

KING HENRY II AND THE GLOBAL FINANCIAL CRISIS

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I. Introduction

“Will no one rid me of this turbulent priest!” lamented King Henry II, which to his purported surprise led four knights to murder Thomas Becket, the Archbishop of Canterbury.¹ To the knights, the King’s wishes were clear. But the wording of his statement and its ambiguity allowed King Henry to deny that he authorized, or even knew of, the barbarity committed on his behalf. Following the financial crisis of 2008, the financial industry has arguably experienced a number of such “King Henry moments,” where senior executives have allegedly been aware of, or turned a blind eye to, questionable actions that occurred on their watch.

Headlines abound with recent examples of senior executives channeling their inner King Henry and tacitly allowing, if not silently encouraging, their employees to undertake improper and systematically harmful actions—often for the executives’ own personal benefit.² For example, supervisors at JPMorgan Chase encouraged employees to

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¹ Ben Johnson, *Thomas Becket*, HISTORIC UK: THE HISTORY AND HERITAGE ACCOMMODATION GUIDE, <http://www.historic-uk.com/HistoryUK/HistoryofEngland/Thomas-Becket/>.

² See, e.g., Gretchen Morgenson, *Behind Insurer’s Crisis, Blind Eye to a Web of Risk*, N.Y. TIMES (Sept. 27, 2008), <http://www.nytimes.com/2008/09/28/business/28melt.html?pagewanted=all> (explaining that “[i]n the case of A.I.G., the virus . . . flourished in a climate of opulent pay, lax oversight and blind faith in financial risk models” and contributed to the vulnerable financial system that caused the financial crisis); see also *All In With Chris Hayes* (MSNBC television broadcast Nov. 10, 2014), available at http://www.nbcnews.com/id/56403976/ns/msnbc-all_in_with_chris_hayes/t/all-chris-hayes-monday-

push sub-standard, toxic mortgages, which were among the precipitating causes of the 2008 financial crisis, in order to increase the supervisors' own bonus pool. At the same time, they prohibited diligence managers from using emails and took other steps to obscure their own involvement in the improper scheme.³ However, no senior executives were held accountable for these actions or the damages to which they contributed. Senior executives at MF Global claimed ignorance when, in direct response to their oblique request to their employees for funding, hundreds of millions of dollars of customer assets were used to support the firm's proprietary transactions, resulting in the eighth largest bankruptcy in history.⁴ No senior executives were held accountable for these actions or the resulting customer losses.⁵ Executives of Barclays Plc looked the other way when its traders manipulated Libor in order to increase the bank's profits, despite the significant negative impact on worldwide financial markets.⁶ No senior executives were held personally accountable for these actions or the resulting market impact.⁷ Senior executives at Standard Chartered Bank and ING Bank N.V. processed (and collected fees on) transactions for internationally sanctioned countries, thereby contributing to money laundering and terrorism financing.⁸ Again, no senior executives were held accountable

november-th/ (discussing bank executives' improper practices with Alayne Fleischman and Matt Taibbi).

³ For example, a whistleblower at JPMorgan explained that at the bank, supervisors acted to distance themselves from actions that could lead to accountability, in part because individual compensation was tied to the quantity of mortgages the bank purchased, without regard to the quality of those mortgages. *See All In With Chris Hayes*, *supra* note 2.

⁴ *See* Sarah N. Lynch & Aruna Viswantatha, *Mf Global Execs Ignore, Silence Stymie Congress*, REUTERS, Mar. 28, 2012, <http://www.reuters.com/article/us-mfglobal-idUSBRE82R0YI20120329>; *see also* Alex Howe, *The 11 Largest Bankruptcies in American History*, BUSINESS INSIDER (Nov. 29, 2011, 12:33 PM), <http://www.businessinsider.com/largest-bankruptcies-in-american-history-2011-11>; Lisa Du, *Report: Jon Corzine Ordered \$200 million of MF Global Customer Funds to be Moved Before Bankruptcy*, BUSINESS INSIDER (Mar. 23, 2012, 4:20 PM), <http://www.businessinsider.com/report-jon-corzine-ordered-200-million-of-mf-global-customer-funds-to-be-moved-before-bankruptcy-2012-3>.

⁵ *See* H.R. REP. NO. 113-469, at 5 (2014) ("After MF Global filed for bankruptcy, it was revealed that in the final days before the firm's failure, customer segregated funds . . . were used to fund the company's liquidity needs . . ."); *see also* Mark Gongloff, *Here's Why There Will Be No Criminal Charges In the MF Global Case*, HUFFINGTON POST (June 28, 2013, 1:35 PM), http://www.huffingtonpost.com/2013/06/28/criminal-charges-mf-global_n_3516652.html.

⁶ Jonathan Stempel, *Barclays Settles With U.S. Investors Over Libor Manipulation*, REUTERS, Nov. 25, 2015, <http://www.reuters.com/article/2015/11/25/barclays-libor-settlement-idUSL1N13K1MA20151125#E1SWefgMBP5u1GhJ.97>.

