In devising punishments, SEC faced with competing interests

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What's $75 million?

For Citigroup, it's a week of profits, less than 0.1 percent of its market value, a rounding error on a balance sheet worth more than $2 trillion.

And for the Securities and Exchange Commission, it's a fair price to pay for the bank to settle allegations that it misled its shareholders about nearly $40 billion in subprime mortgage investments it held in 2007, the year before the bank began its slide into the abyss.

The settlement of the Citigroup case last week, after settlements earlier this year with key Wall Street banks involved in the financial crisis, has raised a host of questions about how the SEC devises punishments to meet the alleged crimes.

Two competing factors have been at play.

On the one hand, the agency wants headline-grabbing settlement numbers that send a message that regulators will be tough on companies that do bad things. On the other hand, the agency is cognizant that it's a company's shareholders, who might have been harmed in the first place, who ultimately pay when the agency assesses a fine.

"The punishment of a corporate entity like Citigroup serves a limited purpose," said Mark J. Roe, a professor at Harvard Law School. "There's a lot of smoke and drama around it, but it ends up shifting money from one group of shareholders to another."

Two other major settlements involving Wall Street banks this year have been with Goldman Sachs, which paid $550 million, and Bank of America, which paid $150 million.

In the Goldman case, the bank paid what amounted to two weeks of profit for allegedly selling an investment to two clients that was secretly designed to fail. No senior executive was charged.

In the Bank of America case, the bank was accused of concealing billions of dollars in losses and compensation from shareholders. No executive was charged by the SEC, but a lawsuit against the bank filed by New York Attorney General Andrew Cuomo is pending.

In initially rejecting the $33 million Bank of America settlement, U.S. District Judge Jed S. Rakoff of the Southern District of New York was incredulous about the terms, saying the settlement suggested "a rather cynical relationship between the parties."

But even when executives are charged and have to pay a fine, there is a question about whether the price is high enough. The SEC doesn't have criminal authority and so it can't use that ultimate weapon -- jail -- to deter and punish financial misconduct.
For example, Gary Crittenden, former chief financial officer of Citigroup, is paying $100,000 for his alleged role in the coverup of subprime mortgage investments.

In 2007, the year of the alleged wrongdoing, Crittenden took home nearly $13 million in compensation, including $3 million cash. He knew about the $50 billion in subprime exposure, but took steps that led the public to think that the bank had only a $13 billion in exposure, according to the SEC. For his alleged role in misleading shareholders, he has agreed to pay less than 1 percent of his 2007 compensation. The value of Crittenden's compensation, which was largely stock-based, fell when Citigroup's shares collapsed, but he's still paying just 3 percent of his cash salary in 2007.

A Crittenden spokesman said last week that he did not admit or deny any liability. Citigroup said he played a key role in helping the company navigate the financial crisis.

A 2008 law review article by Paul Atkins, then an SEC commissioner, raised other questions about whether executives can use the size of a corporate penalty to face a smaller fine themselves. "One moral hazard is the possibility that managers of companies might agree to a large corporate penalty in order to avoid or soften actions against culpable individuals," Atkins and a colleague wrote.

While the philosophic and practical questions raised by assessing a company a financial penalty remain unsettled, research shows that the price paid by companies and executives can be well beyond what a regulator deems fair punishment.

Ninety-three percent of executives involved in an SEC or Justice Department enforcement action lose their jobs, according a 2007 study by Jonathan Karpoff, a University of Washington professor. Another study by Karpoff shows that organizations suffer much more in terms of decreased stock price and damaged reputations when they face regulatory sanction.

"Organizations suffer many more consequences that appear not to depend very much on the legal penalties" imposed by regulators, Karpoff said.