

Financial Times - Scandals and Debacles

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Introduction

Over the last 120 years the *Financial Times* has reported numerous scandals and debacles that have engulfed City firms and individuals. Ten such episodes that both shocked and entertained readers are profiled below. The paper has also covered the many scandals that rocked Wall Street and other financial centres. For the general public, it is largely through such often colourful episodes that the financial world impinges on their consciousness.

The years from the paper's foundation to the mid-1930s saw a string of financial scandals and debacles. However, the decades from the mid-1930s to the mid-1960s were notably free of major scandals, both in the City and Wall Street, reflecting the economic and political constraints that accompanied and followed the depression and war. But recent decades have seen the return of financial scandals and debacles in ever more outrageous forms, though almost always with clear echoes of historical forerunners.

Baring Crisis, 1890

In November 1890 the City and nation were shocked to learn that Baring Brothers, one of the City's most renowned and trusted merchant banks, had been rescued from collapse.

Barings's difficulties arose from the firm's underwriting commitments in respect of a series of bond issues by Argentinean borrowers to fund local infrastructure investments. While the projects were inherently sound, foreign investors had taken fright at the overall scale of Argentinean borrowing and had

stopped buying new Argentinean bond issues. Barings found its working capital unexpectedly tied up in Argentinean bonds and thus without the liquid funds to meet its immediate financial obligations. Its default would not only have created problems for its own counterparties, it would have delivered a shock to confidence that would most likely have triggered a general rush for liquidity that would have led to the failure of many other City firms—a systemic crisis.

The Governor of the Bank of England was secretly made aware of the crisis. Having ascertained that Barings's problem was essentially liquidity rather than solvency, he set about organising a rescue fund, soliciting contributions from City firms and the major commercial banks. The existence of the lifeboat fund sustained confidence, preventing the feared run and the threat to the financial system. A restructured Barings paid off the loan from the rescue fund in 1895. The Bank of England's coordination of the rescue of Barings is regarded as a key turning point in the development of central bank responsibility for the stability of the financial system.

Jabez Balfour, 1895

Jabez Spencer Balfour was one of Britain's earliest self-made millionaire businessmen. His fortune was derived from a complicated, inter-connected group of property companies that operated a large-scale, long-running Ponzi scheme. Balfour and shareholders were handsomely remunerated from funds derived from the creation of additional group companies that generated new subscriptions and fictitious property transactions within the network. In the good years of the 1870s and 1880s he was mayor of Croydon, his home town, and a Member of Parliament.

But then in November 1892, in the post-Baring Crisis downturn, the Liberator Building Society, Balfour's principal property vehicle, failed leaving thousands of

small savers penniless. Balfour went on the run, but was eventually apprehended in Argentina. Convicted of fraud in November 1895, he was sentenced to 14 years penal servitude. Upon release from prison in 1906, his memoirs were serialised in the press. There is street named after him in his native Croydon, a south London suburb.

Whitaker Wright, 1904

Whitaker Wright made a huge fortune from the promotion of overseas mining companies. The collapse of London & Globe Finance Corporation, Wright's financial flagship, in December 1900 provoked panic on the London Stock Exchange and bankrupted twenty firms of stockbrokers.

Born in Cheshire in 1846, the son of a Methodist minister, Wright made a fortune in the 1870s and 1880s through the promotion of silver-mining companies in the US. From 1889 he was based in the City, making another fortune through the promotion of Australian and Canadian mining companies on the London market. He lived and entertained lavishly, owning a mansion in Park Lane, an estate in Surrey and a racing yacht called the Sybarita. His extravagant parties were attended by the cream of London society, and aristocrats graced the boards of his companies. But his Midas touch deserted him when he backed a bond issue for the Bakerloo Line of the London underground. It flopped, bringing down Wright's empire.

Furious investors who had suffered large losses from the crash brought a private prosecution. Wright, who had fled, was arrested in New York. Tried in January 1904, he was found guilty of fraud and sentenced to seven years.

