

From Wall Street to Crawl Street

Markets punish greedy manipulators

Wall Street – A castle to rip people off

“That Wall Street has gone down because this is justice,” says Steve Eisman, manager FrontPoint Partners, a Wall Street hedge fund: “They fxxxxd people. They built a castle to rip people off”.

In 1902, Franklin Keyes, a prominent Wall Street lawyer once said: “Wall Street speculation fosters a ring of idle gamblers, parasites upon society, who prey upon the fortunes of the honest and industrious; such people are a menace to the legitimate business interests of the country and an element of danger to the republic.”

The Satyam fraud characterizes that corporate greed that has infected the world financial system. The frauds sit in corporate books ticking like time bombs on river beds waiting to go off as the tide goes out. They persist because the perpetrators think that they are too smart or too well connected to get caught. Both Raju and Madoff belonged to the same ilk. They forgot how internet has empowered investors and spurred activism. Satyam fraud would never have seen the light of the day but for the diligence and courage of a determined group of investors. The board had already passed the resolution on 16 December 2008 unanimously to acquire promoter’s son’s property companies to provide a cover for the cash hole and give a fresh lease to his guile in siphoning off investor’s funds.

The essential story of all fraudsters - Long Term Capital Fund, Ivan Boesky, Enron, Worldcom, Parmalat, Hollinger et al is the same. They choose cosy and pliable people brimming with greed as auditors and independent directors, cooks books to show great growth, offers fabulous returns to investors and shareholders by fudging accounts. Extra cash keeps everyone in thrall including governments and regulators who play bets on his stellar performance. As the going gets tough and the boss runs out of options and makes a clean confession. There is a din of shock and horror. New laws are passed. Tougher than before. Everyone is satisfied and things go back to normal.

Satyam investors and employees thought their company was gilt-edged

Satyam has shocked the world and interrupted India’s narrative. It has shattered the dreams of hundreds of thousands of investors and employees who thought their company was gilt edged. They wonder how a billion dollars could disappear from the company accounts certified by one of the world’s best auditing company supervised by a board that listed names from Harvard who’s who as independent directors. Only last year they were told that the company’s earnings performance was the best among its competitors.

Self-denial, blame game, parochial national interests and political patronage feed frauds

Lot of western media is using this scam to snipe at India’s outsourcing strength and blaming it on its lax rules in corporate governance little realizing that Satyam is listed on NYSE and subject to one of the world’s most stringent controls under Sarbanes Oxley Act signed by President George Bush on 30 July 2002. The act makes both the CEO and CFO personally responsible for the accuracy of their financial statements. Lest they claim ignorance, the act casts personal responsibility on both CEO and CFO for designing and monitoring controls that ensure all material information is made available to them. It also enhances the responsibility of the auditors in terms of the quality and independence of audits. The penalties for violation are draconian – 20 years prison sentence besides \$20 million fine.

The clever lot who fooled all of us all the time

When Satyam boat was drowning in the aftermath of that ill-fated resolution of 16 Dec 2008 acquiring Maytas Properties and Maytas Infra – property companies owned by promoter’s son – Mr Raju sought refuge by asserting Satyam was the winner of Golden Peacock Award for Corporate Governance.

Admittedly Satyam did win the award in one of the categories but this would amount to Bernie Madoff claiming that he was after all the chairman of NASDAQ . Or John Thain claiming he was the wizard of Wall Street from time immemorial. All this shows how clever these guys have been in fooling all of us all this time. It is only now that the world has found out that John Thain, the celebrated rescuer of New York Stock Exchange is one of the 9 architects of Wall Street's destruction.

It is nice of British Foreign Secretary, David Miliband to return the hospitality of his hosts and be charitable to say "I don't believe that one bad apple means that the whole barrel is rotten." The unfortunate fact is that Satyam is not just one rotten apple. And that this rot is not country specific. Satyam scam is a microcosm of the unregulated and unbridled greed that has infected the capital markets worldwide and indeed is the main cause of the current meltdown. The only saving grace is that despite its well known endemic corruption, Indian government has moved swiftly to put the main culprits including auditors behind bars within days of his confession and instituted cases against the board including independent directors. His US counterpart, Bernie Madoff, whose scale of fraud is infinitely larger is still living in the luxury of his swanky penthouse in Manhattan. The issue is not relativity of the criminality but capturing the gravity of the rot in its global context.

Culture of cosiness, conceit, concealment and corruption unmasked by public scrutiny

With 40,000 blogs and similar number of home videos uploaded everyday on YouTube and other internet sites, all this has changed. Markets have become clever and started taking revenge. Marketers could not let the likes of Jimmy Cayne, John Thain, John Mack, Richard Fuld, Angelo Mozilo, Phil Gramm and Hank Paulson – all named as “The Architects of Destruction” in a special report by Wealth Daily Investment Research of Baltimore, get away with their booty. The strobe like glare of public scrutiny wrested the veil of secrecy and unmasked their misdeeds and exposed the culture of cosiness, conceit, concealment and corruption that has characterized the financial markets. The cat was let out of the bag by the long queues outside a seemingly robust British Bank – Northern Rock over 18 months ago. Soon thereafter the French Bank, BNP Paribas froze withdrawals from three of its funds.

Citigroup which in 2003 was a behemoth with \$250 billion of assets is only a fraction of that at \$38 billion. Its boss Chuck Prince was chucked out. Despite all the help from Phil Gramm, a US Presidential hopeful, or perhaps because of it , UBS, his benefactor Swiss bank, had to write down \$19 bn debts resulting in the sacking of UBS's boss. UBS is currently being investigated for a massive tax evasion. The manipulators and fraudsters have nowhere to hide in this economy of strobe like glare. Markets were waiting with bated breath for holding the guilty accountable. With insider knowledge markets are using the same instruments to bust the last refuge of scoundrels – shorting the sub-prime and the property market to pulverise their asset values.

Market's retribution to the architects of meltdown

Within a span of next 12 months the heads of the world's 5 biggest investment banks - James Cayne of Bear Stearn, Richard Fuld of Lehman Brothers, Blankfien of Goldman Sachs, John Thain of Merrill Lynch and John Mack of Morgan Stanley lost combined personal wealth to the tune of \$2.2bn. Other fraudsters have been given the boot. Markets are in turbulence only because there are still several at large. It will calm down once all have been held to account.

