INAPPROPRIATE

Banker Scams Continue as Washington Fails to Reform Pay as Mandated by 2010 Law

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Executive Summary

The 2008 financial crash stemmed from numerous causes, and risk-taking by bankers in pursuit of incentive-based compensation figured as one of the most conspicuous triggers. Bankers committed massive frauds selling flawed mortgages, ultimately sending the economy into a Great Recession. Congress responded in 2010 with the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1] This law mandated several executive pay reforms, including requiring the drafting of a rule to prohibit compensation structures that promote "inappropriate" risk-taking. Fraud certainly is inappropriate. Congress set a deadline for implementation of this rule: May 2011. Twelve years since passage of the law, this rule remains unimplemented.

Perhaps there might be an excuse for the government's inaction if the rule were no longer relevant or urgent. However, that is not the case. Bankers continue to engage in inappropriate risk-taking, including perpetrating fraud. Well-known cases abound. JP Morgan lost $6 billion in flawed derivatives bets known as the "London Whale," connected to plan to boost senior executive pay.[2] [3] Goldman Sachs bribed Malaysian government officials to win lucrative bond underwriting deals, which also involved embezzlement of more than $1 billion that might have gone to needed development in that country.[4] Wells Fargo placed untenable quotas on its agents to increase consumer accounts, forcing them to create fake accounts so as to boost senior executive pay linked to account growth metrics.[5] Supporters of a OneWest merger flooded regulators with suspect endorsement letters in a deal that promised a $24 million payout for the CEO. The firm faced criticism for massive foreclosures, an action that might have stymied the merger under the Community Reinvestment Act.[6]

In 2022 alone, numerous cases link compensation to fraud and investor abuse by banks, including examples such as: a fake account scam at U.S. Bank[7]; abuse in student loans by

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[1] *Dodd-Frank Wall Street Reform and Consumer Protection Act*, GOVERNMENT PRINTING OFFICE (2010) https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf

[2] *JP Morgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses: Hearing Before The Permanent Subcommittee on Investigations*, 113 Cong. (March 2013), https://bit.ly/3eu7Ugz

[3] Bartlett Naylor, *JP Morgan Cheated on Stress Test*, ECONINTERSECT (May 13th, 2013), https://bit.ly/3akmx2C

[4] NPR, *A former Goldman Sachs banker is found guilty in a plot to loot Malaysia's 1MDB fund* (April 8th, 2022), https://n.pr/3cy7klW

[5] Michael Tanglis, *The King of "Cross-Sell" and the Race to Eight*, PUBLIC CITIZEN (Sept. 29, 2016), Inthttps://bit.ly/2VwBrO0

[6] Bartlett Naylor, *The Revolving Door and the Assault on Community Reinvestment*, AMERICAN PROSPECT, (Nov. 21, 2018) https://prospect.org/economy/revolving-door-assault-community-reinvestment/

[7] *U.S. National Bank Association*, CONSUMER FINANCIAL PROTECTION BUREAU, (July 28, 2022) https://www.consumerfinance.gov/enforcement/actions/us-bank-national-association/

Navient[8]; investor abuse by Allianz[9], Schwab[10], First Republic Bank,[11] and Credit Suisse[12]; and maintaining insufficient anti-money laundering controls by USAA Federal Savings Bank[13] and Wells Fargo.[14]

This ongoing litany of inappropriate action by executives in search of enrichment clearly demonstrates the urgency of why regulators must take swift action to finalize this pay reform rule.

Introduction

Bankers pursuing incentive-based compensation figured as one of the most important causes of the financial crash of 2008.

The 2008 financial crash centered around unsafe mortgage-making and trading. Risky mortgages became part of complicated debt packages, sold to investors around the world. When mortgage borrowers began to default, the problems spread throughout the financial plumbing. Misguided pay structures figured at every stage. Mortgage sales agents intentionally sold expensive, subprime mortgages to borrowers who qualified for better, prime mortgages. That's because subprime mortgages generated better commissions for sales agents.[15] Securitization of those mortgages into bonds meant lucrative underwriting fees for investment bankers. When the supply of sound mortgages began to dwindle, as most qualified borrowers already owned homes, the industry reduced its underwriting standards, awarding mortgages to unqualified borrowers to keep the fee-generating securitization machine buzzing.

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[8] Arizona Attorney General, *Attorney General Mark Brnovich Announces $1.85 Billion Settlement with Student Loan Servicer Navient* ARIZONA ATTORNEY GENERAL,(Jan. 13, 2022) https://www.azag.gov/press-release/attorney-general-mark-brnovich-announces-185-billion-settlement-student-loan-servicer

[9] *Three Portfolio Managers And Allianz Global Investors U.S. Charged In Connection With Multi-Billion Dollar Fraud Scheme,* DEPARTMENT OF JUSTICE, (May 17, 20220 https://www.justice.gov/usao-sdny/pr/three-portfolio-managers-and-allianz-global-investors-us-charged-connection-multi

[10] Securities and Exchange Commission, *Schwab Subsidiaries Misled Robo-Adviser Clients about Absence of Hidden Fees* SECURITIES AND EXCHANGE COMMISSION (June 13, 2022) https://www.sec.gov/news/press-release/2022-104

[11] Securities and Exchange Commission, *In the Matter of First Republic Investment Management,* SECURITIES AND EXCHANGE COMMISSION (May 19, 2022) https://www.sec.gov/litigation/admin/2022/ia-6030.pdf

[12] Securities and Exchange Commission, Credit Suisse to Pay Nearly $475 Million to U.S. and U.K. Authorities to Resolve Charges in Connection with Mozambican Bond Offerings, SECURITIES AND EXCHANGE COMMISSION, (Oct 19, 2021) https://www.sec.gov/news/press-release/2021-213

[13] Financial Crime Enforcement Network, In the Matter of USAA Federal Savings Bank, Financial Crimes Enforcement Network, (March 31, 2022) https://www.fincen.gov/sites/default/files/enforcement_action/2022-03-18/USAA%20Consent%20Order_Final%20508%20(2).pdf

[14] Securities and Exchange Commission, *SEC Charges Wells Fargo Advisors With Anti-Money Laundering Related Violations* SECURITIES AND EXCHANGE COMMISSION (May 20, 2022) https://www.sec.gov/news/press-release/2022-85

[15] Gretchen Morgensen, *Inside the Countrywide Lending Spree,* NEW YORK TIMES (August 26, 2007), https://nyti.ms/2XLALXI

Bankers also profited from failure. Goldman Sachs bankers generated fees for themselves by bundling bad mortgages into securities they sold to investors, and then won more by placing bets those securities would falter.[16]

"[F]lawed incentive compensation practices in the financial industry were one of the many factors contributing to the financial crisis that began in 2007," according to a collective statement by federal regulators.[17] Separately, the Financial Crisis Inquiry Commission found that pay systems too often encouraged "big bets" and rewarded short-term gains without proper consideration of long-term consequences.[18] Wall Street bankers themselves agree, with surveys demonstrating that more than 80 percent of financial market participants believe that compensation practices played a role in promoting the excessive risk that led to the financial crisis.[19]

