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Singapore Sling: How Coercion May Cure the Hangover in Financial Benchmark Governance

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Singapore Sling:
How Coercion May Cure the Hangover in Financial Benchmark Governance

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Abstract The International Organization of Securities Commissions (IOSCO) has formalized a set of principles designed to restore confidence in a range of systemically important financial benchmarks. The alacrity with which IOSCO has moved and its endorsement by the G20 is notable. It is far from clear, however, whether the principles provide a basis for sustainable reform. This derives from diametrically conflicting views within IOSCO as to whether benchmarks based on hypothetical submissions can be reformed or must be replaced by systems anchored in observed transactions. As a consequence the principles paper over rather than resolve core ethical deficiencies exposed in a still metastasizing scandal. The paper examines how and why the IOSCO process has privileged symbolism over substance. It then evaluates an alternative approach. The Monetary Authority of Singapore (MAS) has developed an innovative solution whereby contributing banks to the Singapore Interbank Offered Rate (Sibor) are mandated to privilege the integrity of the benchmark over individual institutional reputational or litigation risk. This regulatory re-engineering of risk management integrates rules, principles and social norms to forge restraint. The paper concludes that this holistic approach, once calibrated to the specific political, economic and cultural dimensions of specific markets, is more likely to embed ethical decision-making, reduce the risk of institutional corruption and achieve socially beneficial outcomes.

Keywords: London Interbank Offered Rate (Libor), International Organization of Securities Commissions, financial benchmark governance, financial crisis

INTRODUCTION

The effectiveness of any regulatory system derives from the dynamic interaction between rules, principles and social norms. Absent widespread agreement on the legitimacy of regulatory purpose the system is pre-destined to be gamed and, ultimately, to fail. Critically, there is a need to separate 'purpose' from 'ends.' No practice can lead to the sustainable achievement of desired 'ends' if the 'purpose' for holding the beliefs that animates practice differs in substance from the primary goal. The ultimate end of the physician, for example, is to heal. If, however, the 'purpose' of believing in or seeking to achieve that 'goal' is to make money, for example, the end can be subverted. Unnecessary tests or procedures may be prescribed that increase the financial burden on the patient, insurance company or taxpayer. The patient may not necessarily be harmed; she may in fact be healed. The conduct, however, if replicated across a given market, is undesirable. It can impose additional costs, financial and emotional. It also threatens the corruption of the primary end: the protection of life through the application of the do no harm principle. The imposition of unnecessary costs clearly violates the individual. It also risks bringing the wider institutional system into disrepute.

This critical distinction between ultimate 'ends' and 'purpose' has deep resonance for participants involved in the governance of financial markets. It has particular relevance to the global search for alternative mechanisms to set and administer the benchmarks on which trillions of dollars of derivative contracts are set. The corruption of these benchmarks has had a deleterious if not calamitous effect on market integrity. As a consequence of an ongoing global investigation, which has generated billions of dollars in fines against UBS, RBS and Barclays, the International Organization of Securities Commissions was charged with establishing an overarching set of principles governing the setting and administration of domestically controlled benchmarks. The principles cover practical and aspirational dimensions. They include indicators designed to improve the transparency and quality of internal governance, mechanisms to embed integrity, granular advice on improving the methodology and quality of the submissions and the data, and articulation of specific measures to secure greater accountability.[1]

The Financial Stability Board endorsed the framework as a critical component of attempts to recalibrate the global architecture of financial markets. In a progress report to the G20, the FSB explained that 'assessing the benchmarks [deemed of systemic importance against these principles] is intended to demonstrate to the market and the general public that the deficiencies in benchmark design and the absence of robust governance processes that contributed to past abuses involving these benchmarks are being effectively addressed.'[2] The final St Petersburg communiqué explicitly noted that 'we endorse IOSCO's Principles for Financial Benchmarks and look forward to reform as necessary of the benchmarks used internationally in the banking industry and financial markets, consistent with the IOSCO Principles.'[3] This leaves open to question whether the principles are in themselves sufficient to guarantee such an outcome. This is by no means a foregone conclusion, not least because of the lack of a clear normative basis on which to base analytical review.

The paper suggests that this can be rectified by adopting a much more holistic conceptual framework on which to measure accountability, legitimacy and authority. A functioning ethical environment necessitates a much more granular articulation of and commitment to the duties and responsibilities of market participants in the creation and maintenance of integrity. In this context, financial benchmarks need to be recast as public goods rather than commoditized opportunities for gaming. The first section sets out and evaluates the IOSCO Principles. The analysis explores the implications of the absence of a requirement to negotiate shared commitment to regulatory values and purpose, the breach of which would constitute misleading, deceptive and unconscionable conduct. It is argued this key weakness

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[1] The Board of the International Organization of Securities Commissions, 'Principles for Financial Benchmarks: Final Report' (Report No FR07/13, IOSCO, July 2013), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>.

[2] Financial Stability Board, 'Progress report on the oversight and governance framework for financial benchmark reform: Report to G20 Finance Ministers and Central Bank Governors' (Report, Financial Stability Board, 29 August 2013) 2, available at <http://www.financialstabilityboard.org/publications/r_130829f.pdf>.

[3] Russia G20, 'G20 Leaders' Declaration' (Declaration, G20, September 2013) 18, available at <http://en.g20russia.ru/news/20130906/782776427.html>.

in the conceptual framing risks perpetuating a Potemkin façade. The second section explores how and why this has occurred, notwithstanding the evidential basis, particularly in the United Kingdom, of flaws in prior banking and regulatory practice. The third section outlines an innovative solution being pioneered by Singapore to uphold the integrity of its rate, one deemed not globally systemic by IOSCO but of critical domestic and regional importance. Although tailored to the specific political, economic and cultural realities of the city state, a calibration of the Singapore model could have much broader application, particularly if mechanisms to enhance the accountability of the regulator are included in the policy framework. The final section concludes.