⁷ Alexandra Alper & Kirstin Ridley, *Barclays paying \$453 million to settle Libor probe*, REUTERS, June 27, 2012, <http://www.reuters.com/article/us-barclays-libor-idUSBRE85Q0J720120627> (discussing the involvement of Barclays and other banks in Libor manipulation and noting that "no criminal charges have been filed").

⁸ *See* Press Release, U.S. Dep't of Justice, *Standard Chartered Bank Agrees to Forfeit \$227 Million for Illegal Transactions with Iran, Sudan, Libya, and Burma* (Dec. 10, 2012), <http://www.justice.gov/opa/pr/standard-chartered-bank-agrees-forfeit-227-million-illegal-transactions->

for their actions or the resulting societal harm.⁹

The collapse of MF Global and other events following the 2008 financial crisis have fueled populist complaints that senior executives are never held accountable and that Wall Street was bailed out rather than penalized.¹⁰ Admittedly, the financial institutions referenced above, as well as many others, have faced substantial fines as a result of their improper behavior, but these fines have been levied against the corporations themselves and not against the senior executives who actually allowed these improper actions to occur. As the continual stream of headlines demonstrates, fines against corporate entities fail to dis-incentivize individual executives who personally benefit from improper and illegal actions, and overall, there has been systemic failure to bring senior executives to heel for their “King Henry moments.”

These events have properly led to calls to reform existing legal structures so that liability would be imposed on senior executives for similar future incidents.¹¹ Although recent headlines highlight the need for reform,¹² it is important to recognize that the

iran-sudan-libya-and (“[F]rom 2001 through 2007, SCB violated U.S. and New York state laws by moving millions of dollars illegally through the U.S. financial system on behalf of Iranian, Sudanese, Libyan and Burmese entities subject to U.S. economic sanctions.”); Press Release, U.S. Dep’t of Justice, ING Bank N.V. Agrees to Forfeit \$619 Million for Illegal Transactions with Cuban and Iranian Entities (June 12, 2012), <http://www.justice.gov/opa/pr/ing-bank-nv-agrees-forfeit-619-million-illegal-transactions-cuban-and-iranian-entities-0> (explaining that “ING Bank knowingly and willfully engaged in . . . criminal conduct, which caused unaffiliated U.S. financial institutions to process transactions that otherwise should have been rejected, blocked, or stopped . . .”).

⁹ See Brett Wolf, *Bankers to Be held Personally Responsible for Sanctions Violations* Treasury, REUTERS, Mar. 22, 2013, http://www.huffingtonpost.com/2013/03/22/bank-sanction-violations_n_2934839.html (“Since 2005, OFAC and its U.S. law enforcement partners have targeted HSBC, Standard Chartered Bank, ING Bank NV, Credit Suisse, Barclays, Lloyds TSB Bank and ABN AMRO for sanctions violations. Still, no individual bankers were held to account.”).

¹⁰ See, e.g., Editorial Board, *The Case of the Missing White-Collar Criminal*, BLOOMBERG VIEW (June 22, 2014 6:02 PM), <http://www.bloombergvew.com/articles/2014-06-22/the-case-of-the-missing-white-collar-criminal> (“The evidence strongly suggests that prosecutors could have done more to identify and punish the people who caused a crisis that has visited suffering on millions.”); see also Gretchen Morgenson & Louise Story, *In Financial Crisis, No Prosecutions of Top Figures*, N.Y. TIMES (Apr. 14, 2011), http://www.nytimes.com/2011/04/14/business/14prosecute.html?_r=0.

¹¹ See, e.g., Michael S. Barr, *The Financial Crisis and the Path of Reform*, 29 YALE J. ON REG. 91, 92–108 (2012) (explaining that the “[financial] crisis demonstrated the need for comprehensive financial reform” and identifying areas for reform beyond the Dodd-Frank Act); Eric C. Chaffe, *A Panoramic View of the Financial Crisis that Began in 2008: The Need for Domestic and International Regulatory Reform*, 35 U. DAYTON L. REV. 1, 2 (2009) (discussing “the importance of reform in international securities regulation as a means of preventing or lessening any future financial crisis”).

¹² See, e.g., Henry Engler, *Global finance leaders to banks: reform culture and conduct or face more regulation*, REUTERS: FINANCIAL REGULATORY FORUM (Aug. 3, 2015), <http://blogs.reuters.com/financial-regulatory-forum/2015/08/03/global-finance-leaders-to-banks-reform-culture-and-conduct-or-face-more->

improper behavior generating these headlines represents a very small fraction of overall financial industry behavior. Reforms should balance the need to dis-incentivize excessive risk-taking and other behavior with the need to preserve and promote healthy, active, and well-functioning financial markets. With this purpose in mind, this Article outlines the current state of the law governing senior executive liability, summarizes recent headline events in the financial industry, and provides a series of recommendations for proportionate reforms to correct current incentive imbalances.

II. The Current Framework for Executive Liability

Understanding the limitations of the current legal framework governing executive liability is essential to appreciating recent populist calls for reform. The framework is geared toward insulating executives from shareholder lawsuits that question legitimate business decisions. It is neither intended nor equipped to address incidents of fraud and failures of senior management to properly supervise subordinates.