The 10 senior executives of Bear Stearns and Lehman Brothers, which failed under those executives' leadership, were paid $1.4 billion, including severance packages, in the years leading to the '08 crash. That's an average of $140 million each. They made riches to risk—and lose—their companies.[20]

The Senate Permanent Subcommittee on Investigations found that pay incentives throughout the firm played a major role in inducing Washington Mutual to make inappropriately high-risk loans, eventually driving the firm into bankruptcy.[21]

In the restrained terms of the Securities and Exchange Commission (SEC): "Poorly structured incentive-based compensation arrangements can provide executives and employees with incentives to take inappropriate risks that are not consistent with the long-term health of the institution and, in turn, the long-term health of the U.S. economy. Larger financial institutions are interconnected with one another and other companies and markets, which can mean that any negative impact from inappropriate risk-taking can have broader consequences. The risk of these negative externalities may not be fully considered in incentive-based compensation arrangements, even arrangements that

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[16] *The 2011 Pulitzer Prize in National Reporting*, THE PULITZER PRIZES https://bit.ly/3etrLMX

[17] Joint Statement, *Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies*, OFFICE OF THE COMPTROLLER OF THE CURRENCY (June 30, 2010) https://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-24.html

[18] Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report*, FINANCIAL CRISIS INQUIRY COMMISSION (Feb. 25, 2011) https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf

[19] Financial Stability Forum, *FSF Principles for Sound Compensation Practices*, Financial Stability Forum, (April 2, 2009) . See page 4, footnote 2, for a review of these surveys. https://www.fsb.org/wp-content/uploads/r_0904b.pdf

[20] Lucian Bebhuk, et., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008,* YALE JOURNAL ON REGULATION, (2010) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1513522

[21] Permanent Subcommittee on Investigations, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*" U.S. SENATE, (April 13, 2011), https://www.hsgac.senate.gov/imo/media/doc/Financial_Crisis/FinancialCrisisReport.pdf?attempt=2

otherwise align the interests of shareholders and other stakeholders with those of executives and employees."[22]

In these examples from the '08 crash, senior bank managers obscured vital risk information. This misled shareholders, auditors, and prudential supervisors.[23] The risky behavior stemmed from the fact that senior managers were compensated largely in stock options. Firms that pay executives with stock options provide an asymmetric incentive to produce financial results that may involve excessive risks. If the risks lead to rewards, the stock options can pay handsomely. If those risks instead lead to losses, the manager does not suffer a loss of pay. Individual regulators agree. Steven Harris, then a member of the Public Company Accounting Oversight Board, observed that certain stock-option plans proved to be "strong incentive for excessive risk-taking."[24]

Bankers also engaged in wholesale fraud based on the compensation packages leading to the 2008 crash. For this, 49 financial institutions paid various government entities and private plaintiffs nearly $190 billion in fines and settlements, according to one analysis.[25]

Before the pay-fueled financial crash of 2008, compensation figured at the center of other bank-related fiascos. The Wall Street crash of 1929 leading to the Great Depression of the 1930s, followed massive fraud by senior bankers aiming to fatten their already enormous compensation.[26] The Latin American debt crisis of the 1980s, where American bankers plied Central and South American governments with more loans than they could repay, stemmed from pay packages connected to the volume of loan-making.[27]

And, as detailed below, this compensation-fueled risk taking and wrongdoing is not a relic of the past, and instead is currently driving bad decision-making by bankers.

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[22] Incentive compensation, joint rulemaking, Securities and Exchange Commission (2016) https://bit.ly/2XTucm8

[23] The Federal Reserve found that "risk-taking incentives provided by incentive compensation arrangements in the financial services industry were a contributing factor to the financial crisis that began in 2007." Federal Reserve, Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations, (October 2011), https://bit.ly/2XTkkst

[24] Statement of Steven B. Harris, *PCAOB Open Board Meeting titled Auditing Standard on Related Parties and Proposed Amendments on Significant Unusual Transactions,* (February 28, 2012), https://bit.ly/2Seja7p

[25] William Cohan, *How Bankers Stayed out of Jail*, THE ATLANTIC, (September 2015) https://www.theatlantic.com/magazine/archive/2015/09/how-wall-streets-bankers-stayed-out-of-jail/399368/

[26] Michael Perino, *The Hellhound of Wall Street*, PENGUIN GROUP (2011) https://www.penguinrandomhouse.com/books/307362/the-hellhound-of-wall-street-by-michael-perino/

[27] Ayan Kose et al, *Global Waves of Debt*, WORLD BANK GROUP, (2021) https://thedocs.worldbank.org/en/doc/9eeb21e4426d6c3113f9bed45853e160-0350012021/original/Global-waves-of-debt-full-report.pdf

Pay Reform: Section 956

Following the financial crash of 2008, Congress responded in 2010 with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[28] This statute directed regulators to write and implement some 400 rules designed to increase the safety of banks and combat reckless loan-making. One of these is Section 956, part of a suite of six pay rules designed to blunt the role of compensation in promoting bad banking. Section 951, for example, requires a shareholder vote on compensation disclosures, ideally enlisting bank owners to guard against bad pay practices. Section 954 calls on banks to recover pay in the past when it turns out that performance metrics to which the pay was linked were untrue. Before the crash, bankers might have been paid for making good loans; when those loans went bad, that pay could be recouped.

Then there is Section 956. This brief section of the statute "prohibit[s] any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages *inappropriate* risks by…financial institutions." (Emphasis added.)[29] To establish this prohibition, Congress called on five regulators to coordinate a final rule: The Federal Reserve, Federal Deposit Insurance Corp (FDIC), the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission (SEC) and the National Credit Union Administration.

Of the 400 rules of the 853-page Dodd-Frank Act, few placed deadlines on the regulators. Presumably, this meant that they were of less urgency, and given the massive number, Congress may have understood that finalization would take regulators time to complete. Congress did mandate deadlines for a few rules. One of these was Section 956, presumably underscoring its importance and urgency. That deadline was May 2011, which passed without agencies finalizing a rule.

The agencies did propose a rule in 2011 but, as noted, failed to finalize it. Public Citizen and others criticized this initial proposal and called for a more robust rule. In 2016, regulators obliged with another, somewhat stronger proposal. But they again failed to finalize this rule. During the Trump administration, regulators failed to propose any rule.

The most common explanation for this delay in regulatory action on Section 956 has been the complication of five-agency coordination. But under the Obama administration, the agencies were able to propose a rule—twice. Moreover, other Dodd-Frank rules required multiple agencies, such as the so-called Volcker Rule that bars proprietary trading, which was finalized in 2013.[30]

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[28] *Dodd-Frank Wall Street Reform and Consumer Protection Act*, GOVERNMENT PRINTING OFFICE (2010) https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf
[29] *Id.*
[30] Peter Schroeder, *D-Day for Volcker Rule,* THE HILL, (Dec. 10, 2013) https://thehill.com/policy/finance/192554-d-day-arrives-for-volcker-rule/

For the American public, the important question is whether implementation of Section 956 remains relevant. Afterall, the financial crash took place 14 years ago.

The sad, urgent, and perhaps obvious answer is yes.