Sensationally, he committed suicide at the Royal Courts of Justice minutes after his conviction by biting a cyanide capsule concealed in his mouth.

Horatio Bottomley, 1922

Horatio Bottomley was a flamboyant company promoter, swindler, newspaper proprietor and Member of Parliament. Born in London's East End in 1860, he joined a firm of legal shorthand writers where he picked up the rudiments of law and the court system, which proved useful later in life. He founded his first newspaper in 1884 and then acquired a printing company. The latter's first client, in 1888, was the newly established *Financial Times*, of which it quickly took control with Bottomley installed as the first chairman. However, only months later Bottomley parted company from the *Financial Times* to seek his fortune with bolder ventures.

In 1889 he launched Hansard Union, a printing-cum-property company, which failed a few years later leading to his unsuccessful prosecution for fraud. During the 1890s he promoted a series of mostly fraudulent mining companies, exploiting investors' euphoria for Australian gold mines. He then promoted a number of equally unsuccessful domestic companies, from which he benefited at the expense of investors. His plausibility and public profile were enhanced by his election to Parliament in 1906 as Liberal MP for Hackney South. Prosecuted again for fraud in 1908 he once more escaped conviction, though his bankruptcy in 1912 obliged him to resign from Parliament.

During the First World War, Bottomley used his mass-circulation paper, *John Bull*, to whip up anti-German feeling and was a star turn on recruiting platforms. His patriotic posturing made him a popular celebrity and in 1918 he was elected as an Independent MP for Hackney South. Bottomley's long-awaited downfall came as a result of irregularities in the management of his "John Bull Victory Bond Club", which purported to be a means by which small savers could invest in government bonds. In 1922, after a sensational trial that held the nation spell-bound, he was

convicted of twenty-three charges of fraud, perjury and false-accounting, and sentenced to seven years. One day the prison chaplain at Wormwood Scrubs Prison found him stitching mail bags. 'Ah, Bottomley. Sewing?' he exclaimed. 'No padre', Bottomley replied, 'reaping.'

Clarence Hatry, 1929

Clarence Hatry was a significant City financier whose downfall in September 1929 was a contributory factor to the erosion of investor confidence that triggered the Wall Street Crash of October 1929. Born in 1889, Hatry began his career in insurance and prospered as a businessman from opportunities thrown up by the First World War. Nevertheless, in 1924 his Commercial Corporation of London failed. Borrowing from friends and his wife, he paid off his creditors and rehabilitated himself in the City as "The Man Who Always Pays", shrewdly turning adversity to advantage.

In the late-1920s, Hatry launched an ambitious plan to amalgamate the fragmented British steel industry, facilitating economies and efficiencies, and raised £4 million to fund his rationalisation scheme. However, when Austin Friars Trust, his chief finance company, got into trouble he loaned it £1.5 million of the steel funds to keep it afloat. To plug the hole Hatry resorted to issuing illegal duplicate certificates for loans he was managing for English local authorities, which he used as collateral for loans from banks. But the deceit came to light and on 20 September 1929 the Hatry group collapsed, sending tremors through the London and New York stock markets. In January 1930 Hatry was sentenced to fourteen years for fraud and forgery.

Royal Mail Case, 1931

In 1931 the chairman of the Royal Mail Steam Packet Company, Lord Kylsant, and a partner in Price Waterhouse, a leading City accountancy firm, were controversially charged with publishing a false prospectus with intent to deceive investors.

The Royal Mail Steam Packet Company was the world's largest shipping group, of which Kylsant, a well-known and highly respected businessman, had been chairman since 1902. The company experienced trading problems in the mid-1920s, leading the directors to transfer funds from inner reserves to pay dividends, at the time a widespread business practice. The prospectus issued by the company in 1928 to raise new funds gave the impression that profits were generated by trading rather than by transfers from reserves. Kylsant was found guilty, an outcome regarded by much of the City as outrageous, and sentenced to twelve months. The case had a major impact on the way companies were audited and the reporting of financial information.