Generally, the individual executive who authorizes a corporate action is shielded from personal liability—even when that action has negative consequences for the corporation and its shareholders.¹³ For example, when a shareholder alleges that a board of directors' decision constitutes a breach of fiduciary duty, courts generally defer to the decision-making ability of the directors—rather than second-guess their decision—under the doctrine known as the business judgment rule.¹⁴ This deference holds unless the shareholder can establish a lack of careful board deliberation, self-dealing, or bad faith.¹⁵

regulation/.

¹³ The business judgment rule amounts to “a presumption that ‘in making a business decision the directors of a corporation acted on an informed basis . . . and in the honest belief that the action taken was in the best interests of the company [and its shareholders].’” *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 747 (Del. Ch. 2005) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)), *aff'd*, 906 A.2d 27 (Del. 2006); *see also In re Caremark Int'l*, 698 A.2d 959, 967 (Del. Ch. 1996) (“[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through ‘stupid’ to ‘egregious’ or ‘irrational,’ provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests.”).

¹⁴ *In re Walt Disney Co.*, 907 A.2d at 747 (explaining that, under the business judgment rule, the court presumes that a director of a corporation made a decision on an informed basis, and that the presumption can be rebutted by a showing that the board violated its fiduciary duties).

¹⁵ *Ryan v. Gifford*, 918 A.2d 341, 357 (Ch. Del. 2007) (finding that a complaint, which alleged breach of duty of loyalty by directors who approved or accepted backdated stock options, stated a claim sufficient to rebut the business judgment rule); *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) (explaining that the business judgment rule would not apply “where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally

The business judgment rule reflects the idea that directors are motivated to act in the best interests of the corporation and its shareholders.¹⁶ It allows corporate executives to fulfill their duty to make a corporation profitable without fear that an informed but ultimately costly decision will result in exposure to liability.

Under this legal framework, an individual executive often will only be prosecuted for financial or other white-collar crime (or be found civilly liable on related theories) if it can be demonstrated that he had actual knowledge of the actions that harmed his corporation or clients, or willfully blinded himself to such knowledge.¹⁷ Because of this high bar to individual prosecution, regulatory enforcement actions typically focus on corporate entities. Although these efforts sometimes produce large monetary settlements,¹⁸ they illustrate the shortcomings of the current legal framework that make it difficult to hold individual executives culpable for improper management or supervision.

In addition to inhibiting the prosecution of individuals,¹⁹ the current legal framework tends to misalign the interests of executives, shareholders, and the public, because it discourages internal investigation and reporting of wrongdoing while simultaneously incentivizing risk-taking by the financial institutions' employees. For example, an executive in an oversight role who investigates and uncovers wrongdoing but fails to act may expose himself to liability. That same executive, however, might avoid personal exposure if he simply fails to investigate, or distances himself from the wrongdoing—despite the fact that this “see no evil” posture may cause substantial damage to his corporation. This problem is magnified when the improper or reckless

fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties”) (internal citation omitted).

¹⁶ *In re Caremark Int'l*, 698 A.2d at 967–68 n.16 (“The corporate form gets its utility in large part from its ability to allow diversified investors to accept greater investment risk. If those in charge of the corporation are to be adjudged personally liable for losses . . . such persons will have a strong incentive at the margin to authorize less risky investment projects.”).

¹⁷ *In re Walt Disney Co.*, 906 A.2d, at 67 (agreeing with the lower court’s post-trial opinion in its explanation of actions that constitute a failure to act in good faith).

¹⁸ For example, Bank of America agreed to a \$16.65 billion settlement with the DOJ to resolve claims against the bank for financial fraud. See Press Release, U.S. Dep’t of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), <http://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading>.

¹⁹ The DOJ, however, has not hesitated to require banks to plead guilty to criminal charges. In May 2014, Credit Suisse pleaded guilty to conspiracy for aiding its customers in hiding accounts overseas to avoid taxes. Also, BNP Paribas entered a guilty plea to a charge of conspiracy to violate economic sanctions in June 2014. See Peter J. Henning, *The Prospects for Pursuing Corporate Executives*, N.Y. TIMES (Sept. 14, 2015), http://www.nytimes.com/2015/09/15/business/dealbook/theprospects-for-pursuing-corporate-executives.html?_r=0.

behavior may produce a bonus of millions of dollars if the bet, made with shareholder funds, wins.

III. An Overview of Recent Headlines Regarding Misconduct in the Financial Industry

Recent headlines highlighting allegedly improper actions of individuals at major financial institutions illustrate the problems that stem from the limitations of the current legal framework and associated incentives that prioritize profit-seeking and risk-taking by individuals.

