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CENTRE FOR CRIME AND JUSTICE STUDIES

Knowledgeable consumers?

Corporate fraud and its devastating impacts

Dr Basia Spalek

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Editorial

In this briefing Dr Basia Spalek draws together the findings from her research on the experiences of people affected by corporate fraud and its long-term impacts. She draws on her research with Maxwell pensioners and those employed by the Bank of Credit and Commerce International (BCCI), and then reflects on other recent financial scandals such as WorldCom and Enron. This research shows that the harms caused by corporate fraud are equivalent to, and often more devastating than, those usually focused on by the criminal justice system. Victims express a range of emotional and health problems, long-term financial difficulties and other impacts that are not fully appreciated by government policy. Dr Spalek also reviews contemporary developments relating to the deregulation of financial services and argues that, while policy is premised on the idea of a 'knowledgeable consumer', if such a consumer existed, in reality they would be unable to protect themselves in the case studies discussed.

Rebecca Roberts and Will McMahon, Centre for Crime and Justice Studies

Introduction

The last three decades have witnessed a series of corporate scandals in the UK and in other western democratic societies involving crimes and abuses of trust that include false accounting, fraud, conspiracy and the decimation of company pension schemes. Despite the devastating consequences upon those victims whose lives have been caught up in financial scandal, their experiences remain hidden and ignored.

This briefing paper is a contribution towards redressing this imbalance by outlining the impacts of financial crime and abuse upon victims. It also highlights the role that wider structural processes play in reproducing and perpetuating such harms. This paper outlines the experiences of victims of financial deviance and corporate unethical behaviour. It explores the similarities between the accounts of these victims and the victims of crimes that are more likely to claim the attention of politicians, policy makers and researchers - for example, robbery, burglary and some categories of interpersonal violence such as physical assault. It is argued that there is insufficient protection for potential victims of financial harm, and virtually no support offered to actual victims, due to wider structural factors that not only set the frame through which financial abuses thrive, but also which serve to confine policy implementation aimed at responding to victimisation to a narrow, criminal justice, focus rather than taking the broader and more challenging perspective of viewing victimisation through the lens of social (in)justice.

Financial crime and abuse as violence

While the process of victimisation by a wide range of crimes, including different forms of interpersonal violence, has been extensively documented, only a handful of studies have explored the experiences of individuals whose lives have been affected by financial crimes and abuses. Two high-profile case studies, based on qualitative research (Spalek, 1999; Spalek, 2001), are drawn upon below to shed light on the process of victimisation: the cases of Robert Maxwell and the Bank of Credit and Commerce International (BCCI).

Following the death of Robert Maxwell on 5 November 1991, it became apparent that hundreds of millions of pounds were missing from the pension funds of companies belonging to Maxwell's business empire, and that the lives of approximately 30,000 Maxwell pensioners across the UK were affected. Robert Maxwell had essentially juggled assets around his business empire, which involved him using company pension scheme assets as collateral for bank loans that were then partly used to fund a lavish lifestyle.

The BCCI was registered in Luxembourg on 21 September 1972, and quickly expanded into an organisation which comprised over 400 branches in 73 different countries, employing approximately 11,000 people. On 5 July 1991 the Bank of England closed down BCCI, alleging that this was a result of large-scale fraud and corruption. The founder of BCCI and some high-ranking employees of the bank were accused of engaging in false accounting, drugs money laundering, fraud and conspiracy. Branches were closed, deposits were frozen and staff members were made redundant.

Twenty-five Maxwell pensioners and ten former employees of BCCI were interviewed at length, and the process of their victimisation recorded. These cases highlight how financial crime and abuse can lead to individuals experiencing substantial emotional, psychological, behavioural, physical and financial costs, which in many ways are similar to the impacts experienced as a result of many other crimes, such as burglary, robbery and some categories of interpersonal violence.

