Perseus.

²⁵ These financial products were called SIV perhaps in jest (simian immunodeficiency virus which affects apes and monkeys). These papers were in addition to the multitrillion CDO and the synthetic CDO market. Brokers have a sense of humour- Enron

LIBOR

The equivalent in Europe including in the UK, is known as LIBOR, an average interest rate calculated through submissions of interest rates by major London banks, which had been fraudulently manipulating their rates so as to profit from trades, and to give the impression that they were more creditworthy. The shock was that LIBOR underpins approximately \$350 trillion in derivatives. Thankfully, since January 2014, LIBOR is now overseen by NYSE Euronext and hopefully such white collar crimes will not be seen again.

History repeating itself with modern tools

However, we need not feign shock at all these almighty catastrophic shenanigans because the world has suffered similar financial crises in the past, but not the whole world at the same time, apart from war, since we were not yet electronically networked to the extent that we are at this time in history. History records the shenanigans of Ivan Boesky²⁶; Charles Ponzi²⁷; the ‘common practice’ which the English Guinness serious fraud case uncovered; the Japanese banking scandal; the American “Daisy Chain” which decimated America; and many more.

²⁶ Ivan Boesky gambled tens of millions of dollars on risky security deals. He was a law graduate who worked in New York for various stockbrokers and discovered the risk arbitrage world and in the sixties he accumulated \$700,000 with which he formed his own arbitrage firm. By the seventies he was worth \$2 Billion because his riches were due to insider trading. In May 1986, FBI fingered Bernard Levine, who told about Ivan Boesky who ‘whistleblew’ on those who gave his insider information, including the giant firm Drexel Burnham Lambert. For this plea bargain, he received a lenient three year prison sentence and a fine of \$100 Million.

²⁷ Charles Ponzi was an Italian who emigrated to America in 1899 at 22 years old. His fraud started off when he legitimately bought up “international postal-union reply coupons” at depressed prices in certain foreign countries and sell them in the United States at a profit of 50%. Then he decided to deal in massive amounts in order to make a hue profit quickly, so he needed a large capital sum. He successfully advertised his wealth and prospective wealth of all persons who put to capital in his charge and money rolled in from all and sundry- money he used to pay profits to earlier “investors”, until the Boston Post newspaper investigated him and discovered his past life as a dishwasher, ex-forgery, and ex-smuggler, with a criminal record. Typically, Charles Ponzi, now the dandy, had big-gun lawyers file lawsuits against the newspaper, but he was charged and convicted of mail fraud, totally some \$10 Million (small beer compared to today’s banking fiasco) and he was imprisoned for 11 years in total, and then deported to Italy. He died a sick pauper in Brazil in 1949.

Conclusion

Nicholas Ryder's book, *The financial crisis and white collar crime*, is pretty exhaustive in its description of the financial crisis and deserves a place among the reference books relating to the global financial crisis. I heartily recommend it, but my feeling is that we have not seen the last of this crisis. Vigorous legal changes and implementation of policies is needed rather than the slow piecemeal way those changes are taking place. We must never again be lulled with sweet talk by confidence tricksters. There used to be an old school motto which stated: 'Everything worth doing is worth doing well.' Lawyers today cannot afford to specialise without also taking a holistic approach to their work - because life is not compartmentalised. The trouble with the professions of law and accountancy is that they are compartmentalised, causing the right hand not to know what the left hand is doing, or, in other words, full transparency and accountability is needed, along with vigorous punishment implemented to deter others from trying to commit white collar crime to any scale.²⁸ Fraudsters are cunning and manipulative and until a crash occurs, only a whistleblower from the inside can possibly alert the regulatory authorities. This global financial crisis must be studied and understood from a criminal law viewpoint of mens rea, actus reus, conspiracy, professional ethics, corruption, fraud and theft. This is a sober lesson for all to learn how such fraud offences can be prevented. Professor Ryder has excelled himself in writing this book.

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²⁸ Editor, 'Sovereign Wealth Funds: the new bogeyman of International Finance'. *Economist Intelligence Unit*, 4 July 2007.

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