Conflicts of Interest and the Crash of 2008

Jeffrey Elkner

University of the People

BUS 5115: Business Law, Ethics, and Social Responsibility

September 14, 2021

Conflicts of Interest and the Crash of 2008

The conflict of interest at the center of the case of Enron Corporation and its accounting firm, Arthur Anderson LLP is captured by the old idiom of the fox guarding the hen house. Anderson's accounting role in "providing strong, independent verification of its financial reports" for Enron was undermined by the desire to make those same reports help generate the incredible wealth on which Anderson's lucrative relationship with Enron depended (McRoberts, F., 2002, Sept. 3). Enron committed fraud on a massive scale, and its CEO Jeffrey Skilling was sentenced to several years in jail as a result, while Anderson's original guilty verdict for obstruction of justice was later overturned on appeal (Segal, T., 2021, May 31). In the aftermath, congress passed the Sarbanes-Oxley Act as a direct answer in an effort to prevent this from happening again (Berry-Johnson, J., 2020, Feb. 4).

Similar fox in the hen house problems are at the root of the even larger disaster that occured in 2007 and 2008 across the global banking industry. The biggest of these was the conflict of interest on the part of credit rating agencies between the service their ratings were supposed to provide to the purchasers of the mortgage-backed securities and collateralized debt obligations they rated, and their dependence on the sellers of these financial instruments for the fees from whence came their revenue. This conflict of interest is pointedly presented in the 2015 film, The Big Short, which follows investors at three investment firms that saw the crash coming. At one point in the film FrontPoint Partners leader Mark Baum sits down in a meeting with an acquaintance of his named Georgia at the Standard & Poor's rating agency. Pressing her as to why they have not downgraded the ratings on the mortgage security bonds as the default rates on mortgages were raising, he finally asks if S&P had ever refused to rate an upper trench bond AAA, to which she replies, "If we don't give them the ratings, they go to Moody's, right down the block. If we don't work with them, they will go to our competitors. Not our fault, simply the way the world works." (McKay, A., Director, 2015, 01:05:46).

Another conflict of interest presented in The Big Short is that of government workers tasked with regulating financial institutions between their role in investigating the regulated institutions and their desire to get the much higher paid salaries available to them working for those same institutions. In a scene set at the 2007 American Securitization Forum in Las Vegas, Brownfield Capital's Jamie Shipley meets with his brother's ex-girlfriend who works at the Securities and Exchange Commission, asking her off the record if the SEC was worried at all about housing bonds. She responds, "Oh we don't investigate mortgage bonds. Truth is, since we got our budget cut, we don't investigate much" (McKay, A., Director, 2015, 01:16:10). She then tells him that she is not at the conference representing the SEC, but that she is there on her "own dime", since she has been floating her resume to some of the big banks in attendance. The quick dialog then proceeds. Jamie: "How are you floating your resume to big banks. I mean, you're supposed to be the ones policing the big banks." Ex-girlfriend: "Oh grow up, Jamie." Jamie: "There must be some kind of law against working in a financial institution right after you've been working in financial regulation. Am I right?" Ex-girlfriend: "No… *no*." (McKay, A., Director, 2015, 01:16:36).

In an article on the website, truthout.org, titled *The Indisputable Role of Credit Ratings Agencies in the 2008 Collapse, and Why Nothing Has Changed*, author Deena Zaidi discusses how the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act was written specifically to address both of these conflicts of interest, but a 2015 report by the SEC states that "credit ratings agencies continue to pose a threat to the existing financial system" (Zaidi, D., 2016, March 19).

As growing wealth inequality in the United States continues to increase the power the rich have over our political system, the more likely it is that the fox will be able to purchase a choice seat atop the hen house. The only way conflicts of interest like those contributing to the Enron and 2008 financial crash disasters can be avoided is to weaken the power of big money over the political process and strengthen the democratic power of the people.

References

Berry-Johnson, J. (2020, Feb. 4). Sarbanes-Oxley (SOC) act of 2002. *Investopedia*. Retrieved Sept. 13, 2021 from https://www.investopedia.com/terms/s/sarbanesoxleyact.asp

McKay, A. (Director). (2015). The big short [Film]. Regency Enterprises.

McRoberts, F. (2002, Sept. 3). Ties to Enron blinded Anderson. *Chicago Tribune*. Retrieved Sept. 13, 2021 from https://www.chicagotribune.com/news/chi-0209030210sep03-story.html

Segal, T. (2021, May 31). Enron scandal: The fall of a wall street darling. *Investopedia*. Retrieved Sept. 13, 2021 from https://www.investopedia.com/updates/enron-scandal-summary/

Wikipedia contributors. (2021, Aug. 14). Credit rating agency. *Wikipedia*. Retrieved Sept. 11, 2021, from https://en.wikipedia.org/w/index.php?title=Credit_rating_agency&oldid=1038688419

Wikipedia contributors. (2021, Sept. 2). Arthur Andersen. *Wikipedia*. Retrieved Sept. 13, 2021, from https://en.wikipedia.org/w/index.php?title=Arthur_Andersen&oldid=1041968656

Zaidi, D. (2016, March 19). The indisputable role of credit ratings agencies in the 2008 collapse, and why nothing has changed. *Truthout*. Retrieved Sept. 11, 2021 from https://truthout.org/articles/the-indisputable-role-of-credit-ratings-agencies-in-the-2008-collapse-and-why-nothing-has-changed/