Anger, anxiety, fear and depression: the psychological impacts of corporate fraud

Anger is an emotional response common in victims of a wide variety of crimes, and the individuals caught up in both Maxwell and BCCI have reported feeling angry and outraged in the aftermath of these scandals. For example:

> *'You know our money, we earned it and somebody else pinched it, and we're really angry about that because when you go out to work and you've earned your money you want it.'* Maxwell pensioner

Anxiety, stress, fear and depression are also common emotional reactions to crime, and these are evident in the reactions of both the Maxwell pensioners and former employees of BCCI:

> *'You never knew whether you would get it [the pension] or not.'* Maxwell pensioner

> *'I experienced a sense of helplessness against institutions like the Bank of England and the rights that have been given to liquidators.'* Former BCCI employee

A victimising experience can alter a person's cognitive meanings about the world, so that they view their environments with distrust. The Maxwell pensioners' perceptions of pensions as being 'safe', protected and invulnerable were forever changed by the disappearance of their company pension schemes:

> *'I think a pension is a thing you should never have to worry about, it's a thing you should be looking forward to. But now you're worrying about whether it's safe all the time, it's terrible.'* Maxwell pensioner

> *'I would warn everybody, don't do what we did, don't just assume because you're paying into a private pension, don't assume. I've told everybody don't assume because you're working for X, you're working for Y, that they are good companies and your pension's going to be honoured.'*
> Maxwell pensioner

Many former BCCI employees have argued that they were stigmatised in the aftermath of the closure of the bank and, as a result, found it very difficult to find new employment:

> *'Due to the closure of the bank and propaganda by the media, it is very difficult to secure any job in my own field like financial institutions, banks etc.'*
> Former BCCI employee

Research exploring victimisation has also revealed that individuals may change their behaviour and lifestyles in the aftermath of a crime. For instance, they may avoid particular situations or locations which they feel are unsafe (Stanko, 1990; Felsenthal, 2004). Interviews with Maxwell pensioners reveal that, in the aftermath of the scandal, they began adopting avoidance strategies aimed at reducing their risk of future abuse from financial crime:

> *'It's [the Maxwell scandal] made me more interested in what's going on. I'm more aware. I would think twice - is my money safe?'* Maxwell pensioner

It seems that many of the Maxwell pensioners interviewed began limiting their involvement in financial investment. Some decided to spread their risks by investing their money in a variety of financial schemes and institutions, enhancing their own knowledge of the financial system to try to avoid potential abuse:

> *'I never had any doubts about the pension before Maxwell. It has affected my trust now. I don't have any insurance firms or anything like that. The money that I have is in National Savings and that's committed charge isn't it? Hopefully. I won't buy shares. I know that my money's going into the stockmarket at some places, it must be mustn't it? But there's no way that I would ever buy shares again. Our stockmarket isn't like it ever was.'* Maxwell pensioner

Similar to street crime, financial abuses can have a physical impact on victims. For example, some of the Maxwell pensioners have argued that their partners' health deteriorated in the aftermath of the scandal:

> *'I was devastated because I knew X was worrying, it was making him ill and he was a changed person. And he was very, very bitter about it, which doesn't help an illness does it?'* Maxwell pensioner

One widow whose husband had been a BCCI employee explained how, following the closure of the bank, her husband could not find new work. He then experienced a mental breakdown and was violent towards her and their children.

More recently victims of failed company pension schemes in the UK have experienced chronic stress and depression following the collapse of their pensions. According to Andrew Parr of the Pensions Action Group in some cases this has had devastating consequences. He says that at least two individuals have taken their lives unable to cope with the prospect of retiring without a company pension to support them in later life (Parr, 2007).

Financial impacts

The financial impact on former BCCI employees was severe and multi-faceted. When BCCI was closed on 5 July 1991, employees were made redundant. Although they received redundancy payments, these were considered to be too low by former employees. Many employees also had held bank accounts with BCCI, which meant that they also lost access to their funds. Moreover, many of the employees held mortgage accounts with BCCI, and when the bank was closed down they then owed this money to the liquidator. The liquidator in turn charged a high rate of interest on mortgages, and in many cases former employees were unable to pay since they no longer had an income. By October 1997 there were approximately 200 former employees in Britain who owed around £40 million to the liquidator as a result of outstanding mortgages and loans. Keith Vaz MP condemned the response of the liquidator as being aggressive.