Perfecting the art of HNTGC – (How Not To Get Caught)

Mr Henry Paulson, the outgoing Treasury Secretary, worked in the office of President Nixon in the early seventies. Mr Nixon who was successfully impeached for Watergate Scandal used to say “You can disobey all Ten Commandments as long as you follow the eleventh one: “thou shalt not be found out”. This maxim created a breed of executives whose success depended not on doing the right thing but manipulating success at all cost by perfecting the art of HNTGC (How Not To Get Caught). As the rules got more and more complex you needed young executives who were brighter and communicative enough to master the art of HNTGC. So these financiers queued up outside best business schools to recruit such executives at remunerations that were a King's ransom. Hence today's financial world is replete with Harvard and other Ivy School MBAs. It is these bright MBAs who used their creativity and innovation in

designing mathematical models to unleashed an insatiable appetite and turned into weapons of massive destruction.

Financial analysts had no training and no clue

In a recent interview to Bloomberg, Harvey Pitt , a former chairman of Securities and Exchange Commission, lamented how appalled he was to see young MBA executives being recruited at outrageous salaries to deal with much older and much more experienced fund managers. He said “these financial analysts had no training and no clue to what was going on”.

Wall Street – A factory of unethical practices

Michael Lewis author of *Liar’s Poker*, chronicles the excesses of Wall Street in a recent article in *Conde Nast Portfolio*. “The outrageous bonuses, the slender returns to shareholders, the never-ending scandals, the bursting of the internet bubble, the crisis following the collapse of Long-Term Capital Management: Over and over again, the big Wall Street investment banks would be, in some narrow way, discredited. Yet they just kept on growing, along with the sums of money that they doled out to 26-year-olds to perform tasks of no obvious social utility. The rebellion by American youth against the money culture never happened.”

He continues “The essential function of Wall Street is to allocate capital—to decide who should get it and who should not. Believe me when I tell you that I hadn’t the first clue. I’d never taken an accounting course, never run a business, never even had savings of my own to manage. To this day, the willingness of a Wall Street investment bank to pay me hundreds of thousands of dollars to dispense investment advice to grownups remains a mystery to me. I was 24 years old, with no experience of, or particular interest in, guessing which stocks and bonds would rise and which would fall.”

Michael Lewis describes the excesses of Wall Street of the eighties in his book *Liar’s Poker* to dissuade young MBA graduates to join the financial profession. Unfazed by all this , 6 months after the publication of the book he is “knee-deep in letters from students at Ohio State who wanted to know if I had any other secrets to share about Wall Street. They’d read my book as a how-to manual”

Unbridled greed due to poor securitization and remuneration model

The unbridled greed of the market manipulators that took the form of financial innovations such as derivatives, MBS, CDOs ostensibly intended to spread the risk is unmatched in its reach and magnitude. It destroyed all credibility and trust and is the real reasons behind this credit crunch. Despite central banks bailing out the banks, banks have stopped lending even to each other. As such ordinary tax payers are underwriting the excesses of monied class whose take home packages have been King’s ransom.

The current securitisation and remuneration model is packed with greed, opacity and irresponsibility. It reduces the incentive for the originator of the claims to monitor the creditworthiness of the borrower. Every intermediary in the chain is interested only in its fee and eventually transfers the credit risk to those least able to understand it and bear it.

CDS – a Wall Street Ponzi Scheme

No market instrument has caused so much havoc in financial history as the credit default swaps. The aim of the article is to present an insider view of the Shenanigans of Wall Street. For this I have had to quote verbatim conversations of parties and need to be forgiven for the language. According to the International Swaps and Derivatives Association, the total value of credit default swaps (CDS), at one stage was staggering \$64 trillion. A credit default swap is, essentially, an insurance contract between a protection buyer and a protection seller covering a corporation’s or sovereign’s specific bond or loan. A protection buyer pays an upfront amount and yearly premiums to the protection seller to cover any loss on the face amount of the referenced bond or loan. Fundamentally, this kind of derivative serves a real purpose - as a hedging device. The actual holders, or creditors, of outstanding corporate or sovereign loans and bonds might seek insurance to guarantee that the debts they are owed are repaid.

Risk speculators who wanted exposure to certain asset classes - bonds, loans, or security pools such as residential and commercial mortgage-backed securities, including subprime mortgage-backed securities that you've been reading about, but didn't actually own the underlying credits, now had a means by which to speculate on them. In the end credit default swaps turned out to be a Wall Street Ponzie scheme far bigger and far more lethal than that of Bernie Madoff.

This is what precisely befell AIG. There's nothing wrong with AIG's insurance subsidiaries. What happened to AIG is simple: AIG got greedy. AIG, as of June 30 2008, had written \$441 billion worth of swaps on corporate bonds, and worse, mortgage-backed securities.

The Fed could not let Bear Stearns enter bankruptcy because the trillions of dollars of credit default swaps on its books would be wiped out. All the banks and institutions that had insurance written by Bear would not be able to claim that they were insured or hedged anymore. They would have to write-down billions and billions of dollars in losses.

Grilling of Greenspan by Lawmakers

In recent Congressional hearings, Mr Greenspan conceded that the use of exotic financial instruments called, derivatives, had gotten out of control and that the multitrillion-dollar credit default swaps, instruments originally created to insure bond investors against the risk of default, needed to be restrained.

"This modern risk-management paradigm held sway for decades," he said. "The whole intellectual edifice, however, collapsed in the summer of last year."

Now 82, Mr. Greenspan came in for one of the harshest grillings of his life, as Democratic lawmakers asked him time and again whether he had been wrong, why he had been wrong and whether he was sorry.

For years, a Congressional hearing with Mr Greenspan was a marquee event for corporate America. Lawmakers doted on him as an economic wizard, a saviour of capitalism. Markets jumped up or down depending on what he said.