A prime example of the problems that can emerge is the \$13 billion settlement between JPMorgan and the Department of Justice (DOJ), which freed JPMorgan from any civil liability associated with the bank's alleged fraudulent mortgage operations that may have played a role in the 2008 financial crisis.²⁰ The settlement agreement is the result of federal and state claims against the bank for issuing residential mortgage-backed securities that JPMorgan represented as being in compliance with underwriting guidelines. The employees are alleged to have known of the misrepresentations, but pushed them through anyway in order to increase compensation awards.²¹

The incentive of senior managers to seek immediate profits at the potential expense of their firm's long-term health is also illustrated by the recent settlement between Standard Chartered Bank and the DOJ.²² U.S. federal and state prosecutors

²⁰ See Press Release, U.S. Dep't of Justice, Federal and State Partners Secure Record \$13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), <http://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement>. As part of its settlement with the DOJ, JPMorgan acknowledged that it made serious misrepresentations to the public and to investors about numerous residential mortgage-backed securities transactions.

²¹ See *id.* (noting that the settlement agreement alleges JPMorgan employees knew the loans in question did not comply with underwriting guidelines, but represented otherwise to investors). A whistleblower and former securities lawyer for JPMorgan provided her view on how the misalignment of interest of the bank employees and those responsible for diligence allowed the practice of pushing toxic mortgages to emerge. She explained that supervisors pushed quality control managers to approve sub-standard mortgages because individual compensation was tied to the quantity (without regard to quality) of mortgages the bank purchased. See *All In With Chris Hayes*, *supra* note 2. In early 2015, JPMorgan and the DOJ entered into another settlement, which required JPMorgan to pay over \$50 million to over 25,000 homeowners in bankruptcy as a result of the bank filing more than 50,000 payment change notices that were improperly signed. See Press Release, U.S. Dep't of Justice, Trustee Program Reaches \$50 Million Settlement with JPMorgan Chase to Protect Homeowners in Bankruptcy (Mar. 3, 2015), <http://www.justice.gov/opa/pr/us-trustee-program-reaches-50-million-settlement-jpmorgan-chase-protect-homeowners-bankruptcy>.

²² See Press Release, U.S. Dep't of Justice, Standard Chartered Bank Agrees to Forfeit \$227 Million,

investigated Standard Chartered for processing thousands of allegedly illegal transactions through the U.S. financial system on behalf of sanctioned entities (Iran, Sudan, and others), which allegedly made Standard Chartered millions in transaction fees.²³ Emails from the investigation revealed that the senior managers were warned that the transactions could result in “very serious or even catastrophic reputational damage to the bank,” but continued to process and collect fees on the questioned transactions.²⁴ This was not Standard Chartered’s first settlement related to the same illegal schemes, as the bank had previously settled similar charges with state regulators.²⁵ Regulators have also investigated and reached settlements with other banks whose senior management actively pursued and concealed similarly improper but profitable transactions with sanctioned entities.²⁶

The reports of the manipulation of ISDAfix exemplify how limitations on imposing liability on individuals can also pose a systemic risk to the financial markets. The lawsuit against these banks alleges that the defendants rigged the ISDAfix, a benchmark used to set rates for interest rate derivatives, and thereby were in a position to

supra note 8.

²³ Jessica Silver-Greenberg, *Standard Chartered Agrees to Settle Iran Money Transfer Claims*, N.Y. TIMES (Dec. 10, 2012), <http://dealbook.nytimes.com/2012/12/10/standard-chartered-agrees-to-settle-iran-money-transfer-claims/>; *see also* BBC News, *Q&A: Standard Chartered Iran Allegations*, BBC (Dec. 10, 2012), <http://www.bbc.com/news/business-19157426>.

²⁴ Dominic Rushe & Jill Treanor, *Standard Chartered bank accused of scheming with Iran to hide transactions*, THE GUARDIAN (Aug. 6, 2012, 19:34 EDT), <http://www.theguardian.com/business/2012/aug/06/standard-chartered-iran-transactions>.

²⁵ *See* Press Release, N.Y. Dep’t of Financial Services, Statement from Benjamin M. Lawsky, Superintendent of Financial Services, Regarding Signing of Final Agreement with Standard Chartered Bank (Sept. 21, 2012), <http://www.dfs.ny.gov/about/press/pr1209211.htm>; *see also* Jessica Silver-Greenberg, *supra* note 23. Still, it seems that these large settlements may not have been large enough to deter Standard Chartered as reports indicate that the bank may still be processing transactions for entities tied to sanctioned countries. Andrew Zajac & Richard Partington, *Standard Chartered Iran-Trade Oversight Extended 3 Years*, BLOOMBERG (Dec. 9, 2014 3:51 PM), <http://www.bloomberg.com/news/articles/2014-12-09/standard-chartered-extends-us-prosecution-deal-over-sanctions>.