Financial abuse leaves a devastating impact upon individuals, in many cases far outweighing the financial costs that street crime imposes on victims in terms of, for example, lost income when people have to take time out from work as a result of experiencing trauma, or, for example, having to pay for improved security. Following the disappearance of money from the Maxwell-owned company pension schemes, the schemes' trustees wrote to the pensioners informing them that there may not be sufficient funds to be able to pay them their monthly pensions. The uncertainty around Maxwell pension schemes lasted for four years because, following the disappearance of Robert Maxwell in October 1991, the pensioners were not guaranteed the full payment of their pensions until February 1995.

Enron and WorldCom

Although the Maxwell and BCCI scandals took place over ten years ago, more recent cases, such as the collapse of Enron and WorldCom in the USA and the decimation of a large number of company pension schemes in the UK, reveal that there are significant similarities and overlap between these individuals' experiences and accounts and those of the Maxwell pensioners and BCCI former employees. The collapse of Enron led to an estimated 21,000 redundancies.

The victims here lost their jobs, savings and pensions and experienced significant trauma, as the following quotation from an ex-Enron employee reveals:

> *'Never in my wildest dreams would I think I would be facing what I'm facing when I turn 65, and that is there is no retirement,' she said, telling Skilling that his actions were motivated by 'greed, nothing but greed, and you should be ashamed of yourself.'* (Clark, 2006)

Enterprise culture, trust and risk

In the UK, the economic philosophy of the state tends to be one of non-intervention in the financial markets, so that there are many 'sites of trust' within the financial system that potential offenders can exploit. This is a potentially toxic situation, where an enterprise culture that places profits above ethics, and where an atmosphere of greed prevails, so that corporate frauds and financial harms can flourish. Moreover, when scandals have arisen the regulatory response has often been slow and ineffective. It is important to emphasise that these activities may not always be illegal and within the financial system there are sites of trust that can be abused. Many harms are caused as part of legal activity that nonetheless is unethical or has wider implications.

Since the early 1980s there has been a fundamental shift from state provision of universal social insurance to an emphasis on individual responsibility. Individuals are now expected to use the financial markets in order to insure themselves against sickness, unemployment, old age and so forth. The notion of individual responsibility extends to individuals' avoidance of financial crime and abuse, since too much regulation is viewed by the state as imposing too many costs upon companies.

After the implementation of the Financial Services Market Act 2000 on 1 December 2001, the Financial Services Authority (FSA) became the single financial regulator in the UK, with powers over the entire financial system, including the banking sector (which had been previously supervised by the Bank of England). The FSA governs the financial system through an actuarial approach, whereby the notion of risk plays a fundamental role in informing the approach to, and intensity of, supervision.[1] Importantly, this risk-based approach also features in the FSA's ethos towards investors, whereby it is considered to be acceptable for investors to be exposed to the risks of financial crime and mismanagement, since regulation is viewed as aiming to 'strengthen but not ensure the protection of depositors' (Davies, 1998). This reflects the position traditionally adopted by regulators of the UK financial system, who have taken the view that economic prosperity arises from liberalisation and freemarket competition. For example, in the aftermath of the Maxwell scandal, the Governor of the Bank of England responded by claiming that whilst changes needed to be made to accounting standards, corporate governance, the lending banks, the regulators and pension fund trustees, these did not have to extend to the general framework within which these agents and agencies operate. This is because, although people might yearn for a risk-free world, this would conflict with the financial prosperity which springs from deregulation and free competition (Leigh-Pemberton, 1992: 210). Indeed, in 1996, the Deputy Governor of the Bank of England argued that in the financial markets, as in other markets, there is a role for the principle of 'caveat emptor', meaning that investors are accountable for the transactions that they make, and should not therefore be given complete protection by regulators (Davies, 1996). According to the FSA, 'The Financial Services and Markets Act 2000 states that our consumer protection objective must have regard to the general principle that consumers should take responsibility for their decisions' (Financial Services Authority, 2006).