Self-correcting powers of free market failed, says Mr Greenspan

The hearings following the meltdown were a different cup of tea – perhaps his life's most humiliating experience. In intense exchange with Representative Waxman, Chairman House Committee on Oversight and Government Reform, Mr. Greenspan admitted that he had been wrong in believing in the self-correcting power of free markets, repeating what Eliot Spitzer said four years ago as the Advocate General of New York. He conceded he had failed to anticipate the self-destructive power of wanton mortgage lending. He added,

"Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief"

Repeated warnings from WCFCG ignored

He need not claim such state of shocked disbelief because we forecast that through our research and Corporate Governance journal repeatedly emphasized the dangers we were heading unless we brought transparency in the capital market and improved quality of disclosure. In the August 2007 issue of our Corporate Governance journal we wrote:

"It is the rolling back of regulation that added opacity in the markets and allowed hedge funds to act aggressively and irresponsibly. Markets became jittery only because following the subprime lending crisis nobody knew who had lost what. Market valuation of CDOs (Collateral Debt Obligations) and CLOs (Collateralised Loan Obligations) are presumptive. The exposures are not objectively validated. Banks behind the subprime loans had sold the debt to other banks and specialised funds known as CLOs and hedge funds exposing them to billions of dollars of debt when mortgagees defaulted."

It is therefore naïve to suggest that self-regulation can work in the markets. In an interview to Wall St. Journal, Eliot Spitzer, the former Attorney General of New York, said: "The honor code among CEOs didn't work. Board oversight didn't work. Self-regulation was a failure". The situation today shows no change.

In the same issue we warned:

"The rules of the game in the financial markets are set up solely to benefit the financiers whether in London, New York or Hong Kong. Globalisation today appears to be run in the interest of big monied class which has western governments in its thrall."

Warnings of speculative bubble

We called for the end of rolling back of regulation and warned of speculative bubble. We suggested:

"Interpol should make arrests in New York, London, Tokyo, Beijing, Frankfurt and Paris, starting with all the executives in the credit-rating agencies who blithely ranked the debt as creditworthy in exchange for fat fees and freebies from the very banks who were making the absurd loans. Governments should bring suits against the executives involved, the repositories of vast personal wealth, to help repair the hole in private and public balance sheets."

Greenspan – the main architect of the meltdown

As the Fed slashed interest rates to nearly record lows from 2001 until mid-2004, housing prices climbed far faster than inflation or household income year after year. By 2004, a growing number of economists were warning that a speculative bubble in home prices and home construction was under way, which posed the risk of a housing bust.

Mr. Greenspan brushed aside worries about a potential bubble, arguing that housing prices had never endured a nationwide decline and that a bust was highly unlikely.

Mr. Greenspan, along with most other banking regulators in Washington, resisted calls for tighter regulation of subprime mortgages and other high-risk exotic mortgages that allowed people to borrow far more than they could afford and is the architect of the market meltdown

However Mr Greenspan placed far more blame on the Wall Street companies that bundled subprime mortgages into pools and sold them as mortgage-backed securities. Global demand for the securities was so high, he said, that Wall Street companies pressured lenders to lower their standards and produce more "paper." "The evidence strongly suggests that without the excess demand from securitizers, subprime mortgage originations (undeniably the original source of the crisis) would have been far smaller and defaults accordingly far lower," he said.

Phil Gramm turned capital markets into Wild West

In an article in The New York Times of 16 Nov 2008, Eric Lipton and Stephen Labaton described Mr Phil Gramm, the single most important reason for the current financial crisis. Regarded as the Unswayed Champion of Deregulation, Mr Gramm pushed laws that injected virus of greed in venerable institutions. He pushed through a provision that ensured virtually no regulation of the complex financial instruments known as derivatives, including credit swaps, contracts that would encourage risky investment practices at Wall Street's most venerable institutions and spread the risks, like a virus, around the world. The resulting lack of oversight has turned the orderly capital markets into the Wild West. The deregulation set in motion with the passage of Commodity Futures Modernisation Act created a financial Armageddon through a system of incentives that channeled the greed of an industry that never had any conscience.

In 2001, a year after passage of the commodities law, the derivatives market insured about \$900 billion worth of credit; by last year, the number had swelled to \$62 trillion.

"Recession is only mental – America is a nation of whiners"

In an interview on 11 July 2008 Mr Gramm said "Recession is only mental. America is a nation of whiners." Many experts feel that passage of Commodity Futures Modernisation Act that has led to the current grief of market meltdown. They say the lack of oversight left the system vulnerable and allowed abuses that have threatened the global economy.

Looser regulation had no role according to Phil Gramm

A detailed portrayal of Mr Gramm became necessary because of the shrill voices of deregulation that still rent Wall Street. Mr Phil Gramm insisted "looser regulation had no role. It was simply an emerging myth. There is this idea afloat that if you had more regulation you would have fewer mistakes." He said. "I don't see any evidence in our history or anybody else's to substantiate it." He added, "The markets have worked better than you might have thought."

But Michael D. Donovan, a former S.E.C. lawyer, faulted Mr. Gramm for his insistence on deregulating the derivatives market. He said of Mr Gramm "He was the architect, advocate and the most knowledgeable person in Congress on these topics," Mr. Donovan said. "To me, Phil Gramm is the single most important reason for the current financial crisis."

Paul Krugman on Phil Gramm

2008 Nobel Laureate in Economics Paul Krugman, a supporter of Barack Obama, described Gramm during the 2008 presidential race as "the high priest of deregulation," and has listed him as the number two person responsible for the economic crisis of 2008 behind only Alan Greenspan. On October 14, 2008, CNN ranked Gramm number seven in its list of the 10 individuals most responsible for the current economic crisis.[16] In January 2009, The Guardian's City editor Julia Finch identified him as one of twenty five people who were at the heart of the financial meltdown.

Mr Phil Gramm epitomised a peculiar relationship that has existed in US between the monied class and politician. Being a presidential contestant and having served as a Republican senator on the Capital Hill from 1984 from Texas, he moved in 2002 to join UBS as a senior investment banker and head of the company's lobbying operation. Mr. Gramm, now 66, who declined to discuss his compensation at UBS, picked an opportune moment to move to Wall Street. Major financial institutions, including UBS, were growing, partly as a result of the Gramm-Leach-Bliley Act which he pushed to become law. But this hegemony too was found out and UBS paid heavily for its involvement in toxic assets.