²⁶ *See* Press Release, U.S. Dep’t of Justice, ING Bank N.V. Agrees to Forfeit \$619 Million, *supra* note 8; Press Release, U.S. Dep’t of Justice, 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 (Dec. 11, 2012), <http://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations>; *see also* Annie Lowrey, *ING Bank to Pay \$619 Million to Settle Inquiry Into Sanctions Violations*, N.Y. TIMES (June 12, 2012), <http://www.nytimes.com/2012/06/13/business/ing-bank-to-pay-619-million-over-sanctions-violations.html>; Ben Protess & Jessica Silver-Greenberg, *HSBC to Pay \$1.92 Billion to Settle Charges of Money Laundering*, N.Y. TIMES (Dec. 10, 2012 4:10 PM), <http://dealbook.nytimes.com/2012/12/10/hsbc-said-to-near-1-9-billion-settlement-over-money-laundering/>.

profit in separate derivatives trades with clients that sought to hedge against moves in the interest rates.²⁷ In order to see such financial gain, the ISDAfix only needed to be “manipulated by as little as . . . 0.0025 percent” of a point of the overall rate for the banks to potentially earn millions.²⁸ On May 20, 2015, the Commodity Futures Trading Commission (CFTC) settled charges against Barclays Plc for \$115 million as a penalty for the attempted manipulation of the ISDAfix.²⁹ Though the settlement required Barclays to take remedial steps that would help “detect and deter trading intended to manipulate swap rates and improve internal controls,” no individuals were held personally liable.³⁰

The 2008 financial crisis as a whole serves as an illustration of the potential systemic risk created by the current legal framework. The Financial Crisis Inquiry Report found that the 2008 financial crisis was avoidable, but that “the captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks.”³¹ The Report recognizes this misalignment, explaining that the compensation systems at “important financial institutions” rewarded the “quick deal” without considering future consequences, and “encouraged the big bet” that would yield a huge upside to compensation with limited downside.³² The Report showed egregious examples of individuals putting their compensation at the forefront while taking risks with others’ money.³³

The collapse of Lehman Brothers—which remains today the largest chapter 11

²⁷ Class Action Complaint, *Alaska Electrical Pension Fund v. Bank of America Corp. et al.*, Case No. 14-CV-07126 (JMF) (Sept. 4, 2014) (Docket No. 1); *see also* Bob Van Voris and Matthew Leising, *Barclays, BofA, Citigroup Sued for ISDAfix Manipulation*, BLOOMBERG (Sept. 5, 2014, 1:02AM), <http://www.bloomberg.com/news/articles/2014-09-04/barclays-bofa-citigroup-sued-for-isda-fix-manipulation>; Mary Tonkin, et al., *Claims for ISDAfix manipulation*, LEXOLOGY (Oct. 23, 2014), <http://www.lexology.com/library/detail.aspx?g=f443ea5a-7afd-4eff-9de5-eb9b6a32c53f>.

²⁸ Matthew Leising, *Banks Rigged Rate at Expense of Retirees*, BLOOMBERG (Aug. 2, 2013, 2:00 AM), <http://www.bloomberg.com/news/articles/2013-08-02/swaps-probe-finds-banks-manipulated-rate-at-expense-of-retirees>.

²⁹ Press Release, U.S. Commodity Futures Trading Commission, CFTC Orders Barclays to Pay \$115 Million Penalty for Attempted Manipulation of and False Reporting of U.S. Dollar ISDAFIX Benchmark Swap Rates (May 20, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7180-15>.

³⁰ *Id.*

³¹ FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT, at xvii (Jan. 2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

³² *Id.* at xviii–xix.

³³ *See id.* at xix. Such examples include AIG senior management ignoring the “risks of the company’s \$79 billion derivatives exposure to mortgage-related securities” and “Fannie Mae’s quest for bigger market share, profits, and bonuses, which led it to ramp up its exposure to risky loans and securities as the housing market was peaking.” *Id.*

filing in history—is a prime example of how the “King Henry” problem contributed to the 2008 financial crisis. First, the investment bank business model, which was not unique to Lehman but shared by the major investment banks at the time, followed a “high-risk, high-leverage model” that “rewarded excessive risk taking.”³⁴ In order to instill confidence in the market, Lehman exceeded its own risk limits and became significantly over-leveraged.³⁵ When the sub-prime mortgage crisis emerged, instead of reducing its risk, “Lehman made the conscious decision to ‘double down’” in an attempt to make a profit.³⁶ Further, the business judgment rule protected the decisions of Lehman executives, which allowed them to make “serious but non-culpable errors of business judgment.”³⁷

IV. Surgical Reform Proposals

These recent headlines, combined with the ongoing examination of the events that led to the 2008 financial crisis, have contributed to increasingly vocal calls to reform the legal framework for individual liability. Serving as the trustee for the Securities Investor Protection Act liquidation of MF Global, Inc., the Author witnessed the damage inflicted on innocent parties when senior management advances a policy of excessive risk-taking while simultaneously failing to properly supervise the risk-takers. These experiences may be helpful as a guide on how potential reforms to the existing legal framework could realign incentives and better permit regulators and other entities to hold senior managers responsible for fraudulent and otherwise improper actions. The following sections provide an overview of four specific proposals, which, if adopted, would advance these goals.