Investors as knowledgeable consumers

A key strategy of the FSA is to create confident consumers, knowledgeable about financial institutions and products, and about the risks that they run from potential crime and abuse, through 'financial capability education, information and advice' in schools, universities, colleges, workplaces as well as at other sites (Everitt, 2006). The FSA issues tips for consumers about how they can best protect themselves from crime. For example, under a section headed 'Stay Safe' on the FSA website, it is claimed that 'there's plenty you can do to protect yourself from dodgy salesmen, bad deals and outright fraud' by 'knowing the right questions to ask when buying financial services or seeking advice; by knowing the warning signs to look out for if anything is wrong; and by being familiar with how criminals operate scams and swindles so you don't get caught out by one' (FSA, 2007).

[1] For example, all firms operating within the financial system are risk-assessed in terms of probability and impact factors. Probability relates to the likelihood of the event occurring, measured in terms of the firm's board, management and staff, and controls culture (among other factors). Impact refers to the scale and significance of the problem in terms of, for example, the impact on and number of retail customers, the availability of compensation for consumer loss and the systemic nature of the firm (Spalek, 2004).

The assumption underpinning the FSA's regulatory approach is that individual consumers have some degree of control over the risks that they are exposed to and that they can act to avoid becoming the victims of financial crime and abuse. It is important to critique these assumptions by scrutinising the notion of 'individual choice' that lies at the core of the FSA's strategy. In a political climate of self-sufficiency and self-protection, whereby the state has sought to impose the costs of welfare upon individual citizens, it might be argued that notions of 'free choice' are problematic. During the 1980s and 1990s in Britain, successive governments have pursued a policy of 'popular capitalism', encouraging people to become home-owners, shareholders and portable pension owners. Government policies have constructed markets that offer deregulated financial products which replace the previously offered universal provision. So it seems that individuals have little choice but to use the financial markets as a way of managing their personal lives.

At the same time, as graphically illustrated by cases such as Barings, Maxwell, BCCI, Enron and WorldCom, there is little that individuals can do to avoid being victimised if they are the employees or former employees of fraudulent and/or unethical companies. For example, securities fraud, illegal insider trading and filing false financial reports are some of the practices that occurred at Enron, which was declared bankrupt on 2 December 2001. The financial manipulation of Enron's profitability meant that its earnings had been overstated during the previous four years, leading to the largest bankruptcy in history. Whilst top executives were able to sell Enron shares for large amounts of money, lower level employees were locked into retirement plans with Enron stock. This means that at the same time that a group of 29 Enron executives and directors received around $1.1 billion by selling shares between 1999 and 2001, employees lost around $1.2 billion from their pensions (Tran, Guardian, 18 January 2002). Ordinary employees were not allowed to sell their share options. City analysts have criticised the business culture at Enron, which some claim led to its bankruptcy (Teather, Guardian, 18 June 2002).

It is important to note the lack of protection afforded to the company pension schemes of British workers. Currently in the UK, when a company is declared bankrupt, there is no protection for workers' pension schemes.[2] As a result, an estimated 125,000 workers are considered to have lost their pensions since 1983 due to their companies going bust. For example, an employee who had worked in the shoe industry in Leicester for 40 years, who had hoped to have retired and paid off his mortgage, told an ITV presenter: 'I have paid all that money in and planned all my life for probably nothing now' (Cowie, 2007).

The emphasis on individual consumer responsibility may appear to conform to free-market orthodoxy but does not address the issue that, often, there is little victims can do to avoid experiencing financial abuses, especially as many victims may be the (former) employees of fraudulent or unethical companies. The case studies explored above indicate that the text book assumption that consumers can have an adequate knowledge of complex unregulated financial markets or company structures, and are able to act as equal partners in such market transactions, is not borne out in practice.

These cases draw attention to victimisation that is structurally based (Walklate, 1989) where the structural framework is the deregulated 'free market' which encourages corporations, employers and managers to maximise profits at the expense of the individuals who vest their trust in them. Employees are structurally less powerful than their employers, so that whilst fraudulent employees can be sacked or demoted, there is little that employees can do to a fraudulent employer.