Financial Plutocracy and Crony Capitalism

Such financial plutocracy has been unique the US financial system. The current issue of Conde Nast carries an interesting story of 'conspiracy' of Goldman Sachs to take over the US financial system. Goldman Sachs has always been envied as the holy grail of investment banking and has managed to remain one up all through its history.

Mr Bush's Treasury Secretary Hank Paulson who together with Mr Bernanke was the architect of the biggest bailout of banks in history is a former Goldman CEO. In fact most readers would still remember John Ehrlichman who was worked in President Nixon's office. Henry Paulson served John Ehrlichman from 1972 to 1973, during the events of the Watergate scandal for which Ehrlichman was convicted, and sentenced to prison.

Hank Paulson's replacement at Treasury, Tim Geithner, was mentored by Goldman alumni. Mario Draghi, who is leading the crisis response for the EU is a former Goldman Vice Chairman. Ad Liddy, the new CEO of AIG, was Goldman's Vice Chairman.

World Bank President Robert Zoellick was a Managing Director, Mr Niel Kashkari, 35 year old young man charged to oversee the \$700 bn TARP was also a Vice President of Goldman.

Back in 2000, when Paulson was CEO of Goldman Sachs, he testified in front of the Security and Exchange Commission. Among other things, Paulson lobbied the SEC to enact a "change to self-regulation" for Wall Street.

Paulson remains a Wall Street insider and still maintains close friendships with higher-ups of the bailout beneficiaries. The proposed bill would give the United States Treasury Secretary unprecedented powers over the economic and financial life of the U.S.

TARP being spent on short sellers

It is important to internalise how this TARP (Troubled Assets Relief Programme) is being spent. Smart hedge fund managers like Steve Eisman of a hedge fund called Front Point Partners identified pools of subprime which had no money down and no documentation and started shorting them. They would pay Goldman Sachs and Deutsche Bank X% of the principal amount a year, say 10% or 8%. In exchange, if the subprime mortgage pool busts, Deutsche Bank or Goldman Sachs has to pay Steve Eisman the whole principal. So, if he is betting on, say \$500 million of subprime mortgages, and he wants to short them, he pays \$5 million a year to do that, but if all of a sudden they go bad, they have to pay him \$500 million.

So, he shorted the subprime mortgage market by picking the best – “the juiciest short”. And what is amazing is that these firms have created this casino of bets which are bigger than the kitty.

That market was to go bust was plain common sense

Meredith Whitney was another Wall Street trader mentored by Steve Eisman in his days with Oppenheimer Securities who saw it coming. Whitney was an obscure analyst until on October 31, 2007, ceased she predicted that Citigroup had so mismanaged its affairs that it would need to slash its dividend or go bust. It's never entirely clear on any given day what causes what in the stock market, but it was pretty obvious that on October 31, Meredith Whitney caused the market in financial stocks to crash. By the end of the trading day, a woman whom basically no one had ever heard of had shaved \$369 billion off the value of financial firms in the market. Four days later, Citigroup's C.E.O., Chuck Prince was chucked. In January, Citigroup slashed its dividend.

Bailouts getting berserk

In November, after Citi Group's stock dropped more than 60% in one week, in comes Paulson and injects \$20bn US tax payer's hard earned money into Citi adding to the \$25bn already committed. US has 34 million poor who cannot pay their health insurance. Think how many of them could have been helped with this money?

Using TARP to pay Eisman

So when you look at what is going on with these bailouts funded by tax payers you feel livid why the Treasury and the Fed are throwing away good money - throwing \$150 billion at AIG to prevent it from going bust and you ask why is an insurance company getting \$150 billion in this crisis? This is because Goldman Sachs, having taken Steve Eisman's side bet, turned around and laid it off on AIG. And AIG greedily ensured the subprime mortgage market. So, what the Treasury is doing is paying off AIG's bad debts to Goldman Sachs, so Goldman Sachs can pay to Steve Eisman.

Bailouts enriching Madoffs

Ask yourself would you trust your money to someone who was giving it away to bail out people who were compulsive gamblers simply because he had a cosy golfing connection with them? How is packaging a 720K loan, to a migrant worker earning 14k a year, into a AAA rated bond any different from what Bernie Madoff has done. Either everyone involved in the former should go to the slammer or Bernie should get TARP funds to repay his investors.

Commodity Futures Modernisation Act – Race to the Bottom in Regulation

Wall Street has always been fearful of its own incompetence and nepotism. It has always argued that too many restrictions would hurt financial activity and spur traders to take their business overseas. In the final days of the Clinton administration Mr. Gramm, determined to close the door on any future regulation of the emerging market of derivatives and swaps, helped push through legislation that accomplished that

goal. He was the architect of the Commodity Futures Modernization Act which was passed unanimously as part of a larger bill thanks to the domination of Mr Gramm in the Senate debate.

“This legislation is important to every American investor,” he said at the time. “It will keep our markets modern, efficient and innovative, and it guarantees that the United States will maintain its global dominance of financial markets.”

John Thain – the Wizard of Wall Street

The financial headlines read a lot differently only a year ago for John Thain... "The Man Who Saved Merrill" and the "Best Paid CEO of 2007" (\$81.3 million total compensation), just to name a few. Today's he's just "the guy at the helm" when the Merrill ship went down... another high-profile financial that bloodied its fingers in subprime and paid the price. Thain has been accused of misleading investors over a span of months as Merrill took hit after hit, insisting the firm was well-capitalized. Among Thain's now-infamous quotes during his company's historic swan dive: "We're very confident that we have the capital base now that we need to go forward in 2008." (January 18, 2008 -- quoted by the New York Times)

"...Today I can say that we will not need additional funds. These problems are behind us. We will not return to the market." (March 8, 2008 -- France's Le Figaro newspaper)

v And by July 18, 2008, after Merrill Lynch wrote down \$9.4 billion and sold a 20% stake in Bloomberg, Thain said, "We believe that we are in a very comfortable spot in terms of our capital."