A. Proposal One: Require executives to certify financial statements with strict civil liability in the event of regulatory shortfall

Following a liquidity crisis that precipitated a “run on the bank” scenario, MF Global filed for bankruptcy on October 31, 2011.³⁸ A thorough and detailed investigation showed that MF Global’s collapse, and the resulting shortfall in segregated customer

³⁴ Report of Anton R. Valukas, Examiner, *In re Lehman Brothers Holdings Inc.*, Case No. 08-13555 (JMP) (S.D.N.Y. Mar. 11, 2010), available at <https://jenner.com/lehman/VOLUME%201.pdf>.

³⁵ *Id.* at 4 (“In 2006, Lehman made the deliberate decision to embark upon an aggressive growth strategy, to take on significantly greater risk, and to substantially increase leverage on its capital Lehman significantly and repeatedly exceeded its own internal risk limits and controls.”).

³⁶ *Id.*

³⁷ *Id.* at 3.

³⁸ Voluntary Petition For Bankruptcy, *In re MF Global Holdings Ltd.*, No. 11-15059 (MG) (Bank. S.D.N.Y. Oct. 31, 2011) (No. 11709).

assets, was caused by the failure of MF Global's senior management (i) to install sufficient monitoring and internal compliance systems, (ii) to maintain integrated systems for tracking liquidity and the movement of funds, (iii) to properly supervise key treasury functions, (iv) to avoid the fragmentation of responsibility, and (v) to pay adequate attention to the details of maintaining the segregation of customer funds.³⁹ These failures occurred at senior levels of the company and led to the improper use of customer property, which was an attempt to shore up liquidity drains caused by an overly risky investment strategy.⁴⁰ This tactic was calculated to increase profits and grow MF Global.

The first lesson to be learned from the collapse of MF Global, as well as the other events detailed above, is that there must be stronger incentives for senior management to actively monitor and supervise their employees. This can be accomplished in part by imposing greater requirements on senior executives to ensure the accuracy of their internal monitoring and reporting. For example, CFTC regulations require futures commission merchants (FCMs) to segregate customer funds at all times.⁴¹ Accordingly, it would be an appropriate reform to impose civil fines on the executives responsible for signing the firm's financial statements in the event of a regulatory shortfall, such as the failure to segregate customer funds as seen in MF Global. In addition, the chief executive officer, the chief financial officer, the chief compliance officer, and the general counsel of an FCM should be required to certify on a frequent and continuing basis not only the company's financial statements, but also their compliance with customer segregation requirements. It is also necessary to impose certain internal compliance measures, such as requiring these executives to establish and oversee the company's internal controls and procedures, and to further certify that they have done so.⁴² Upon a shortfall in customer funds, Congress should make these individuals personally and civilly liable for their certifications. Similar certification requirements are imposed by the Sarbanes-Oxley Act.⁴³ In these circumstances, executives should be held strictly liable without a proof of

³⁹ Report of the Trustee's Investigation and Recommendations, *In re MF Global Inc.*, No. 11-02790 (MG) (June 4, 2012) (No. 1865).

⁴⁰ *Id.* at 15 (“[T]he actions of management and other employees, along with lack of sufficient monitoring and systems, resulted in FCM customer property being used during the liquidity crisis to fund the extraordinary liquidity drains elsewhere in the business . . .”).

⁴¹ Futures customer funds to be segregated and separately accounted for, 17 C.F.R. § 1.20(a) (2014) (“A futures commission merchant must separately account for all futures customer funds and segregate such funds as belonging to its futures customers.”).

⁴² See *Trustee for the Securities Investor Protection Act Liquidation of MF Global Inc.: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 1–2 (2012) (statement of James W. Giddens, Trustee for the Securities Investor Protection Act).

⁴³ See 18 U.S.C. § 1350 (2002).

intent requirement, and without the defense that they delegated these essential duties and responsibilities.

Similar calls for reform for executive personal liability have been heard in the United Kingdom. These calls led to reform proposals by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA),⁴⁴ which included provisions aimed at increasing the individual accountability of senior managers in the United Kingdom.⁴⁵ The new regulatory framework introduces the concept of a “senior management function,” and any individual performing such a function must obtain pre-approval by the relevant regulator.⁴⁶ The reforms also require that each application for approval to perform a senior management function is accompanied by a “statement of responsibilities” document which sets out the senior manager’s roles and responsibilities along with a “responsibilities map” that describes the firm’s overall governance framework.⁴⁷ Additionally, the new regime imposes criminal liability on senior managers making a decision (where that decision falls far below what could reasonably be expected of a person in their position) that causes a firm to fail.

The proposed reforms initially included a “presumption of responsibility” whereby senior managers would be deemed guilty of misconduct unless they could show that they had taken all reasonable steps to prevent a particular contravention from occurring. However, following a backlash from the financial sector, the U.K. regulators revised the proposals such that regulators must now prove that a senior manager did not take all reasonable preventative steps.