Limiting social justice to criminal justice

Over the last four decades, policy makers have increasingly turned their attention towards the victims of crime, with the implementation of a wide variety of victim legislation, as well as the development of a broad range of victim initiatives. Policy makers have acknowledged that negative treatment by, and experiences of, the police and courts may adversely affect victims, and so have instigated a wide range of initiatives designed to improve victims' experiences of the criminal justice system and to provide them with emotional and practical support.

While policy makers have increasingly turned their attention towards developing initiatives aimed

[2] The European Court of Justice has said that, under the European Union Insolvency Directive, the UK government pension protection regime is 'inadequate'. However, this ruling falls well short of saying that people should be compensated. The case will go back to the High Court, which may rule that people who have lost out should be compensated (http://news.bbc.co.uk/1/hi/business/6294825.stm).

at providing victims of crime with practical and emotional support, it is important to note that these have been targeted primarily at individuals who have experienced the volume crimes of robbery, burglary and some forms of interpersonal violence. As I have argued elsewhere, victims' needs have been 'co-opted by government in order to pursue broader goals linked to the development and operation of more efficient systems of criminal justice' (Spalek, 2006). Individuals experiencing financial crimes and abuses have largely been overlooked. The regulatory response to financial crime can also detrimentally impact upon victims (Spalek, 2001),[3] and yet currently no political consideration is paid to the ways in which an adverse regulatory reaction can impact upon individuals.

It might be suggested that because victims of financial crime are often not required as witnesses in the process of investigation and prosecution, agencies policing white-collar deviance are less concerned with the plight of these victims. It seems that victims of financial abuse have no 'bargaining tool' with which to attract the attention of policy makers. This is in stark contrast to the victims of other crimes, whose central position in the reporting and prosecution of cases has acted as a powerful mechanism through which to enable their voices and requirements to be heard by government (Zedner, 1994). It may also be the case that these victims are not considered to be useful to the efficient running of the criminal justice system. Financial fraud and corporate deviance can be complex in nature. They are also not typically the 'low hanging fruit' which provide the simple and successful prosecutions that facilitate the meeting of targets which have been the focus of recent government strategy.

National crime surveys have been developed, which measure (among other things) the extent and nature of victimisation. For example, the British Crime Survey (BCS) is carried out every year and documents people's experiences of crime as well as their attitudes to the police and other criminal justice agencies and individuals' fear of crime. However, the BCS excludes fraud as well as other types of white-collar deviance, so the extent and impact of white-collar offences remains largely undocumented and ignored by policy makers.[4] The extent and devastating social consequences of financial crimes are largely unrecorded. The lack of information about white-collar victimisation

[3] For example, in the case of BCCI, when the regulatory response effectively labelled the entire bank as being corrupt, this stigmatised the employees who had worked there (Spalek, 2001).

[4] The independent review of crime stats highlighted the lack of victimisation data on fraud. The government currently has no immediate plans to extend BCS to include fraud but says it has introduced new procedures for police recording of fraud.

'Well yes, when it first came through it worried me to death. I was thinking I'd have to sell the house. That was what I thought it would come to if the pension stopped, I'd just be on my widow's pension which would only be just over a hundred....I mean we weren't exactly flush but I said we might have to tighten our belts even more if the pension's cut and they (children) were concerned obviously. It was horrible at the time, couldn't sleep you know, tossing and turning wondering what was going to happen sort of thing. I mean this house I've been in since I was small and we bought this extension when we got married and we've been quite happy here. We didn't really want to move and the thought that I might have to sell it and move to somewhere smaller and not such a nice area was particularly awful, I didn't want to have to do that. I mean I said to them (children) that would be the final straw you know if we're really desperate then we'll have to move but I'll fight tooth and nail to stay here as long as we can. But thankfully it didn't come to that, but it certainly was a worrying time.'

Maxwell pensioner

'Street crime can involve you being physically assaulted but with white-collar crime you are physically and mentally assaulted, particularly if you are predisposed to worrying.'

Former BCCI employee

clearly illustrates that the experiences of victims of white-collar crime do not feature significantly on policy agendas, even though victims' accounts suggest that their reactions to such crimes are often significant and long-lasting.