Begging from a Private jet

Truth was, the company was writing down \$5.7 billion more and wanted to offer \$8.5 billion worth of shares. And here's the kicker. Just recently, Thain redefined the "performance-based bonus" by lobbying (unsuccessfully) the Merrill board for a cool \$10 million... by actually insisting that he saved a fortune in shareholder money... simply by selling the company to Bank of America. That's the same kind of delusion leaders of Detroit's Big 3 must've been under... after flying into Washington by private jet to beg for a bailout. Surprise, surprise it worked.

Platinum Parachutes

- John Thain: A swank new title: President of Global Banking, Securities and Wealth Management at Lehman's rescuer, Bank of America. That was until Thursday, January 22, 2009 when Thain was given the boot.
- In December 2003, interim chairman John Reed at the New York Stock Exchange told The Wall Street Journal that Thain would be paid "a plain vanilla number", about \$4 million a year including bonus, with no "strange retirement" program like the one former NYSE CEO Dick Grasso was given.
- Upon joining Merrill Lynch, Thain received a \$15 million signing bonus. The firm announced that Thain would receive at least \$50 million per year in compensation and could be paid as much as \$120 million a year, based on the company's stock price. The Associated Press,[1] in 2007 found Thain as the best paid among the executives of S&P 500 companies, as he had received \$83.1 million in compensation.
- Thain suggested to directors that he receive a bonus in 2008 of as much as \$10 million, because he "saved Merrill" by selling it off to Bank of America. After the compensation committee at Merrill resisted the request, Thain reportedly dropped his request on December 8, 2008.
- On January 16 2009, Bank of America announced that Merrill suffered an unexpected loss of \$15 billion for the fourth quarter of 2008, nearly collapsing BofA's purchase. Bank of America CEO Ken Lewis said that without \$138 billion in government assistance, including the infusion of \$20 billion from the federal government he would have pulled out of the Merrill deal, which was approved by BofA shareholders in early December. Thain had come under pressure after several top executives at

Merrill, including brokerage chief Bob McCann and investment banking head Greg Fleming, abruptly resigned from the firm citing differences with Thain. People close to Lewis say his relationship with Thain was further strained by Merrill's massive fourth quarter loss. Lewis himself had faced criticism for rushing to buy Merrill for \$28 billion after less than two days of due diligence.

- On January 22, 2009, at CNBC's The Call, Charlie Gasparino reported that Thain was going to meet Lewis later in the day. Gasparino added that Thain's future at Bank of America was in doubt, although it was not certain whether he would be leaving. Gasparino then reported that Thain spent \$1.22 million to refurbish his office, shortly after he was named as CEO of Merrill in January 2008.[14] Merrill was still an independent firm at the time, and some analysts forecast that, with Thain as new CEO, the company would be back on track for a strong performance in the midst of disappointing results on Wall Street.
- The tension between Thain and Lewis had been building since mid-December and culminated on January 22, 2009 when Lewis flew to New York to meet with Thain. After a 15-minute conversation between the two men, Thain agreed to resign.

Comments by President Barack Obama

- On January 23, 2009 President Obama referred to John Thain by saying "the reports that we've seen over the last couple of days about companies that have received taxpayer assistance then going out and renovating bathrooms or offices or in other ways not managing those dollars appropriately." President Obama's press secretary Robert Gibbs also said taxpayer money shouldn't go to "line the pockets of people" who've gotten financial assistance. "The American people need to be greatly assured that their hard-earned money is not going to the bonuses or the remodeling of an office at a bank that's in trouble," Gibbs said.
- On January 29, 2009 President Obama publicly criticized the large bonuses such as those handed out by Thain. President Obama said: "I saw an article today indicating that Wall Street bankers had given themselves \$20 billion worth of bonuses at a time when most of these institutions were teetering on collapse and they are asking for taxpayers to help sustain them, and when taxpayers find themselves in the difficult position that if they don't provide help that the entire system could come down on top of our heads -- that is the height of irresponsibility. It is shameful. And part of what we're going to need is for folks on Wall Street who are asking for help to show some restraint and show some discipline and show some sense of responsibility. The American people understand that we've got a big hole that we've got to dig ourselves out of -- but they don't like the idea that people are digging a bigger hole even as they're being asked to fill it up." Vice President Joe Biden also said the bonuses "offends the sensibilities. I mean, I'd like to throw these guys in the brig."
- On January 27, 2009 New York Attorney General issued a subpoena to John Thain in a probe into the bonuses he paid and received just days before the BofA takeover. Charges of criminal fraud against those involved in the payouts could be brought under the Martin Act.

Wall Street – An Engine of Doom

I take liberty of quoting Mr Michael Lewis from his piece called The End of Wall Street's Boom featuring in Condé Nast Portfolio.com. Michael Lewis writes:

"I stumbled into a job at Salomon Brothers in 1985 and stumbled out much richer three years later, and even though I wrote a book about the experience, the whole thing still strikes me as preposterous—which is one of the reasons the money was so easy to walk away from. I figured the situation was unsustainable. Sooner rather than later, someone was going to identify me, along with a lot of people more or less like me, as a fraud. Sooner rather than later, there would come a Great Reckoning when Wall Street would wake up and hundreds if not thousands of young people like me, who had no business making huge bets with other people's money, would be expelled from finance."

The rebellion by American youth against the money culture never happened. Why bother to overturn your parents' world when you can buy it, slice it up into tranches, and sell off the pieces?

Most important financial people are either lying or deluded

There's a long list of people who now say they saw it coming all along but a far shorter one of people who actually did. Of those, even fewer had the nerve to bet on their vision. A handful of people had been inside the black box, understood how it worked, and bet on it blowing up. Whitney rattled off a list with a half-dozen names on it. At the top was Steve Eisman.

Eisman entered finance about the time I exited it. He'd grown up in New York City and gone to a Jewish day school, the University of Pennsylvania, and Harvard Law School. In 1991, he was a 30-year-old corporate lawyer. "I hated it," he says. "I hated being a lawyer. My parents worked as brokers at Oppenheimer. They managed to finagle me a job. It's not pretty, but that's what happened."