Major Cases of Banker Misconduct Tied to Compensation

Below is a sampling of some of the more infamous instances since 2010 where major harms to Americans and others resulted from "inappropriate" actions taken by bankers and where their compensation structures can be identified as a contributing factor. What is "inappropriate" risk-taking may be subject to interpretation, especially when it applies to banks. By nature, banks take risks when they make loans—a risk that the borrower will not repay. Some borrowers may be less creditworthy. Others may be involved in socially problematic enterprise. For example, Public Citizen believes that banks should not lend to firms that exacerbate climate change.[31] However, there can be no debate that engaging in activity that involves fraud, consumer abuse and other actions that result in penalties and/or prison for bankers is "inappropriate." Where compensation may promote such fraud and abuse, Section 956 should apply. The following well-known cases involved fraud and abuse that led to government sanctions, and have been shown to have been prompted, at least in some part, by executives' search for increased riches.

Goldman Sachs Bribery

In 2020, the Department of Justice (DOJ) announced that during a period of five years, Goldman Sachs conspired in "a sweeping international corruption scheme" that involved more than "$1.6 billion in bribes to multiple high-level government officials across several countries so that the company could reap hundreds of millions of dollars in fees."[32] There can be no debate that bribery is inappropriate.

One government that was involved in this scandal was Malaysia. The Malaysian government created a fund known as 1Malaysia Development Berhad, or 1MDB, to promote economic development in the country through global partnerships and foreign direct investment. The funds were intended to be used for improving the well-being of the Malaysian people. Malaysia is a relatively successful emerging economy; poverty rates have declined in the last two decades.[33] The funds were intended to help keep these improvements on track.

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[31] Yevgeny Shrago and David Arkush, *Looking Over the Horizon*, PUBLIC CITIZEN (June 2011) https://rooseveltinstitute.org/wp-content/uploads/2022/06/RI_Climate-Related-Risk-Supervision_202206.pdf

[32] *Goldman Sachs Charged in Foreign Bribery Case and Agrees to Pay Over $2.9 Billion* DEPARTMENT OF JUSTICE, (Oct. 22, 2020) https://www.justice.gov/opa/pr/goldman-sachs-charged-foreign-bribery-case-and-agrees-pay-over-29-billion

[33] *Poverty and Equity Brief: Malaysia*, WORLD BANK (April 2019) https://databankfiles.worldbank.org/data/download/poverty/33EF03BB-9722-4AE2-ABC7-AA2972D68AFE/Archives-2019/Global_POVEQ_MYS.pdf

Instead, more than $1 billion of these funds—generated in part by Goldman Sachs bond underwriting—"were taken and spent on a wide variety of extravagant items, including luxury homes and properties in Beverly Hills, New York, and London; a 300-foot superyacht; and fine art by Monet and Van Gogh," according to the DOJ.[34] Other funds went to acquisition of a boutique hotel in Beverly Hills; a movie production company that made "The Wolf of Wall Street" (!), the redevelopment of the Park Lane Hotel in Manhattan; and shares in EMI, the largest private music-rights holder.[35] Najib Razak, the Malaysian prime minister who established and oversaw the fund reportedly deposited $731 million of these funds into his personal bank account.[36]

In October 2020, Goldman Sachs "admitted to conspiring to violate the Foreign Corrupt Practices Act (FCPA) in connection with a scheme to pay over $1 billion in bribes to Malaysian…officials," according to the DOJ.[37] Goldman Sachs paid these bribes to win underwriting deals for roughly $6.5 billion in three bond deals for 1MDB. The bank received some $600 million in fees for these deals.

The embezzlement led to protests involving hundreds of thousands of Malaysians. At least three people were murdered in association with the scandal and investigation, including one Malaysian prosecutor.[38]

The fees meant a major reward for certain senior Goldman Sachs bankers, notably Tim Leissner, the former Southeast Asia Chairman and participating managing director of Goldman Sachs. Leissner sealed three bond deals that netted Goldman $600 million and meant he received "large bonuses," according to U.S. prosecutors.[39] Leissner pleaded guilty to violations of anti-bribery laws. [40]

Leissner's Goldman partner, Ng Chong Hwa, also known as Roger Ng, was convicted in 2022 by a federal jury in the embezzlement scheme. Commented prosecutor Breon Peace,

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[34] *Over $1 Billion in Misappropriated 1MDB Funds Now Repatriated to Malaysia,* DEPARTMENT OF JUSTICE, (Aug. 5, 2021) https://www.justice.gov/opa/pr/over-1-billion-misappropriated-1mdb-funds-now-repatriated-malaysia

[35] *Id.*

[36] Matthew Goldstein et all, *Goldman Sachs Ensnarled in Vast 1MDB Fraud Scandal* New York Times, (Nov. 1, 2018) https://www.nytimes.com/2018/11/01/business/goldman-sachs-malaysia-investment-fund.html

[37] *Goldman Sachs Charged in Foreign Bribery Case and Agrees to Pay Over $2.9 Billion,* DEPARTMENT OF JUSTICE (Oct. 22, 2020) https://www.justice.gov/opa/pr/goldman-sachs-charged-foreign-bribery-case-and-agrees-pay-over-29-billion

[38] Romil Patel, *Malaysia 1MDB Scandal: Death Toll Mounts In Multimillion-Dollar Graft Probe,* INTERNATIONAL BUSINESS TIMES, (Sept. 3, 2016) https://www.ibtimes.co.uk/malaysia-1mdb-scandal-death-toll-mounts-multimillion-dollar-graft-probe-1548461

[39] *U.S. v. Tim Leissner*, US District Court for the Eastern District of New York, (website viewed August 22, 2022) https://www.justice.gov/usao-edny/press-release/file/1106971/download

[40] Tom Wright, *Goldman Sachs's Ex-CEO Lloyd Blankfein Met Malaysian at Center of 1MDB Scandal* WALL STREET JOURNAL (Nov. 9, 2018) https://www.wsj.com/articles/goldman-sachss-ex-ceo-met-malaysian-twice-at-center-of-1mdb-scandal-1541779363

the verdict was "a resounding victory for justice and for the people of Malaysia who were the victims of this massive scheme that the defendant and his partners in crime carried out in a frenzy of greed to get rich by stealing millions of dollars from [a] fund intended to benefit that country's economy."[41]

Other Goldman executives may have participated in the scheme to benefit their compensation as well, and not simply one or a few rogue bankers.[42] More than 30 senior Goldman executives reportedly knew about the bank's dealings with 1MDB.[43]

Goldman Sachs CEO, Lloyd Blankfein, attended two meetings with the Malaysian financier at the center of one of the schemes, including one meeting after Goldman's compliance department had raised multiple concerns about the financier's background and said the bank shouldn't do business with him, according to the Wall Street Journal.[44] In addition, CEO Blankfein openly praised his Malaysian bankers at a meeting in 2014: "Look at what Tim and Andrea [Vella, a third executive who helped structure the bonds] did in Malaysia…We have to do more of that."[45]

After Goldman admitted to criminal wrongdoing in the Malaysian bribery and embezzlement scheme, Goldman announced it would claw back $174 million in pay to past and present executives: CEO Lloyd Blankfein, COO Gary Cohn and CFO David Viniar. It also announced pay cuts for the current chief executive and his top lieutenants.[46]

