Lehman bankruptcy report exposes Wall Street criminality

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A report released March 11 by a bankruptcy court-appointed examiner concludes that in the months leading up to its September 2008 collapse, the Wall Street investment bank Lehman Brothers issued financial statements that were "materially misleading" and its top executives engaged in "actionable balance sheet manipulation."

The 2,200-page document details accounting fraud on a massive scale, involving secret transactions that enabled the bank to falsify its level of debt and conceal the scale of its losses from toxic mortgage-linked assets.

Lehman's collapse on September 15, 2008 sparked a global crash of credit markets, which was used by the US government and governments around the world to justify the outlay of trillions of dollars in public funds to bail out the banking system. The financial crisis precipitated the deepest recession since the 1930s, wiping out millions of jobs. Now, governments are imposing brutal austerity measures to make the working class pay for the bankrupting of state treasuries for the benefit of the bankers and speculators.

The Lehman report demonstrates that workers' jobs, homes, wages and life savings, as well as their access to health care, education and even such rudimentary necessities as light and heat, are being sacrificed to pay for the criminality of the financial elite, which has further enriched itself from the catastrophe of its own making.

In the wake of the report's release, major Wall Street firms such as Goldman Sachs and JPMorgan Chase have expressed shock over the Lehman revelations and averred that they never employed the accounting dodges used by their former competitor. One is reminded of the film *Casablanca*, in which Captain Renault declares his "shock" at discovering gambling in Rick's casino.

All of the major banks employed intricate schemes, such as "structured investment vehicles," to shift their losses off of their balance sheets, and made billions by repackaging what they knew to be dubious sub-prime loans and selling them as "collateralized debt obligations." Lehman's practices have been exposed only because it was the weakest of the big Wall Street firms and was forced into bankruptcy, in large part because its bigger rivals, smelling blood, took aggressive actions to push their struggling rival over the edge.

According to the examiner's report, Lehman specialized in vastly overvaluing its mortgage-backed securities and manipulating its books to produce end-of-quarter financial reports that concealed its true level of indebtedness. As the author of the report, Anton R. Valukas of the law firm Jenner & Block, put it: "Unbeknownst to the investing public, rating agencies, government regulators, and Lehman's board of directors, Lehman reverse engineered the firm's net leverage ratio for public consumption."

The bank's major accounting gimmick was known internally as "Repo 105." Repos, short for repurchasing agreements, are a standard practice on Wall Street. To obtain short-term cash to fund operations, a bank will borrow from another bank, giving that bank some of its assets with the stipulation that it will buy back the assets within a set number of days.

For accounting purposes, such transactions are recorded as financings, not sales, and the assets that are shifted, often overnight, remain on the balance sheet of the bank doing the borrowing. Lehman, however, valued its repo assets at 105 percent or more of the cash it received, and on that basis recorded its "repo 105's" as sales—moving bad debts off of its balance sheet just long enough to doctor its quarterly financial reports.

According to the examiner, Lehman by such means shed $39 billion from its balance sheet at the end of the fourth quarter of 2007, $49 billion in the first quarter of 2008, and $50 billion in the second quarter.

The accounting scam was so smelly that Lehman was unable to find a US law firm that would sign off on its legality. In the end, it retained a British firm that sanctioned the maneuver as legitimate under British law. Lehman had to conduct its “Repo 105” operations through its London-based branch and shift funds from the US to Europe to carry out the deals.

Valukas asserts that CEO Richard S. Fuld Jr. and three chief financial officers knew of and approved the shady transactions, and the bank’s auditor, accounting firm Ernst & Young, covered up for the executives. The examiner concludes that the four executives breached their “fiduciary duty” to Lehman’s shareholders and board of directors, and adds that there is “sufficient evidence” to support a legal claim that Fuld was “at least grossly negligent.”

The examiner’s report further details the role of the Federal Reserve Bank of New York in allowing Lehman to exchange worthless securities for public funds from March of 2008, when Bear Stearns collapsed and was taken over by JPMorgan Chase in a deal subsidized by the Fed, to September of that year, when Lehman filed for bankruptcy protection. The president of the New York Fed at the time was Timothy Geithner. Obama rewarded Geithner for his services as chief bagman for Wall Street by making him his treasury secretary.

Neither Fuld, whose compensation for 2007 totaled $22 million, nor any other Lehman executive has been prosecuted for their crimes. Nor has any other top executive on Wall Street.

In response to the greatest social catastrophe since the Great Depression, the Obama administration and the Democratic-led Congress have rejected any serious reform of the financial system. They have held no one accountable for plunging the US and the world into an economic disaster. Instead, they have devoted their efforts to covering the bad debts of the financial oligarchs and enabling them to expand their swindling and increase their wealth.

The Lehman story is not an aberration. Corruption, fraud, criminality are not simply the results of a few “bad apples,” or merely the expression of the subjectively determined depravity of certain executives. The collusion of all official institutions—the White House, Congress, the regulatory agencies, the media—testifies to the systemic character of financial gangsterism.

The criminality of Wall Street is rooted in the crisis and contradictions of the capitalist system. Financial parasitism on an unprecedented scale, with all of its noxious corollaries—increasing social inequality, imperialist war and political reaction—is a manifestation of the putrefaction of the profit system, above all in its center, the United States.

The working class needs to draw the appropriate conclusions. The financial executives whose fraudulent practices played a role in precipitating the economic disaster must be prosecuted. Their ill-gotten wealth must be expropriated and used to provide relief for the unemployed and ensure the provision of basic social needs. The banking system must be nationalized and run as a pubic utility under the democratic control of the working population.

It is not a matter of reforming the system, but building an international socialist movement to consign it to the dustbin of history where it has long belonged.

Barry Grey