Guinness, 1987

The Guinness scandal was about illegal share purchases during a bitter and highly publicised takeover battle for whisky maker Distillers in 1986. The episode revealed a cavalier disregard for the law by some prominent City players that shocked the public.

Ernest Saunders, Guinness's managing director, set out to turn the brewer into a major player in the international drinks industry through a series of acquisitions. He had designs on Distillers, the largest independent Scottish whisky maker and owner of many famous brands, but so did Argyll, a UK retail multiple. Guinness's offer to Distillers shareholders was part cash, part Guinness shares - thus the higher the price of Guinness shares, the more attractive its offer became. A secret 'concert party' of

friendly financiers was organised to boost the Guinness share price by purchases in the market. This was illegal, but allegedly common practice during the mid-1980s takeover boom. And it was effective—in April 1986 Guinness won the City's most savage takeover battle.

The arrest in the US of Ivan Boesky, a flamboyant Wall Street financier, on charges of insider dealing on a massive scale, led to sensational revelations - including the Guinness concert party. Investigations by the UK authorities led to the sacking of Saunders and his City advisers at merchant bank Morgan Grenfell in 1987. In August 1990—after a trial lasting 107 days—Saunders and three concert party participants were found guilty of conspiracy, theft and false accounting and sent to jail. Further trials of the City advisers were planned but never took place.

Bank of Credit and Commerce International, 1991

The BCCI—'Bank of Crooks and Corruption International'—scandal was the biggest bank fraud in history. Founded in 1972 by Agha Hassan Abedi, a Pakistani businessman, BCCI focused on serving Muslim and third-world clients. The quadrupling of oil prices in 1973-74, led to huge deposits by Arab oil producers. BCCI expanded rapidly and by 1991 it had 420 offices around the world and a presence in 70 countries. But its complex structure—Luxembourg registration, London headquarters, Middle-East shareholders, and worldwide operations with numerous tax haven offshoots—made it impossible for outsiders to grasp what was going on.

Although BCCI's published results showed ever-rising profits, by the late 1970s the bank was suffering an alarming level of bad debts due to reckless lending. Reality was not reflected in BCCI's accounts because the losses were concealed in a

Cayman Islands subsidiary, a bank within a bank known internally as 'the dustbin', safe from regulatory scrutiny. As the losses mounted Abedi resorted to more and more desperate ways of keeping the bank afloat. He tried 'proprietary trading', but the results were further huge losses. The bank only kept going by fraudulent accounting and massive misappropriations of depositors' funds. Desperately in need of new sources of deposits and revenue, from the early 1980s BCCI's Panama branch acted as money-lauderer for Latin America's drug barons. These activities eventually attracted the attention of the US and UK authorities and BCCI was shut down by concerted central bank action in July 1991.

The closure left 150,000 depositors around the world scrambling to recover lost money. The biggest loser of all was Abedi's backer, the Sheikh of Abu Dhabi. Eventually small depositors recovered 75 per cent of their claims, a great deal more than the 10 per cent predicted at the time of BCCI's demise, leaving a final loss by depositors of around \$2 billion. Indicted in the US, Abedi died in 1995 before facing trial.

Robert Maxwell, 1991

In November 1991, tycoon Robert Maxwell, 68, was found drowned floating beside his luxury yacht near the Canary Islands. Investigations revealed that Maxwell's publishing and newspaper empire was bust, owing £2.8 billion to its bankers. Furthermore there was a £530 million hole in the pension funds of his 16,000 employees.

Czech-born Maxwell came to Britain as a refugee. His controversial business career began in 1951 with the acquisition of Pergamon Press, a publisher of textbooks and scientific journals, which he built into a very profitable public company. A deal to

sell Pergamon in 1969 turned into a row about Maxwell's accounting practices. A government inquiry found that the firm's profits had been misstated and that Maxwell was unfit 'to exercise stewardship of a publicly quoted company'. Nevertheless, Maxwell subsequently re-acquired control of Pergamon.