Bankers who "work…behind the scenes for their own illegal benefit, and not that of their citizens and shareholders, their behavior lends credibility to the narrative that businesses don't succeed based on the quality of their products, but rather their willingness to play dirty," said Assistant Director in Charge William F. Sweeney Jr. of the FBI's New York Field Office. "Greed eventually exacts an immense cost on society, and unchecked corrupt behavior erodes trust in public institutions and government entities alike."[47]

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[41] *Former Goldman Sachs Investment Banker Convicted in Massive Bribery and Money Laundering Scheme*, DEPARTMENT OF JUSTICE (April 8, 2022) https://www.justice.gov/usao-edny/pr/former-goldman-sachs-investment-banker-convicted-massive-bribery-and-money-laundering

[42] Matthew Goldstein et all, *Goldman Sachs Ensnarled in Vast 1MDB Fraud Scandal* New York Times, (Nov. 1, 2018) https://www.nytimes.com/2018/11/01/business/goldman-sachs-malaysia-investment-fund.html

[43] David Dayen, *Goldman Sachs's Still Unpunished Adventures in Malaysia* AMERICAN PROSPECT, (Jan 29, 2020) https://prospect.org/power/goldman-sachs-unpunished-adventures-malaysia-1mdb-jho-low/

[44] Tom Wright, *Goldman Sachs's Ex-CEO Lloyd Blankfein Met Malaysian at Center of 1MDB Scandal* WALL STREET JOURNAL (Nov. 9, 2018) https://www.wsj.com/articles/goldman-sachss-ex-ceo-met-malaysian-twice-at-center-of-1mdb-scandal-1541779363

[45] David Dayen, *Goldman Sachs's Still Unpunished Adventures in Malaysia* AMERICAN PROSPECT, (Jan 29, 2020) https://prospect.org/power/goldman-sachs-unpunished-adventures-malaysia-1mdb-jho-low/

[46] Andrew Ross Sorkin et al, *Goldman Makes Its Bankers Pay*, NEW YORK TIMES, (Oct. 30, 2020) https://www.nytimes.com/2020/10/23/business/dealbook/goldman-sachs-clawback.html

[47] *Goldman Sachs Charged in Foreign Bribery Case and Agrees to Pay Over $2.9 Billion*,

JP Morgan's London Whale

At JP Morgan, some of the largest paychecks go to derivatives traders. Some of these are employees who make bets on the direction of a financial metric, such as interest or exchange rates. At the end of 2012, JP Morgan deployed about $180 billion worth of deposits into trading, which the bank primly calls "other available-for-sale securities."[48] These "other" securities, it turns out, include bets that the bank dignifies with the term "derivatives." Former Rep. Brad Miller (D-N.C.) observed that JP Morgan's bets "had nothing to do with real credit. These derivatives trades did not make it possible for more businesses to buy equipment, pay overtime or hire new employees; no household was able to buy a new car or replace their furnace. Instead, the trades were "synthetic" credit, a bet on whether a borrower would default on debt to someone else."[49] JP Morgan did well on some of these bets. For example, it bet that American Airlines would go bankrupt. When American Airlines did declare bankruptcy, JP Morgan realized a profit of $450 million.[50] [51] The traders earned handsome bonuses for this success. One trader made $11 million that year, and the trader's supervisor earned $14 million in that same period.[52]

One bet went seriously awry in the case known as the "London Whale." A handful of traders in JP Morgan's London office handling that "excess cash" made mistakes. The bank lost more than $6 billion on the bets, and a U.S. Senate investigation later turned up evidence that an attempt to increase senior management compensation motivated the trades.

In "Exhibit 46" of the Senate report, JPMorgan's chief investment officer directed subordinates to implement a plan to enable the bank to buy back stock. That plan depended on convincing regulators that such a step would be financially prudent. In a series of emails about the trades, the CFO stated she was "trying to work" with the regulators on an "acceptable…increased buyback plan."[53] In conventional terms, the committee report alleged that JPMorgan sought to manipulate how the "whale" trade would conform with regulatory safeguards so that JPMorgan could buy back stock—an

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DEPARTMENT OF JUSTICE (Oct. 22, 2020) https://www.justice.gov/opa/pr/goldman-sachs-charged-foreign-bribery-case-and-agrees-pay-over-29-billion

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[49] The bank gambled in a complicated index composed of bond insurance policies called credit default swaps. As with fire insurance, the failure of a firm to make a bond payment results in payment of the insurance, or credit default swap.

[50] *See* Senate Permanent Subcommittee on Investigations, *London Whale* at p. 62 (March 15, 2013), https://bit.ly/2XHVBqV

[51] Antoine Gara, *American Airlines Bankruptcy Helped JP Morgan,* The Street (March 15, 2013) https://bit.ly/2VPJqpJ

[52] Lyle Brennan, *Boss of Voldermort Trader earns $14 million a year as credit agencies give blank bleak look*, Daily Mail (May 14, 2012), http://dailym.ai/2ylBnZt

[53] Bartlett Naylor, *JP Morgan Cheated on Stress Test,* ECONINTERSECT (May 13, 2013), https://bit.ly/3akmx2C

action that typically boosts a share price and thus leads to higher executive compensation.[54] [55]

Wells Fargo Fake Accounts

Wells Fargo's compensation structure drove widespread fraud in many of its business operations, including checking accounts, credit cards, car insurance, investment accounts and more. Account growth figured as one of the long-standing metrics for senior employees' pay bonuses. Wells Fargo wanted its customers to have not one or two, but as many as eight ("go for gr-eight") connections to the bank, such as a checking account, a credit card, a mortgage and more.[56]

Wells Fargo reported these account connections, known as "cross-selling," as a key indicator of how it could manage growth. When it acquired other banks, such as Wachovia, its employees faced pressure to show how those cross-selling numbers would continue to rise steadily. That satisfied shareholders who might otherwise have been concerned that growth might lead to management complications. And satisfied shareholders meant a rising stock price, and as a result, greater senior management pay. Public Citizen documented this decades-long dynamic in "The King of the Cross-Sell."[57]

Internal whistleblowers alerted their superiors and eventually the media that much of these cross-selling figures were fabricated. Bank employees created fake accounts to meet quotas. Wells Fargo terminated many of these line employees, but senior managers nevertheless retained their bonuses. Eventually, the Consumer Financial Protection Bureau (CFPB) and the City Attorney of Los Angeles brought charges for these fabrications and leveled a record fine against Wells Fargo.[58] When greater scrutiny of the bank followed, even more abuses were revealed, and eventually, the CEO resigned. The fruits from this fraud amounted to $130 million in compensation for the CEO, and millions more for other senior managers.[59]

Once known as the benign mega-bank, the fake account scandal at Wells Fargo became only the first of a wave of problems that surfaced at the company, involving such things as illegal student loan servicing practices, car insurance scams, federal home insurance

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[54] JP Morgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses: Hearing Before The Permanent Subcommittee on Investigations, 113 Cong. (March 2013), https://bit.ly/3eu7Ugz
[55] Bartlett Naylor, *JP Morgan Cheated on Stress Test,* EconIntersect (May 13th, 2013), https://bit.ly/3akmx2C
[56] Michael Tanglis, *The King of "Cross-Sell" and the Race to Eight*, PUBLIC CITIZEN (Sept.. 29, 2016), Inthttps://bit.ly/2VwBrO0
[57] *Id.*
[58] *Id.*
[59] Matt Egan, *Wells Fargo CEO walks with $130 Million*, CNN (October 13, 2016), https://cnn.it/3bjDyez

misconduct, which were arguably most connected to bankers attempting to fatten their compensation packages.[60]

Credit Suisse Bribery

In 2021, Credit Suisse paid $475 million to U.S. and U.K authorities for fraudulently misleading investors and violating the Foreign Corrupt Practices Act (FCPA) in a scheme involving underwriting for state-owned organizations meant to promote tuna fishing in Mozambique. Bankers are paid underwriting fees.