Eisman - From proof reader to lead Analyst

He was hired as a junior equity analyst, a helpmate who didn't actually offer his opinions. That changed in December 1991, less than a year into his new job, when a subprime mortgage lender called Ames Financial went public and no one at Oppenheimer particularly cared to express an opinion about it. One of Oppenheimer's investment bankers stomped around the research department looking for anyone who knew anything about the mortgage business. Recalls Eisman: "I'm a junior analyst and just trying to figure out which end is up, but I told him that as a lawyer I'd worked on a deal for the Money Store." He was promptly appointed the lead analyst for Ames Financial. "What I didn't tell him was that my job had been to proofread the documents and that I hadn't understood a word of the fucking things."

The second company for which Eisman was given sole responsibility was Lomas Financial, which had just emerged from bankruptcy. "I put a sell rating on the thing because it was a piece of shit," Eisman says. "I didn't know that you weren't supposed to put a sell rating on companies. I thought there were three boxes—buy, hold, sell—and you could pick the one you thought you should." He was pressured generally to be a bit more upbeat, but upbeat wasn't Steve Eisman's style.

Eisman stuck to his sell rating on Lomas Financial, even after the company announced that investors needn't worry about its financial condition, as it had hedged its market risk. "The single greatest line I ever wrote as an analyst," says Eisman, "was after Lomas said they were hedged." He recited the line from memory: "'The Lomas Financial Corp. is a perfectly hedged financial institution: It loses money in every conceivable interest-rate environment.' A few months after he'd delivered that line in his report, Lomas Financial returned to bankruptcy.

Making of a Junk Bond

By the spring of 2005, FrontPoint was fairly convinced that something was very screwed up not merely in a handful of companies but in the financial underpinnings of the entire U.S. mortgage market. In 2000, there had been \$130 billion in subprime mortgage lending, with \$55 billion of that repackaged as mortgage bonds. But in 2005, there was \$625 billion in subprime mortgage loans, \$507 billion of which found its way into mortgage bonds. Eisman couldn't understand who was making all these loans or why.

The big Wall Street firms had just made it possible to short even the tiniest and most obscure subprime-mortgage-backed bond by creating, in effect, a market of side bets. Instead of shorting the actual BBB bond, you could now enter into an agreement for a credit-default swap with Deutsche Bank or Goldman Sachs. It cost money to make this side bet, but nothing like what it cost to short the stocks, and the upside was far greater.

Sub-prime – the juiciest short

The juiciest shorts—the bonds ultimately backed by the mortgages most likely to default—had several characteristics. They'd be in what Wall Street people were now calling the sand states: Arizona, California,

Florida, Nevada. The loans would have been made by one of the more dubious mortgage lenders; Long Beach Financial, wholly owned by Washington Mutual, was a great example. Long Beach Financial was moving money out the door as fast as it could, few questions asked, in loans built to self-destruct. It specialized in asking home-owners with bad credit and no proof of income to put no money down and defer interest payments for as long as possible. In Bakersfield, California, a Mexican strawberry picker with an income of \$14,000 and no English was lent every penny he needed to buy a house for \$720,000.

Eisman says he underestimated the total unabashed immorality of America's monied class wedded to American capitalism. For instance, he knew that the big Wall Street investment banks took huge piles of loans that by themselves might be rated BBB. They threw these BBB rated loans into a trust, carved the trust into tranches, and wound up with 60 percent of the new total being rated AAA.

Rating Agencies "a Smirk"- They were assuming home prices would keep going up"

Eisman says "I didn't understand how they were turning all this garbage into gold," he says. He brought some of the bond people from Goldman Sachs, Lehman Brothers, and UBS over for a visit. "We always asked the same question," says Eisman. "Where are the rating agencies in all of this? And I'd always get the same reaction. It was a smirk." He called Standard & Poor's and asked what would happen to default rates if real estate prices fell. The man at S&P couldn't say; its model for home prices had no ability to accept a negative number. "They were just assuming home prices would keep going up," Eisman says.

Moody's were "delusional"

As an investor, Eisman was allowed on the quarterly conference calls held by Moody's but not allowed to ask questions. Eisman and his team were known to be irreverential in asking questions. "With all due respect, sir," Daniel told the C.E.O. deferentially as they left the meeting, "you're delusional." This wasn't Fitch or even S&P. This was Moody's, the aristocrats of the rating business, 20 percent owned by Warren Buffett. And the company's C.E.O. was being told he was either a fool or a crook by one Vincent Daniel, from Queens. You have to understand this," Eisman says. "This was the engine of doom."

Creating a Domsday Machine through CDOs

Eisman finally saw the racket. He'd been making these side bets with Goldman Sachs and Deutsche Bank on the fate of the BBB tranche without fully understanding why those firms were so eager to make the bets. Now the reality dawned. When Eisman bought a credit-default swap, he enabled Deutsche Bank to create another bond identical in every respect but one to the original. The only difference was that there was no actual homebuyer or borrower. The only assets backing the bonds were the side bets Eisman and others made with firms like Goldman Sachs. Eisman, in effect, was paying to Goldman the interest on a subprime mortgage that did not exist.

Wall Street – never had a crisis of conscience

Eisman said "These guys are only beginning to understand how fxxxxd they are. It's like being a Scholastic, prior to Newton. Newton comes along, and one morning you wake up: 'Holy sxxx, I'm wrong!'" Now Lehman Brothers had vanished, Merrill had surrendered, and Goldman Sachs and Morgan Stanley were just a week away from ceasing to be investment banks. The investment banks were not just fxxxxd; they were extinct.

He had tried a thousand times in a thousand ways to explain how screwed up the business was, and no one wanted to hear it. "That Wall Street has gone down because of this is justice," he says. "They fxxxxd people. They built a castle to rip people off. Not once in all these years have I come across a person inside a big Wall Street firm who was having a crisis of conscience."

Greed on Wall Street was a given – almost an obligation

John Gutfreund [CEO of Salomon Brothers] and dubbed as King of Wall Street, breaks down while describing Wall Street. He had been forced to resign from Salomon Brothers and fallen on harder times. He'd sat on a panel about Wall Street at Columbia Business School. When his turn came to speak, he

advised students to find something more meaningful to do with their lives. As he began to describe his career, he broke down and wept.