The purpose of the U.K. reforms is to encourage senior executives to take greater responsibility for their actions, which, in turn, should make it easier for both firms and regulators to hold them accountable. Although there has been a retreat from the original, more draconian proposals, the U.K. regulators are able to look to senior managers’ statements of responsibilities to determine the areas for which they are responsible. The threat of criminal liability should act as an ultimate deterrent to overly risky behavior and

⁴⁴ The PRA and the FCA are the successor entities to the Financial Services Authority. The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers, and major investment firms operating in the United Kingdom, while the FCA is responsible for retail and wholesale conduct of business regulation, regulation of markets, and the prudential regulation of firms not authorized by the PRA.

⁴⁵ See Taylor Wessing, et al., *Accountability, Risk and Reward: The New Regulatory Framework for Senior Managers*, LEXOLOGY (Oct. 2, 2014), <http://www.lexology.com/library/detail.aspx?g=22a66309-f216-4fbe-8fa2-efaaaa9416a7>.

⁴⁶ See *id.*

⁴⁷ See *id.*

decision-making by senior executives.

B. Proposal Two: Obligate misbehaving executives to pay a portion of any regulatory fine

Imposing liability on senior executives, in circumstances where relevant certifications turn out to be incorrect, addresses the failures that led to the collapse of MF Global and other recent financial improprieties. However, such action does not address the more general failure to monitor and report improper activities that allowed, for example, the rate manipulation events at the Standard Chartered Bank and ING Bank, among others.⁴⁸ To address these situations, individual executives should be obligated to pay a portion of any regulatory fine issued against the organization they manage in incidents of fraudulent actions. As noted above, under the current framework, penalties issued by regulatory agencies are paid directly by the relevant corporation,⁴⁹ a cost that is borne by innocent shareholders but not the managers who failed to prevent the fraudulent action. This provides little incentive for executives to change their behavior or prevent fraudulent activities. This proposal is supported by Professors Claire Hill and Richard Painter who have suggested changing this incentive by making highly compensated bank officers personally liable for a portion of the SEC fines.⁵⁰ In an effort to align the competing interests, Hill and Painter propose to make the personal liability proportionate to the officers' compensation.⁵¹ Interestingly, this reform would represent a return to when investment banks were established as partnerships, and partners were liable for the institution's obligations.⁵²

C. Proposal Three: Extend *Park* liability to the financial services industry

The two preceding proposed reforms are prospective only, and intended to

⁴⁸ See Press Release, U.S. Dep't of Justice, ING Bank N.V. Agrees to Forfeit \$619 Million, *supra* note 8; see also Press Release, U.S. Dep't of Justice, HSBC Holdings Plc. and HSBC Bank US N.A. Admit to Anti-Money Laundering and Sanctions Violations, *supra* note 26.

⁴⁹ See *supra* Part B.

⁵⁰ Claire A. Hill & Richard W. Painter, *Why SEC Settlements Should Hold Senior Executives Liable*, N.Y. TIMES DEALBOOK, (May 29, 2012, 11:28 AM), <http://dealbook.nytimes.com/2012/05/29/why-s-e-c-settlements-should-hold-senior-executives-liable/> (“[A]ll of a bank’s most highly compensated officers — those making more than \$1 million a year — should be personally and collectively liable for paying a significant portion (perhaps 50 percent) of S.E.C. fines levied against their bank . . . in proportion to the size of their compensation that year.”).

⁵¹ *Id.*

⁵² See, e.g., Alan D. Morrison & William J. Wilhelm, Jr., *The Demise of Investment-Banking Partnerships: Theory and Evidence*, 63 J. FIN. 311 (2008), https://www.law.virginia.edu/pdf/olin/0506papers/morrison_wilhelm.pdf.

incentivize senior management of financial institutions to more actively manage and supervise their employees. However, they fail to sufficiently address the practical legal difficulties in bringing effective enforcement actions against responsible individuals after the fact. To deal with these concerns, former attorney general Eric Holder outlined potential reforms to the current framework aimed at (i) reducing the difficulty of proving the requisite intent in lawsuits against individual executives and (ii) incentivizing reporting of wrongdoing in the first instance.⁵³ First, Holder suggests considering revisions to relevant financial fraud statutes that would extend the “responsible corporate officer” doctrine, also known as *Park* liability, to the financial services industry.⁵⁴ This doctrine states that an individual can be prosecuted absent any culpable intent or knowledge of wrongdoing, so long as he or she was in a position to have prevented the wrongdoing and failed to do so.⁵⁵ Application of the responsible corporate officer doctrine to the financial industry would limit the protections of the business judgment rule and eliminate problems associated with proving the requisite intent. Second, Holder proposes increasing whistleblower incentives aimed at motivating more individuals to report financial wrongdoing and provide information to aid prosecutions against responsible individuals.⁵⁶ Holder explains that the whistleblower provision of the “little-used” Financial Institutions Reform, Recovery, and Enforcement Act, which caps any award at \$1.6 million, is insufficient considering that the median executive pay in the relevant industry was \$15 million and the collective bonus pool was greater than \$26 billion in 2013.⁵⁷

Although these proposed reforms would make prosecutions of senior executives easier, they may be unneeded. Judge Jed S. Rakoff, who has presided over a number of financial fraud cases, has argued that what is needed is the more wholehearted application of existing tools as opposed to the creation of new standards and rules.⁵⁸ In discussing the alleged difficulties of proving intent, Judge Rakoff noted:

⁵³ Eric Holder, Att’y Gen., U.S. Dep’t of Justice, Remarks on Financial Fraud Prosecutions at NYU School of Law (Sept. 17, 2014), <http://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law>.