The SEC said the underwriting transactions raised more than $1 billion to "perpetrate a hidden debt scheme, pay kickbacks to now-indicted former Credit Suisse investment bankers along with their intermediaries, and bribe corrupt Mozambique government officials."[61]

As a result of the Mozambique scam, along with major losses from deals with Archegos Capital Management, and an accounting fraud loss with a Chinese client, the bank's board responded by cutting executive pay.[62] [63] The Swiss Financial Market Supervisory Authority (FINMA) required pay reforms as well.[64]

One West Homeowner Abuse

High pay also figured in some questionable decisions by the CEO of OneWest, who surprisingly went on to become the nation's chief bank police officer as Comptroller of the Currency. This episode began when hedge fund manager, and subsequently Treasury Secretary, Steven Mnuchin purchased the failed IndyMac savings and loan association from the FDIC and renamed it OneWest. Mnuchin brought in a mid-level manager named Joseph Otting from US Bancorp to serve as OneWest CEO. Under this new ownership, the bank foreclosed on thousands of homeowners by using fraudulent methods: They fabricated foreclosure documents such as filing unnotarized documents with state and federal courts. OneWest's regulator itemized these misdeeds, and under new CEO Otting, the bank signed a "consent order" acknowledging those former misdeeds along with a promise to reform. However, the bank did not reform, and under Otting, OneWest

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[60] Philip Mattera, *Wells Fargo: Corporate Rap Sheet*, CORPORATE RESEARCH PROJECT (website accessed August 22, 2022) https://www.corp-research.org/wells-fargo

[61] Securities and Exchange Commission, Credit Suisse to Pay Nearly $475 Million to U.S. and U.K. Authorities to Resolve Charges in Connection with Mozambican Bond Offerings, SECURITIES AND EXCHANGE COMMISSION, (Oct 19, 2021) https://www.sec.gov/news/press-release/2021-213

[62] Brenna Hughes Neghaiwi, *Credit Suisse overhauls executive board as it estimates Archegos fallout at $4.7 bln*, Reuters, (April 6, 2021) https://www.nasdaq.com/articles/credit-suisse-overhauls-executive-board-as-it-estimates-archegos-fallout-at-%244.7-bln-*2021* and https://www.wsj.com/articles/credit-suisse-ignored-warnings-before-archegos-and-greensill-imploded-11617875627

[63] *Id.*

[64] Myriam Balezou, *Credit Suisse CEO's Pay Drops 43% After Archegos, Greensill*, BLOOMBERG (March 10, 2022) https://www.bloomberg.com/news/articles/2022-03-10/credit-suisse-ceo-sees-43-drop-in-pay-after-archegos-greensill

affiliate Financial Freedom allegedly made false claims to the government for federal insurance and paid a $89 million penalty.[65] Otting's bank put thousands of families out of their homes.[66] One judge deemed this "harsh, repugnant, shocking and repulsive" conduct.[67]

Otting and Mnuchin arranged to sell OneWest to CIT group for a profit; completion of the deal promised Otting a $24 million bonus.[68] What stood in the way of his huge payout were protests by some of those thousands of families and other victims of OneWest's practices. Under the Community Reinvestment Act (CRA), regulators can block mergers where a firm fails to serve its community. In trying to secure approval for OneWest's merger with CIT Group, Otting's bank created an online petition urging Federal Reserve Chair Janet Yellen to approve the transaction without a public hearing. Many of the names were Wall Street associates. The California Reinvestment Coalition noted, "In Mr. Otting's judgment, his friends on Wall Street, thousands of miles away, were somehow better situated to provide input on a California bank merger than the community members who were actually going to be impacted by the merger."[69]

The email campaign also included some irregularities. One petition was composed of 593 individuals purportedly supporting the merger with Yahoo email accounts. (Yahoo has a 3 percent market share for email.) Many these emails were time stamped as 2 a.m., February 13, 2015. Yahoo had suffered a security breach before this period. Other emails came from persons who, after they received receipt confirmation from the Washington regulator, denied they had originated them and theorized their email had been hacked.[70]

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[65] Press Release, *United States Department of Justice , Financial Freedom Settles Alleged Liability for Servicing of Federally Insured Reverse Mortgage Loans for $89 Million* (May 16, 2017), https://www.justice.gov/opa/pr/financial-freedom-settles-alleged-liability-servicing-federally-insured-reverse-mortgage

[66] Jessica Wehrman, *Why Sherrod Brown opposes former OneWest CEO as Comptroller of the Currency*, DISPATCH (September 7, 2017), https://bit.ly/2VZ2hP5

[67] Kieran Crowley, *Judge blasts bad bank, erases 525G debt*, NY POST (November 25, 2009), https://bit.ly/3bCICLg

[68] CIT Group, Schedule 14a, Securities and Exchange Commission (April 11, 2016) https://www.sec.gov/Archives/edgar/data/1171825/000089109216014070/e68787def14a.htm

[69] CRC Statement on Joseph Otting, CALIFORNIA REINVESTMENT COALITION (March 22, 2017), http://www.calreinvest.org/news/california-reinvestment-coalition-releases-statement-on-joseph-ottings-possible-nomination-for-comptroller-of-the-currency

[70] Bartlett Naylor, *The Revolving Door and the Assault on Community Reinvestment,* AMERICAN PROSPECT, (Nov. 21, 2018) https://prospect.org/economy/revolving-door-assault-community-reinvestment/

Despite the foreclosures and violations, despite the protests of the merger, despite the irregularities in the pro-merger petitions, and despite the fact that CIT terminated Otting shortly after then merger, Otting nevertheless received his $24 million payoff.[71] [72]

HSBC Money-laundering

In 2012, the DOJ filed a criminal charge against HSBC for money laundering, entering a so-called "deferred prosecution agreement" and fining the company $1.25 billion. According to the DOJ, HSBC "severely understaffed" its anti-money laundering division, failing to "monitor over $670 billion in wire transfers and over $9.4 billion in purchases of physical U.S. dollars from HSBC Mexico during this period, when HSBC Mexico's own lax AML controls caused it to be the preferred financial institution for drug cartels and money launderers."[73] The Senate Permanent Subcommittee on Investigations noted that those attracting the funds from money launderers received bonuses.[74]

Public Citizen and others questioned why the government didn't seek a final criminal charge, sanction the bank more harshly (the fine amounted to a month's worth of profit), and identify and prosecute responsible individuals.[75] Then-Attorney General Eric Holder told a Senate committee that some firms had become "so large" that a criminal charge against one of them could endanger the world economy; they were "too big to jail."[76]