Researchers have argued that national crime surveys could include questions about corporate deviance (Tombs, 2000). However, it might be argued that there is little political incentive to include white-collar offences in the British Crime Survey as their inclusion would mean an increase in the overall level of 'crime' and victimisation recorded. This would place pressure on politicians to tackle this large area of social injustice, an area that, as argued above, has traditionally attracted minimal state regulation since this has been viewed as imposing too many costs on business (Snider, 2000).

The lack of corporate accountability means that in many instances of financial crime victims will form action groups as a way of fighting for justice and to help and support each other. For example, The Pensions Action Group was formed in 2001 to campaign for government compensation of company pension schemes. According to a member of the group, individuals' lives have been devastated by the decimation of their pensions, leading to marital stress and sleep disturbance. As already highlighted, at least two individuals have committed suicide as a result of the anxiety caused by their impending retirement with no company pension to secure them in their old age (Parr, 2007).

The victim initiatives that exist are simply not targeted at this category of victim. For example, the vast majority of victims who come into contact with local Victim Support schemes are those referred by the police. However, victims of financial crime and abuse may not necessarily, and are unlikely to, be in contact with the police, but they will have contact with other agencies, in particular, with regulatory bodies such as the FSA, for example. The FSA lacks an appreciation of the nature of financial crime and the significant impact upon victims, its policy documents referring solely to financial compensation, as though this were the only effect upon individuals caught up in financial scandal. However, as illustrated in this paper, victims not only require financial compensation, but also they need emotional and psychological help.

'He was getting so bad, so stressed about it, I mean he talked about it every day. And when he didn't talk about it even if his (Maxwell) name came up he went potty. And he was a calm person really. I mean we've had our trials and tribulations and we've worked at them, we lost our only daughter when she was a baby and I thought that had shattered him but I never thought anything of money could worry him. But of course it was our life together really wasn't it? That we weren't gonna have.'

Maxwell pensioner

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'I get bitter sometimes but it doesn't do any good. These guys who lost all this money at Lloyd's topped themselves. I've probably felt like it a few times but I don't think that's a solution to anything. I worry about the house sometimes, what's gonna happen.'

Former BCCI employee

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'I was outraged to think that he (Maxwell) could do such a thing. It's just like taking sweets off a baby. It's just taking advantage of people. It's scheming isn't it?'

Maxwell pensioner

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Conclusions

In conclusion the following six points must be emphasised:

1. Financial abuses impact upon victims in multiple ways, producing emotional, psychological, behavioural, physical and financial reactions that can be severe and long-lasting.

2. In the UK, the economic philosophy of the state is one of liberalisation and free-market competition. There are therefore many 'sites of trust' that are open to crimes and abuses such as false accounting, fraud, conspiracy and the decimation of company pension schemes.

3. The assumption underpinning the financial regulatory approach is that individuals have some degree of choice over the risks that they are exposed to, and that they can act to avoid becoming the victims of financial crime and abuses. However, the notion of 'free choice' is problematic in a contemporary political climate which stresses self-sufficiency and self-protection so that government can push back the contours of the welfare state. At the same time, there is little that employees who work for deviant or unethical companies can do to avoid being victims of a wide range of abuses.

4. Although, over the last four decades, policy makers have increasingly turned their attention towards the victims of crime with the implementation of a wide variety of victim legislation and the development of a broad range of victim initiatives, these have been targeted primarily at the victims of street and property crime and victims of violence.

5. Victims of white-collar and corporate harms do not feature highly on victim policy agendas as they are not considered to be useful to the efficient running of the criminal justice system within the terms of current targets and objectives set by government.

6. There is little political incentive to document the costs and impacts of white-collar crime because this would mean an increase in the overall level of victimisation recorded in the UK. This large area of social injustice therefore remains hidden and is largely bypassed by government.

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This briefing is available as a free download from www.harmandsociety.org.uk. Dr Basia Spalek's published work about BCCI former employees and Maxwell pensioners includes:

- Spalek, B. (2001) 'White collar crime and secondary victimisation: an analysis of the effects of the closure of BCCI', *The Howard Journal of Criminal Justice*, Vol. 40 (2), pp.166-179.
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