⁵⁴ See *id.*; see also Helen Cantwell et al., *DOJ Proposal Shows Focus on Individuals in Corporate Crime*, LAW360 (Sept. 30, 2014 10:14 AM), <http://www.law360.com/articles/582045/doj-proposal-shows-focus-on-individuals-in-corporate-crime>.

⁵⁵ See *United States v. Park*, 421 U.S. 658, 670–71 (1975).

⁵⁶ See Holder, *supra* note 53 (explaining that in order to better equip investigators, there must be incentives for witness cooperation and whistleblowers at financial institutions).

⁵⁷ *Id.*

⁵⁸ See Jed S. Rakoff, *Why Have No High Level Executives Been Prosecuted in Connection With The Financial Crisis?*, THE NEW YORK REVIEW OF BOOKS (Jan. 9, 2014), <http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/>.

Who, for example, was generating the so-called “suspicious activity reports” of mortgage fraud that, as mentioned, increased so hugely in the years leading up to the crisis? Why, the banks themselves. A top-level banker, one might argue, confronted with growing evidence from his own and other banks that mortgage fraud was increasing, might have inquired why his bank’s mortgage-based securities continued to receive AAA ratings. And if, despite these and other reports of suspicious activity, the executive failed to make such inquiries, might it be because he did not want to know what such inquiries would reveal? This, of course, is what is known in the law as “willful blindness” or “conscious disregard.”⁵⁹

In light of the actions of senior management in the headline making events described above, ranging from systematic failure to monitor to active discouragement of communications, one would expect that showing willful blindness or a conscious disregard would not be an insurmountable hurdle.⁶⁰ However, it is important that any reform strike a balance between permitting legitimate risk-taking and providing for punishment of improper actions. As such, calls for the full implementation of the *Park* doctrine should be tabled until a more complete use of the current array of prosecutorial tools proves lacking.

D. Proposal Four: Limit the use of “Cooperation Credit” if responsible individuals are not identified

Historically, the DOJ has given “cooperation credit” to banks and corporations that cooperate with DOJ investigations and provide information regarding wrongdoing.⁶¹ In gauging cooperation, prosecutors were previously able to consider the corporation’s willingness to provide material information about the relevant actors as a mitigating factor.⁶² Now, new DOJ guidelines have made cooperation with the DOJ the threshold for allowing any cooperation credit.⁶³ On September 9, 2015, Deputy Attorney General Sally

⁵⁹ *Id.*

⁶⁰ *Cf. Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060, 2068–69 (2011) (“Many criminal statutes require proof that a defendant acted knowingly or willfully, and courts applying the doctrine of willful blindness hold that defendants cannot escape the reach of these statutes by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances.”).

⁶¹ See U.S. DEP’T OF JUSTICE, U.S. ATTORNEYS’ MANUAL 9-28.700 (1997), available at <http://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations#9-28.700> (“Cooperation is a mitigating factor, by which a corporation . . . can gain credit in a case that otherwise is appropriate for indictment and prosecution.”).

⁶² See *id.* at 9-28.740 (stating that a corporation’s willingness to cooperate is not determinative but may be considered in conjunction with other factors).

⁶³ Memorandum from Deputy Att’y Gen. Sally Quillian Yates, Individual Accountability for

Quillian Yates sent a memo to all U.S. Attorneys and Assistant Attorney Generals setting forth new guidelines to strengthen the pursuit of individual corporate wrongdoing. The Memo explains that “in order to qualify for any cooperation credit, corporations must provide to the Department all relevant facts relating to the individuals responsible for the misconduct.”⁶⁴ In addition, the guidelines state that the DOJ “will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation.” These guidelines shift the focus to the individuals responsible for the wrongdoing and should assist in more thorough investigations by the DOJ, thereby deterring such behavior from the start. The success of these guidelines, however, will of course depend on how they are implemented and to what extent corporations comply.

V. Conclusion

The proposals contained herein, if adopted, would significantly ameliorate the “King Henry” problem and incentivize senior management to adopt a more active role in rooting out and resolving any improper actions before they metastasize into larger scandals. These proposals will also preserve the appropriate level of risk-taking behavior necessary for healthy financial markets. It is the Author’s position that this can be accomplished by creating more stringent requirements for executives to certify financial statements, holding individuals personally liable for regulatory fines imposed on their respective corporations, and extending *Park* liability to the financial sector. The DOJ’s amended guidelines for cooperation credit also may help to ensure individuals are held accountable to deter corrupt practices in the first place. Whatever proposals are adopted, now is the time to focus and evaluate this area of the law.

Corporate Wrongdoing (Sept. 9, 2015), <http://www.justice.gov/dag/file/769036/download>.

⁶⁴ *Id.* at 2.