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[71] Paulina Gonzalez & Sharon Kinlaw, *Let's Stop Wall Street Predators from Banking on Displacement*, TRUTHOUT (November 8, 2019), https://bit.ly/3bjtanb

[72] Otting then became Comptroller. His visits to Capitol Hill for testimony also drew controversy. He declared at one hearing that he's never experienced or witnessed racial discrimination, a plague that the Community Reinvestment Act aims to combat. Asked whether he watched or read the news about the Charlottesville white nationalist demonstration, he claimed that he doesn't read newspapers or watch TV news. As Comptroller, Otting did finalize a rule gutting the Community Reinvestment Act. *Fake it Till They Make It: How Bad Actors Use Astroturfing to Manipulate Regulators, Disenfranchise Consumers and Subvert the Rulemaking Process*, Testimony to House Financial Services Committee (February 6, 2020) https://bit.ly/2VCHDUD. Sylvan Lane, *Bank regulator faces backlash over comments on racism,* The Hill (June 14, 2018) https://bit.ly/2VB1AN2. Emily Flitter, *Bank Regulator's Battle With Anti-Redlining Law Comes to an End*, NEW YORK TIMES (May 28, 2020) https://www.nytimes.com/2020/05/28/business/economy/community-reinvestment-act-joseph-otting.html

[73] *HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement*, DEPARTMENT OF JUSTICE, (Dec. 11, 2021), https://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations

[74] U.S. Permanent Subcommittee on Investigations, *U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History*, U.S. PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, (July 17, 2012) https://www.hsgac.senate.gov/imo/media/doc/PSI%20REPORT-HSBC%20CASE%20HISTORY%20(9.6)2.pdf

[75] Bartlett Naylor, *Too Big*, PUBLIC CITIZEN, (2016) https://www.citizen.org/wp-content/uploads/toobig.pdf

[76] Transcript, *Attorney General Eric Holder on Too Big to Jail,* AMERICAN BANKER (March 6, 2013) http://www.americanbanker.com/issues/178_45/transcript-attorney-general-eric-holder-on-too-big-to-jail-1057295-1.html

Public Citizen and others warned that inadequate justice promotes recidivism. In 2021, officials fined HSBC again for money laundering violations.[77]

Cases From 2022

In addition to the well-publicized examples highlighted above, very recent instances of "inappropriate" behavior connected to compensation abound. Below is a sampling of cases announced this year—2022—which as of this research, is only nine months old.

Credit Suisse (again)

On January 9, 2022, the Financial Industry Regulatory Authority (FINRA) fined Credit Suisse $9 million for an assortment of misdeeds, including failure to explain to clients in its research reports that its Credit Suisse employees might receive compensation from the deals described in these reports.[78] According to FINRA, Credit Suisse issued more than 20,000 research reports between 2006 and 2017 that contained inaccurate disclosures regarding potential conflicts of interest. FINRA requires firms to "disclose in research reports if the firm or any of its affiliates received compensation for [investment banking] services from the subject company in the past 12 months, or if the firm or any of its affiliates expect to receive or intend to seek compensation for [such] services from the subject company in the next three months." In this way, an investor can better understand if a report that promotes an investment might include puffery that serves a current or prospective Credit Suisse client. [79]

Navient

On Jan. 13, 2022, 39 state attorneys general won a $1.85 billion settlement from student loan servicing giant Navient to resolve allegations of widespread unfair and deceptive practices and abuses in originating predatory student loans.[80] The state law enforcers claimed that since 2009, Navient steered struggling student loan borrowers into costly

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[77] Simon Clark, *HSBC Fined $85 Million for Lax Anti-Money-Laundering Controls*, WALL STREET JOURNAL, (Dec. 17, 2021) https://www.wsj.com/articles/hsbc-fined-85-million-for-lax-anti-money-laundering-controls-11639734739

[78] FINRA Rule 2241, and its predecessor NASD Rule 2711, require member firms that issue research reports to make certain conflict of interest disclosures concerning a subject company.7Among other things, a firm is required to disclose: (1) if it or any of its affiliates received compensation for investment banking (IB) services from the subject company in the past 12 months, or if it expects to receive or intends to seek compensation for IB services from the subject company in the next three months; (2) if it has received any non-IB revenue within the previous 12 months from the subject company; or (3) if it was making a market in the subject company's securities at the time the research report was published, https://www.finra.org/sites/default/files/fda_documents/2018059446101%20Credit%20Suisse%20Securities%20%28USA%29%20LLC%20CRD%20816%20AWC%20sl.pdf

[79] *Id.*

[80] Arizona Attorney General, *Attorney General Mark Brnovich Announces $1.85 Billion Settlement with Student Loan Servicer Navient* ARIZONA ATTORNEY GENERAL,(Jan. 13, 2022) https://www.azag.gov/press-release/attorney-general-mark-brnovich-announces-185-billion-settlement-student-loan-servicer

long-term forbearances instead of counseling them about the benefits of more affordable income-driven repayment plans.[81]

Navient compensates its executives based on several factors, including "fee income." The firm explains that "fee income emphasizes the continuing importance of our fee-based businesses, which generate income through loan servicing [and] asset recovery."[82] In addition, the CFPB alleged that Navient's compensation policies for its customer service representatives "incentivized them to push numerous borrowers" into these forbearance plans that were inferior for the student but more profitable for Navient.[83]

USAA Federal Savings Bank

On March 31, 2022, the Financial Crimes Enforcement Network (FinCEN) fined USAA Federal Savings Bank $80 million for anti-money laundering surveillance violations. FinCEN detailed several customers with questionable activity that the bank failed to surveil. For example, "Customer B," a 22-year-old individual in Los Angeles, California, held checking and credit card accounts with USAA for four years. Customer B reported to USAA that she owned a "performance art company." Customer B reported that her annual income was between $50,000 and $100,000, and that her account was for personal and household expenses. However, the bank found that the "performance art" maybe have been an "unlawful internationally-based prostitution/escort" service. One overseas client sent three wire transfers totaling $44,500. The foreign individual was identified in the Panama Papers, a trove of information about offshore accounts. USAA failed to notify FinCEN about Customer B and other suspicious accounts.[84]

FinCEN did not detail how USAA bankers profited from failing to close these accounts, but the Senate Permanent Subcommittee on Investigations found that bankers that secure new deposits, known in accounting terms as Net New Assets (NNA), is "one of the metrics used for measuring employee performance and compensation."[85] Further, FinCEN asserted that as its "consumer base and revenue grew," the bank "willfully failed to ensure that its compliance program kept pace, resulting in millions of dollars in suspicious

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[81] Arizona Attorney General, *Attorney General Mark Brnovich Announces $1.85 Billion Settlement with Student Loan Servicer Navient* ARIZONA ATTORNEY GENERAL,(Jan. 13, 2022) https://www.azag.gov/press-release/attorney-general-mark-brnovich-announces-185-billion-settlement-student-loan-servicer

[82] Navient, Proxy Statement 2017, NAVIENT (2017) https://images.navient.com/investors/shareholder/annual-reports/Navient-2017-Proxy-V4-Print-Ready.pdf