He thought the cause of the financial crisis was “simple. Greed on both sides—greed of investors and the greed of the bankers.” I thought it was more complicated. Greed on Wall Street was a given—almost an obligation. The problem was the system of incentives that channeled the greed.

All governments play hostage to the monied class

The problem was that western governments themselves play hostage to the big financiers and are scared of regulating them lest they move their assets to lightly regulated territories. This is precisely what happened to Wall Street and New York Stock Exchange . Scared of the draconian effect of Sarbanes Oxley Act many companies who delisted from the New York Stock Exchange were coaxed by the London Stock Exchange saying they did not believe in such draconian regulation and UK corporate governance laws did not make the regulation binding and gave the opportunity to the firm to explain why they could not comply with a particular regulation. There was as such a race to the bottom by regulating authorities to invite investment.

The Insider Trading

Satyam’s main contribution should be the unfolding of a sordid state of insider trading - a hush hush word - in all the bourses.

The investigations reveal the large scale selling of the company’s shares by institutional investors days before Raju’s confession of cooking books. US must be given credit for putting an icon like Martha Stewart behind bars for a year for lying in a case of insider trading. Yet insider trading on Wall Street is starting to look as troubling as it was in the time of Ivan Boesky in the 1980s, the head of enforcement at the US Securities and Exchange Commission warned recently. Linda Chatman Thomsen, the SEC’s director of enforcement, said she had been “quite dismayed” at the nature of the commission’s recent insider dealing actions.

“The tippers and tippees have been in senior positions of trust and confidence,” she said. “We are far from low-level employees or people on Main Street.” Ms Thomsen expressed concern at the “multiple incidences” of insider trading and cases involving couples who were both professionals. Recently a former Ernst & Young partner was charged with allegedly passing insider trading information to an investment banker friend ahead of seven deals involving the accounting firm’s clients. In one of the most high-profile cases recently, 13 people, including a Morgan Stanley compliance officer and a UBS executive director, were charged in relation to an insider trading scheme.

It is therefore, naïve to suggest that self-regulation can work in the markets. In an interview to Wall Street Journal, Eliot Spitzer, the much defamed former Attorney General of New York, said: “The honour code among CEOs didn’t work. Board oversight didn’t work. Self-regulation was a failure”. Even a staunch defender of free capital markets as Joseph Ackerman, Chief Executive of Deutsche Bank says “ I no longer believe in the market’s self-healing powers.”

Way Ahead - Challenges for the future

Jesse Livermore , the legendary Wall Street trader of early twentieth century who made millions by short selling committed suicide on 28 Nov 1940 at the age of 63. His suicide note said “I am tired of fighting Wall Street.” He said “Wall Street never changes. The pockets change, the suckers change, the stocks change, but Wall Street never changes because human nature never changes.”

2009 – a year of the churn

But in 21st century we have hope because we have the power and technology to change all this. We are fortified by the epoch making wins of underdogs like Nelson Mandela and Barack Obama. Barack Obama is a transformational leader of a dimension the world has not seen since Gandhi. We must recognize that 2009 will be the year of churn. It will be a year of financial reform as never before. The market meltdown

has no economic basis other than the loss of investor confidence which is feeding itself with more exposures of the kind of John Thain, Bernie Madoff and Ramalingam Raju. Investors have been alarmed by seeing everyone swimming naked. Hence no one trusts any one. The strategy to restore trust is not simply handouts of bailouts but holding people, companies and institutions accountable by enforcing the laws we already have. Bailouts could act as handing snuff to the woman who complains of sneezing. There is no guarantee that these banks will behave more responsibly than before or would ever return the loans. The time may come when big banks are replaced by boutique banks. No harm will be done if Eismen are not paid out. Because to pay every Eisman, who already has abundance, you are depriving thousands who have nothing.

Light touch regulation has been disastrous for investor confidence in UK

Markets are going through a churn. In 2009 churn will go stronger and spread far and wide. Its ripple effect will impact markets around the world. After all it is the City and the London Stock Exchange who with their "Comply or Explain" admitted the renegades of NYSE and started the race to the bottom in enforcement of regulation. Britain was the prime mover in ridiculing and rolling back Sarbox. Mr Blair, its former prime minister, is the first one to admit that regulation of the City needs to change "dramatically and fundamentally". But the former prime minister said the government would have faced a "big political problem" if it had tried to impose tighter curbs before the credit crunch.

No regulation of hedge funds

UK regulators lacked the conviction and allowed private equity and hedge funds to operate with impunity. How could you have in this day and age financial companies reporting no information on their holdings, or their strategies? The regulators are unaware even of the number of hedge funds that exist. Or the money they control. As to hedge fund managers' claim of self-regulation, only 34 of the 400 plus UK hedge funds have signed up to the Hedge Funds Standards Board.

It is a sad commentary that of the 67 cases of hedge fund frauds all were in the UK. UK had no marketing mechanism to monitor the hedge funds. No wonder UK was the first to be hit with queues outside Northern Rock. Yet it persisted with its light touch regulation to attract investment. Knowing that financial sector is UK's biggest export, there are no prizes to guess why UK and its currency has been the hardest hit by the meltdown.

Start Morality and Ethics with Business Schools

To restore trust in the market we have to start with Business Schools. We need classes and credits for ethics and for ownership of failure. My interaction with a large number of business schools shows that their only lure is big bucks from the job that follows. A journalist who studied in Harvard Business School described it as "a factory of unethical practices". Students use educational loan to buy flashy cars and fall into debt trap well before they graduate. Our challenge is to make them aware of the ethical context and sharpen their moral compass. We have to change our metaphors of success "winner takes all" and "success at all costs" and develop a value system that prides in ethics, morality, equity, legitimacy, transparency, value dissent and diversity. Transparency requires courage to say: "We are sorry we made a mistake". That is the only statement that tells your client you are earnest.

We have a policy that aims to reward those who own mistakes and punish those who hide them. Markets must know that there is a greater punishment for concealment than failure itself. As Einstein said it is not the mistake that causes the serious damage. It is the mistake that you make of defending the first mistake that causes it.

