One Man’s View

My first big trade on Wall Street was approved by a fat man smoking cigarettes in a stairway littered with the butts from past conversations. That man, John, was the head of trading at Salomon Brothers, on the executive board, and only one step below the CEO. It was 1994 and he had been with the firm twenty years as a trader. I had been there just one.

I was meeting with him because my boss, and my boss's boss, did not feel comfortable approving my trade, an investment of $200m in Brazil's currency, the real. I believed the currency had a brighter future than many others thought, and John and I met up to talk about it. The smoking ban, only enacted six months before, had pushed us into the fire escape outside his corner office.

I made my pitch. He smoked, belched and listened, before asking me a volley of questions. Most focused on how, when and if I could get out of the trade. Some were amazingly naïve about culture as well as finance: "Can you read Spanish?"

He approved half the trade I wanted: $100m. He tossed his butt on the ground and left, saying, "It's amazing how quickly gold can turn into shit." Two weeks later, my trade was, in fact, starting to act more like shit than gold. To the untrained eye it still looked good, and it was making money, but many of the arguments that had justified the trade were turning out poorly. As I would put it on the trading floor, "the forwards are acting squishy." That meant that the market's confidence in the Brazilian real was starting to dwindle.

After a particularly bad day, I was riding the elevator down to the cafeteria when John got on. For most of the ride he chatted with friends about weekend skiing plans. Near the end he turned to me and asked about the trade: "You thinking of getting out?" I pointed out that the trade was still making money. He pointed out what had changed. It was clear he now knew more about Brazilian currency than I did.

Later, when I told my boss that I was surprised someone so senior knew so much about my trade, he laughed:

"That's his money you are investing. The old managing directors, they still act like partners who own the firm."

After a restless night I unwound the trade the following morning at a small profit. That saved us a loss about $10m. Two weeks later, Brazil blew up. A currency crisis had started.

12 years later, I was working in a different world. Citibank, a firm of roughly 200,000 employees, had digested Salomon Brothers, then a firm of roughly 4,000, and I had moved to the giant bank's proprietary trading department, a special group tasked with placing bets using the banks own money. John, my old boss at Salomon, had moved on to skiing in Colorado.

In my final years many of my last trades were approved by – well, I don't really know what they looked like, since most conversations were held over the phone. Sometimes it would be a gentleman with an Indian accent. Sometimes it was a nervous-sounding man in a satellite office somewhere. For six sweet months it was nobody: I had fallen between administrative cracks in a reshuffle. I set my own limits for trades.

No matter who the risk manager on the telephone was, I always liked to imagine him in a faraway stairwell, smoking cigarettes, like John.

How many people were between the CEO and me at Citigroup? That's also hard to say. There were many different lines of reporting. Some weaved through maybe 10 people before getting to the CEO, others maybe 15. When I had that first conversation in 1994 at Salomon about the Brazilian real, there were only three people standing between me and the CEO.

Salomon in the early 90s, like most investment banks at that time, still had the culture of a private partnership, even though it went public in 1981. Gone were waiters bringing china plates and silverware to trader's desk. Soon to be gone were cigars and open smoking on the trading floor. What was still barely hanging on was a sense of collective ownership, a result of employees having most of their money reinvested in the firm.

Investment banks behaved like a federation of financial businesses, united by joint ownership of the risks and the rewards, with each business run by a partner whose money was invested in his and his friends' businesses. (Yes, almost all male.)

The result was that risk management – or, making sure the bank didn't lose more money than it could afford – was everyone's business. If your friend messed up a trade, then you yourself lost. Consequently, firms were judicious about what businesses they entered and how quickly they grew, often preferring to stay small and keep risk within limits they could understand.

They still made mistakes – which is the nature of taking risks. Salomon messed up royally in 1991, when it was almost brought down by a bid-rigging scandal that required Warren Buffett to save the bank. Yet the smaller size of the banks at the time kept their mistakes from infecting the broader markets.

By 2000, the culture of Wall Street had changed dramatically, driven largely by deregulation and the move towards publicly owned investment banks – the kind with stock listings on the New York Stock Exchange and financial filings with the SEC.

What the banking industry had evolved into was an army of megabanks, such as Citigroup and JP Morgan. They had employees numbering in the hundreds of thousands, and a bureaucracy in place to manage their diverse businesses, which spanned the entire globe.

With so many employees and businesses, it was hard for many of the people working inside to feel any real sense of ownership of the firm.

The result? Investment banks turned into a loose confederation united not by the understanding that their risk was jointly owned, but by a common source of cheap money: bank deposits and government-subsidized debt.

If you ran one of those businesses in the early 2000s – let's say making short-term business loans in Ghana – how you, as a banker, got paid was by growing your particular business. That's where your bonus came from. It did not come from making sure the larger bank made sustainable profits. The incentive was therefore to push the limits of every risk and grab as much cheap funding as possible.

Every manager wanted a slice of the pie, and with easy money available in the early 2000s, senior management hit on a clever idea: make the pie bigger. Soon, the balance sheet – which measured the total assets owned by the bank – was immense, close to $2tn at some institutions.

This quick money helped make some investment banks "too big to fail", by sheer size, yet they were filled with assets of dubious quality that increased the chances they would, indeed, inevitably fail. A few of those assets were rotten to the core, and in 2007, they infected the whole lot, generating a financial crisis that brought Wall Street to the brink of collapse.

People go into academics because they want to master the obscure. People go into social work because they want to help others. People go into banking because they want to make money. That is a reality, and not necessarily a bad thing for either the banking industry or for our economy.

Many businesses, including the ones I chose to work for, still had managers and employees focused on taking smart risks, with any consequences kept steadily in sight. They were driven by personal ethics, rather than the structure and incentives of their firms.

We should all want our money managers to be greedy, with a strong caveat: the self-interest of bankers needs to be aligned with the health of the bank.

The present structure and compensation packages of large banks don't have those interests aligned; this dissonance breaks the fiduciary responsibility between banks, their customers and our larger society as a whole.

A variety of different proposals are being touted to address the banking sector's illness. Almost all of them are better solutions than doing nothing at all.

Still, until the bond of responsibility between the banker and the bank is restored, Wall Street will continue to behave badly.