[83] Consumer Financial Protection Bureau, *CFPB v Navient*, CONSUMER FINANCIAL PROTECTION BUREAU, (Jan. 18, 2017) https://files.consumerfinance.gov/f/documents/201701_cfpb_Navient-Pioneer-Credit-Recovery-complaint.pdf

[84] Financial Crime Enforcement Network, In the Matter of USAA Federal Savings Bank, Financial Crimes Enforcement Network, (March 31, 2022) https://www.fincen.gov/sites/default/files/enforcement_action/2022-03-18/USAA%20Consent%20Order_Final%20508%20(2).pdf

[85] Senate Permanent Subcommittee on Investigations, *Offshore Tax Evasion*, U.S. SENATE (Feb. 26, 2014) https://www.hsgac.senate.gov/imo/media/doc/REPORT%20-%20OFFSHORE%20TAX%20EVASION%20(Feb%2026%202014,%208-20-14%20FINAL).pdf

transactions."[86] In this case, a prominent factor was the compensation *not* paid. FinCEN noted that the bank itself determined in 2018 that it needed 178 permanent staff to comply with anti-money laundering compliance, but a year later, there were 62 vacant positions.[87]

Allianz Global Investors

On May 17, 2022, the DOJ announced guilty pleas of bankers at Allianz Global Investors, and an indictment of a third in a securities fraud conspiracy that led to billions in losses for pension fund and other investors "in order to line their own pockets."[88]

Allianz is a German-based global financial firm that includes subsidiary Allianz Global Investors. Between 2014 and 2020, the Allianz conspirators promoted a set of private funds known as Structured Alpha Funds to "institutional investors, including pension funds for workers all across America," according to the DOJ. They "misled" these investors into believing that the funds were protected from a sudden stock market crash by engaging in sophisticated trading strategies known as hedges. As the cost of this strategy increased, they "decided to lie and secretly buy cheaper hedges that provided much less protection to investors." In March 2020, following the crash in the stock market after the COVID-19 pandemic stifled the world economy, the funds lost an excess of $7 billion in market value. These losses fell on more than 100 institutional investors who held savings of more than 100,000 customers. This included pension funds for teachers in Arkansas, laborers in Alaska, bus drivers and subway conductors in New York City, as well as religious organizations, engineers, and other individuals, universities, and charitable organizations across the United States. [89]

Before the 2020 crash, the scheme enhanced the profits of the firm, including the compensation paid to the conspirators. One of the alleged conspirators was "either the highest or second-highest compensated employee" of the firm. In 2019, two of the conspirators received $13 million each. The DOJ concluded, "As a result of this compensation structure, the [conspirators] earned higher pay by taking greater risk with

[86] Financial Crimes Enforcement Network, *FinCEN Announces $140 Million Civil Money Penalty against USAA Federal Savings Bank for Violations of the Bank Secrecy Act*, FINANCIAL CRIMES ENFORCEMENT NETWORK. (March 17, 2022) https://www.fincen.gov/news/news-releases/fincen-announces-140-million-civil-money-penalty-against-usaa-federal-savings
[87] Financial Crime Enforcement Network, In the Matter of USAA Federal Savings Bank, Financial Crimes Enforcement Network, (March 31, 2022) https://www.fincen.gov/sites/default/files/enforcement_action/2022-03-18/USAA%20Consent%20Order_Final%20508%20(2).pdf
[88] *Three Portfolio Managers And Allianz Global Investors U.S. Charged In Connection With Multi-Billion Dollar Fraud Scheme*, DEPARTMENT OF JUSTICE, (May 17, 20220 https://www.justice.gov/usao-sdny/pr/three-portfolio-managers-and-allianz-global-investors-us-charged-connection-multi
[89] *Id.*

the Funds' money to generate larger performance fee."[90] Certainly this should be seen as inappropriate risk-taking behavior.

In addition to prison sentences for the two conspirators who pleaded guilty, the government fined Allianz $1 billion.[91]

First Republic Bank

On May 19, 2022, the SEC fined First Republic $1.8 million for failing to disclose compensation conflicts with its investing clients. Specifically, the bank received compensation from another firm by placing investors' monies with this second firm, when First Republic could have found more favorable investment opportunities.[92]

In particular, First Republic invested clients' funds in certain mutual funds and so-called cash sweep products that led to a revenue sharing with an affiliated broker. First Republic might have used a different broker that would have been cheaper for First Republic clients.

Wells Fargo (again)

On May 20, 2022, The SEC charged Wells Fargo for failing to file at least 34 Suspicious Activity Reports (SARs) and the firm agreed to pay $7 million to settle the charges. The SEC said Wells Fargo failed to monitor foreign wire transfers properly, including transfers from foreign countries that it determined to be at a "high or moderate risk for money laundering, terrorist financing, or other illegal money movements."[93]

Brokers are generally compensated by charging fees on assets they attract and manage, so it is in their interest to attract, and not reject customers' requests to open an account.[94]

This 2022 fine follows another anti-money laundering fine at Wells Fargo from 2017. In this case, the SEC alleged that a new Wells Fargo manager for anti-money laundering compliance decided the bank was "filing too many" SARS and required that any report contain "proof" of illegal activity, a requirement that naturally led to the bank reporting

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[90] *Statement of Facts*, DEPARTMENT OF JUSTICE (website viewed August 23, 2022) https://www.justice.gov/usao-sdny/press-release/file/1506871/download

[91] *Three Portfolio Managers And Allianz Global Investors U.S. Charged In Connection With Multi-Billion Dollar Fraud Scheme,* DEPARTMENT OF JUSTICE (May 17, 20220 https://www.justice.gov/usao-sdny/pr/three-portfolio-managers-and-allianz-global-investors-us-charged-connection-multi

[92] Securities and Exchange Commission, *In the Matter of First Republic Investment Management*, SECURITIES AND EXCHANGE COMMISSION (May 19, 2022) https://www.sec.gov/litigation/admin/2022/ia-6030.pdf

[93] Securities and Exchange Commission, *SEC Charges Wells Fargo Advisors With Anti-Money Laundering Related Violations* SECURITIES AND EXCHANGE COMMISSION (May 20, 2022) https://www.sec.gov/news/press-release/2022-85

[94]Coryanne Hicks, *What Are Brokerage Fees and How Are They Paid?* US NEWS (May 24, 2021) https://money.usnews.com/investing/investing-101/articles/what-are-brokerage-fees-and-how-are-they-paid

less suspicious activity. Following this, Wells Fargo suspicious activity reporting declined 60 percent.[95]

Charles Schwab

On June 13, 2022, the SEC fined Charles Schwab $187 million for allegedly misleading investors so the firm could profit from reduced earnings for their clients. From March 2015 through November 2018, the SEC said Schwab told customers in its proprietary Schwab Intelligent Portfolios that the amount of cash was determined through a "disciplined portfolio construction methodology" to generate "optimal return[s]." In fact, the SEC said the firm's own data showed that under most market conditions, the cash in the portfolios would cause clients to make less money even while taking on the same amount of risk. Schwab failed to tell clients about this drag on their investment. As a result, the firm profited by "sweeping the cash to its affiliate bank, loaning it out, and then keeping the difference between the interest it earned on the loans and what it paid in interest to… clients."[96] The SEC did not identify specific individuals who many have profited; these profits may have been allocated generally to portfolio managers.