Bring back Eliot Spitzer

In fact a person whom President Obama ought to rehabilitate and bring to White House is Eliot Spitzer. By hauling up big boys among major banks Citigroup, CSFB and Merrill Lynch back in early 2002 in his capacity as the Attorney General of New York, well before the Sarbanes Oxley Act was signed, he threatened to launch prosecution against the heads of these banks for securities fraud and made them shell

out fines amounting to \$1.1 billion. Most people believe that his continuation could have saved the markets from the meltdown. This means we do not lead legislation. We need effective enforcement. In his research paper called “Dangers of disinformation in corporate reporting”, Edward J Kane reports “ In practice accountants can do and do earn substantial profits from credentialing loophole – ridden measurement principles that conceal developments from outside stakeholders. What we need is effective enforcement to curb a cozy culture within the whole industry.

Attitudinal changes and global thinking

The problem with the financial industry is its mind set of conceit, arrogance and a parochial make believe world. It is spawned by a culture of support that stems from old boy’s network where every one supports every one else regardless moral dilemmas. It seems as if the world is run by a cartel of financial people. They went after Eliot Spitzer who as the Attorney General of New York had held them to account. Mr Spitzer was a tremendously gifted public servant who did his job of catching securities fraudsters very well. He symbolized the moral push on the way the business is conducted. It was stupefying to see him resign on 12 March 2008. Traders at NYSE broke out with applause after hearing his resignation. This was because Spitzer prosecuted Grasso the CEO of NYSE for giving himself an outrageous compensation of \$190 million.

Role of Training

These mindsets can only be changed through training. We need training at all levels – boards and investors both. The training should widen the outlook and make business feel global in outlook. A business is different from a political person because the former’s constituency is global. Businesses need to steer clear from blame games between communities, regions and nations. Also unless the governance moves to a global platform it will remain ineffective. The training should be to challenge people to reach beyond their grass – to value failures as building blocks of success and learn to talk about them proudly. The purpose for the training should be to excite the spirit of enquiry, spark innovation and develop holistic, integrated and independent thinking. As Scot Fitzgerald said “The test of first rate intelligence is your ability to hold two opposing views in your mind and still retain the capacity to function”.

Whither corporate governance? Recognising the myth of Independent directors

There is however a general misperception of the role of independents. Studies have shown that their average involvement with boards is attending around 4 meetings in a year each lasting 3-4 hours. That means barely 14 hours a year. This is why there is an elite group everywhere who are members of 15 to 20 boards. There is little of substance that can be achieved with such limited involvement. We have to ensure that multiple directorships are minimised and must not exceed five. Besides directors are encouraged to work through committees such as audit, remuneration, nomination, constitution committees. A committee that has remained conspicuous by absence is the risk management committee.

Enhancing Board Effectiveness

In all our decision making efforts we need to recognize the virtue of Vedic wisdom that says “Let us come together, let us think together. Let us combine our intellectual strength; let our collective brilliance shine. Let there be no ill will, no hidden agenda.” This means deconcentration and dispersal of authority. That is the basis for splitting the roles of CEO and Chairman that continues to be the bane of US corporations. This was also one of the reasons that led to Satyam fraud. We must recognize that collective wisdom is always better than individual and that human nature being what it is we need to have effective institutional mechanisms for monitoring the exercise of authority in whatever context and at each level. Boards can only be effective if they are independent of management and independent in thinking. However their effectiveness can be enhanced only when their composition is diverse. The current tendency is to fill the boards with sameness. This accelerates resistance to change and innovation. Diversity can be harnessed effectively only if we hone the skills of collective thinking and decision making.

Transparency is a competitive differentiator

Today's corporations are facing many challenges. The biggest is the challenge of change. There are two certainties. First is whatever made you successful in the past wont in future. This means you have to constantly innovate. Innovation is a risky business. You have to recognize you cannot succeed all the time. But it is no good hiding when you fail. There is no where you can hide. You are under the constant glare of public scrutiny. The second certainty is that if you try to hide failure, you are bound to be found out. The punishment for being found out is more than being candid in the first place. In order to succeed you have to learn to love failure and learn to talk about them unabashedly as both Mahatma Gandhi and Barack Obama have shown.

Global Governance – an idea whose time has come

We are facing one of the worst recessions in history because of corporate greed and irresponsibility. In President Obama's words markets have spun out of control due to lack of a watchful eye. But no one nation can regulate capital by itself. We have to do it together. We need global oversight of capital markets. Likewise other pressing problems confronting humanity such as of environmental pollution, global insecurity and climate change also call for global solutions. These problems have eluded solution merely because of compartmentalized approaches. What we need is a cohesive approach, conceptual thinking and collective action to find holistic solutions to these conundrums. This would mean improving dialogue to understand each other and discard the Socratic model of monologues. Above all we need to learn to capitalise diversity, dissent, difference and disclosure to build trust for our common goals. Globalisation cannot succeed without global governance. This may seem a hardball to bat. But as President Obama said in his inaugural address: "what men and women can achieve when imagination is joined to a common purpose and necessity to courage."

Greening the Bailouts

In our eagerness of spending public money to contain recession and create jobs it is important to think carefully on the direction of expenditure on bailouts. Generating employment is the key to contain recession. But it will be foolhardy to do that in a way which will make us uncompetitive in the long run. Can a portion of the hundreds of billion dollars of government bailout of banks be used to plough into clean and renewable energy? The future of humanity lies in solar energy. Recognition by markets and policymakers that the only way to achieve sustainability is to speed up innovations and investments in R&D for cleaner fuels and especially solar technology. This will fuel the capital markets and pay itself many times over by creating a world which is not only prosperous but much more equitable, greener, cleaner and sustainable.

Rather than giving huge bailouts to banks and platinum parachutes to those who wrecked the economy, let us spend tax payer's hard earned money on regenerating the planet and creating jobs for our people. Studies have shown that investments in renewable results in four time more employment than traditional sectors. So why not green the bailouts and let business be a driver in regenerating employment and boosting the capital market through clean and green agenda. The alternative is decades of strifes, strikes and suffering at a global scale.

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