In 1980 he bought the troubled British Printing Corporation, which he revived and renamed Maxwell Communications Corporation. His ambition to own a national newspaper was realised in 1984 when he acquired the *Daily Mirror*, which thereafter obediently publicised its proprietor's every action. The purchase of the US book publisher Macmillan in 1988 was another major step, but necessitated taking on yet more debt.

By the end of the 1980s the Maxwell empire, comprising more than 400 companies, was experiencing acute financial difficulties and was only kept afloat by shifting funds around his maze of inter-locking private companies, misappropriating pensioners' funds, and relentless deal-making. In 1991, desperate for money, Maxwell sold Pergamon and floated Mirror Group Newspapers as a public company. But it was too late. Rather than face the music, he apparently jumped overboard—although there were plenty of other colourful speculations about what happened. In 1995, after the most expensive trial in British history, Maxwell's sons, who worked with their father in the business, were acquitted of wrongdoing.

Barings, 1995

The sudden collapse of Barings, one of the City's oldest and most prestigious firms, in February 1995, was a huge shock. Like other merchant banks, Barings developed securities and derivatives trading in the 1980s and 1990s, following the example of US investment banks. Such trading could be highly profitable, but it was

riskier than their traditional activities. Barings was brought down by massive losses incurred by 'rogue trader' Nick Leeson in the bank's Singapore office.

Leeson had recently qualified as a trader when in April 1992, aged 25, he was appointed to run Barings's modest futures trading operation in Singapore. He soon ran up losses, but he hid them in secret account '88888' hoping to win the money back in the future. He was able to do this because he ran the back office that handled the accounts and the settlement of deals—an arrangement that violated all the rules.

By the end of 1993, Leeson had accumulated hidden losses of £25 million. To keep his bosses in London happy, he reported substantial fictional profits and soon came to be regarded as a 'star performer'. They believed Leeson's story that his profits were generated by trading on behalf of clients or inter-exchange arbitrage, both low risk activities. In reality, Leeson was making large, unauthorised and unhedged bets as principal—and losing money hand over fist. By the end of 1994, his trading activities supposedly generated profits of £30 million, but in reality the losses had grown to £208 million.

The gaping hole meant that the only possible way out was to play even higher and wilder. In early January 1995, convinced that Japanese shares were undervalued, he built up a very large uncovered position in Nikkei 225 futures contracts. But the Kobe earthquake on 17 January sent Japanese share prices plummeting, generating the loss of a further £144 million (though Leeson reported a profit of £10 million to London). This drove Leeson to a final, crazy, devil-may-care throw of the dice. In the days after the earthquake he doubled Barings's exposure, betting the bank on an upturn that refused to materialise.

The scale of Leeson's commitments required huge margin payments—deposits against potential losses required by financial exchanges—to the Singapore

exchange. To make these payments, some £500 million—more than half the bank's capital—was forwarded to Singapore in early 1995. But, at last, London was beginning to ask what their man in Singapore was up to. An audit of his operations conducted in mid-February made clear that Barings was facing catastrophic losses. The Bank of England and leading City firms endeavoured to put together a rescue package to keep Barings going, but were unable to do so. The administrators appointed to oversee the stricken bank's affairs quickly came to terms with Dutch bank ING, which acquired Barings, plus its liabilities, for a nominal £1. Thus ended the second Baring Crisis.

Back in Singapore, Leeson disappeared prompting a media hue-and-cry to find him. Arrested on arrival at Frankfurt airport, he was extradited to Singapore where he received a six-and-a-half year jail sentence for securities violations. By then he had become an international celebrity. The rights to his autobiography, *Rogue Trader*, were sold for £500,000 and a film of the same name opened in 1999. Upon release from jail, Leeson found himself in demand as a celebrity speaker, being paid \$100,000 for appearances.

The 21st Century

More recent years have seen the dot.com boom and bust, the Enron scandal, the fall of Northern Rock, the collapse of Lehman Brothers and Bernard Madoff's monumental fraud. And the future will see further such episodes. Financial scandals and debacles are a hardy perennial.