US Bank

On July 28, 2022, the CFPB fined U.S. Bank for a Wells Fargo-like fake-account scam. This allegedly began in 2016. "To increase sales of certain consumer financial products or services, U.S. Bank imposed sales goals on bank employees as part of their job description and implemented an incentive-compensation program that financially rewarded employees for selling those products and services," according to findings of the CFPB.[97] This activity spanned the years 2010 to 2020.[98] U.S. Bank is the nation's fifth largest bank and paid a $37 million penalty.[99]

Policy Reform

Bad pay structures led to the massive frauds precipitating the financial crash of 2008 and the resulting Great Recession. Historically, compensation structures that incentivize bending the rules to line one's pockets have caused crises in American history." Bad pay structures led to other bank-caused crises in American history, most notably the Crash of

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[95]Securities and Exchange Commission, *In the Matter of Wells Fargo Advisors*, SECURITIES AND EXCHANGE COMMISSION, (Nov. 13, 2017) https://www.sec.gov/litigation/admin/2017/34-82054.pdf

[96] Securities and Exchange Commission, *Schwab Subsidiaries Misled Robo-Adviser Clients about Absence of Hidden Fees* SECURITIES AND EXCHANGE COMMISSION (June 13, 2022) https://www.sec.gov/news/press-release/2022-104

[97] Consumer Financial Protection Bureau, *U.S. National Bank Association*, CONSUMER FINANCIAL PROTECTION BUREAU, (July 28, 2022) https://www.consumerfinance.gov/enforcement/actions/us-bank-national-association/

[98] *Consent Order, in the Matter of U.S. National Bank Association*, CONSUMER FINANCIAL PROTECTION BUREAU, (July 28, 2022) https://files.consumerfinance.gov/f/documents/cfpb_us-bank_-na_consent-order_2022-07.pdf

[99] Megan Cerullo, *U.S. Bank Opened Fake Accounts For Unsuspecting Customers*, CBS NEWS (July 28, 2022) https://www.cbsnews.com/news/us-bank-fake-accounts-consumer-financial-protection-bureau-cfpb/

1929 that precipitated the Great Depression. And since 2008, bad pay structures have led to major bank losses, bribery, money laundering, fraud, investor and consumer abuse.

Clearly, Washington rule-makers must use the available tool approved by Congress in 2010 to combat future injuries.

Public Citizen believes that a well-structured rule under Section 956 can help reduce the potential for recurrence of the types of problems this report documents.

We believe any final rule should contain the following.

1. Implement A Ban On Stock Options At Wall Street Banks

Risk-taking can become volatile at a bank when mixed with stock options.[100] Stock options promise executives all the benefits of share price increases with none of the risk of share price declines. In other words, stock options provide executives with asymmetric incentives to shoot for the moon. On Wall Street in the mid-2000s, this meant relaxing the underwriting standards on mortgage lending to generate fees for the bank while inflating the housing bubble. As long as massive stock option jackpots — often worth seven-, eight- and even nine-digits — are sitting on the table, with little or no downside risk, Wall Street executives and traders have a powerful incentive to make outrageous gambles that put us all at risk. Many of the senior executives in cases above profited when they or their subordinates engaged in fraudulent activity because that raised the stock price. For example, pressure by Wells Fargo's executives on the line clerks to fabricate fake accounts for customers yielded growth numbers that pleased Wall Street, driving up the stock price.

Some firms, including JP Morgan and Citigroup, have already voluntarily stopped issuing executive stock options.[101] They should be banned for all bankers. We note that rules from the European Union introduced in 2014 limit banker bonuses to no more than annual salary, or up to 200 percent of annual salary with shareholder approval.

2. A requirement that significant compensation be deferred for 10 years to pay potential misconduct fines

The fraud perpetrated by bankers leading up to the 2008 crash resulted in tens of billions of dollars in fines. But prosecutors failed to imprison any senior banker or assess fines on any of the responsible individuals. Instead, bank shareholders effectively paid those fines. We advocate that a significant portion of senior banker annual pay be deferred for ten

[100] Michael Lewis, *The New New Thing*, W.W. Norton, (2008) https://wwnorton.com/books/9780393347814
[101] Proxy Statement, JPMorgan, (2015).
https://www.sec.gov/Archives/edgar/data/19617/000001961716000933/jpmc2016definitiveproxy.htm#s75F6874A610C1B57AA 641C1B3061F51C

years.[102] These collective funds would then be used to pay fines that a company might incur for misconduct settlements. William Dudley, then president of the New York Federal Reserve Bank, advanced this proposal as a way to change the dangerously reckless, individualistic culture on Wall Street.[103] In concept, it returns investment firms to their pre-public partnership model, where fines were effectively deducted from the profits that might be distributed to partners.

Many of the frauds discussed above must have been understood by at least some senior executives who nevertheless kept quiet lest their lack of loyalty jeopardize their job security. If their own pay were jeopardized, they might have spoken up. If executives knew that the tsunami of fraudulent mortgage-making leading to the 2008 financial crash would lead not to shareholder-funded fines, but elimination of their own bonus, they may have bridled this behavior.

3. A Ban On Executive Hedging Of Bonus Pay

Any effort to reduce inappropriate risk-taking will be ineffective if employees can use hedging strategies to reduce their risk from poor company performance. In 2005, AIG CEO Hank Greenberg bought insurance to hedge about $300 million worth of stock, allowing him to avoid millions of dollars in losses when the firm collapsed in 2008.[104] The Bank of England already imposes a hedging ban on executives of the banks it supervises, and several major U.S. banks have voluntarily instituted such anti-hedging policies.[105] The U.S. rule should do so as well.

Conclusion

Financial institutions play a pivotal role in our economy, matching savers and users of capital. America's great industries grew with the financing of banks, from the railroads, automobiles and airplanes, to pharmaceuticals, technology, food and more. These businesses, in turn, can provide good jobs. Homebuyers can live in greater comfort with sound loan-making. Consumers can access credit for needed purchases.

But when bankers seek to maximize their compensation by any means, the devastation can be equally bleak, as attested by the Great Depression, the Great Recession, money-laundering that fuels drug lords and tyrants, bribery that undermines government

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[102] Ten years is the statute of limitations under the Financial Institutions Reform, Recovery and Enforcement Act, or FIRREA.

[103] Bartlett Naylor, *Decimate Wall Street*, HUFFINGTON POST (NOV. 22, 2014) http://www.huffingtonpost.com/bartlettnaylor/decimate-wall-street_b_6029372.html

[104] Senate Banking Committee, *Examining Incentive Compensation /At Large Financial Institutions*, SENATE BANKING COMMITTEE (Feb. 15, 2012) https://www.gpo.gov/fdsys/pkg/CHRG-112shrg75026/html/CHRG-112shrg75026.htm

[105] PricewaterhouseCoopers, ''*Executive Compensation: Clawbacks, 2014 Proxy Disclosure Study*'' (January 2015), http://www.pwc.com/us/en/hr-management/publications/assets/pwc-executive-compensationclawbacks-2014.pdf

development programs and public trust, consumers paying fees on accounts they didn't open, abused shareholders and investors, and other harms to consumers due to inappropriate behavior by bankers.

Washington's regulators must propose a strong rule to implement Section 956. The time is now.