REGULATORY PENDULUMS AND THE LIMITS OF AUTHORITY

Post-crisis there is always an incentive, if not necessity, for regulators to create new rules to rebuild trust and confidence. Ill considered in design or implementation they can generate high compliance costs if not necessarily reducing risk. They can also exacerbate adversarial tensions. The current deadlock in Washington over implementation of the *Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank) replicates (and indeed speeds up) contestation over authority and legitimacy that is depressingly familiar to students of regulatory dynamics.[4] The *Public Company Accounting Reform and Investor Protection Act of 2002* (Sarbanes-Oxley), for example, passed in the aftermath of the collapse of Enron and WorldCom, was explicitly designed to embed 'corporate conscience.'[5] In implementation it transmogrified into a huge rent seeking opportunity for the audit profession.[6] Market conduct regulators saw authority progressively diminished and legitimacy questioned unless delivering an agenda geared towards the facilitation of risk.[7] This risk we were told, repeatedly, had been diversified. It made the system more resilient than at any other time in history. It was indicative that the then chief executive of Citigroup, Chuck Prince, could tell the *Financial Times* in July 2007 that 'when the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing.'[8]

The scale of the crisis triggered by the vaporization of the American sub-prime securitization market in August 2007 demonstrated the fragility of a global architecture based on such an exceptionally emaciated conception of responsibility. As Alan Greenspan put it in revealing testimony in Congress the following year: 'I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in

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[4] See, Justin O'Brien, *Wall Street on Trial* (John Wiley & Sons, 2003).
[5] Cynthia A. Glassman, 'Sarbanes-Oxley and the Idea of "Good" Governance' (Speech delivered at the American Society of Corporate Secretaries, Washington D.C., 27 September 2002).
Glassman, a Securities and Exchange Commission commissioner noted 'those who act on behalf of a corporation - its officers, directors and employees - *must* be its conscience. Sarbanes-Oxley and the Commission's rules impose specific requirements - coupled with substantial penalties - aimed at ensuring that those who act on behalf of a company give life to the corporate conscience.'
[6] Justin O'Brien, *Redesigning Financial Regulation* (Imperial College Press, 2007).
[7] Justin O'Brien, *Engineering a Financial Bloodbath* (Imperial College Press, 2009).
[8] Michiyo Nakamoto and David Wighton, 'Citigroup chief stays bullish on buy-outs', *Financial Times* (online), 9 July 2007 <http://www.ft.com/intl/cms/s/0/80e2987a-2e50-11dc-821c-0000779fd2ac.html#axzz2gcA3ag5i>.

the firms.'[9] That mistake was equally apparent in the City of London, where the vaunted risk-based principles driven regulatory system was shown to be equally dysfunctional.[10] From the perspective of this paper, and policy formulation more generally, it is essential to emphasize that irrespective of whether a rules or principles based approach was used to interpret regulatory purpose globally post Sarbanes-Oxley, neither proved capable of embedding restraint or effective risk management. This then raises the question of why?

In part the answer lies in the fact that all markets are socially constructed. Their sustainability depends on the strength of the underpinning eco-system that conditions practice. If through design or unintended consequences that system becomes corrupted there can be no long-term solution. The mistake, as Greenspan conceded, was primarily an ideological one based on the illusion of free markets and informed by the efficient market hypothesis. This controversial theory informed regulatory strategies globally. Its falsification has prompted a veritable avalanche of regulatory reform initiatives. Six years on, however, we remain mired in crisis management. This reflects, in part, the power of the financial services lobby. The stasis is also informed by ongoing contestation over what caused the crisis, degree of responsibility and what constitutes or should constitute the balance between rights and duties in the creation and maintenance of market integrity.

The risks have been intensified by the emergence of new series of scandals, most notably the manipulation of key financial benchmarks, such as the London Interbank Offered Rate (Libor). Critically, the manipulation post-dates the onset of the Global Financial Crisis. That traders within RBS, which was effectively made a ward of state because of prior failure, could be allowed to attempt to manipulate Libor demonstrates all to clearly how pernicious banking culture had become and how disconnected from societal obligation contemporary practice within the industry had become. Although still at an exceptionally early stage, the global investigation makes dispiriting reading:

> Recent investigations uncovered *systematic false reporting and manipulations* of reference rate submissions dating back many years. This *misconduct* was designed to either increase the potential profit of the submitting firms or to convey a misleading picture of the relative health of the submitting banks. These actions were *pervasive*, *occurred in multiple bank locations around the world, involved senior bank officials at several banks, and affected multiple benchmark rates and currencies*, including LIBOR, EURIBOR, and the Tokyo Interbank Offered Rate (TIBOR). Each of the banks that faced charges engaged in a *multi-year pattern of misconduct that involved collusion* with other banks. These revelations have undermined the public's confidence in these benchmarks [emphasis added].[11]

It is in this context that the progress towards resolution at global level must be evaluated. The piecemeal progress is a dismal reflection of an ongoing failure to hold the financial

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[9] David Nason, "I made a mistake' admits Alan Greenspan', *The Australian* (online), 25 October 2008 <http://www.theaustralian.com.au/business/opinion/i-made-a-mistake-says-greenspan/story-e6frg9mf-1111117848644>.

[10] Treasury Select Committee, 'Fixing Libor: some preliminary findings' (Report, Treasury Select Committee, 12 August 2012), available at <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/481/48102.htm>.

[11] Financial Stability Oversight Council, 'Annual Report' (Report, Department of Treasury, 25 April 2013) 137.

services industry to account. This was most notably seen in the recent G20 Summit, which privileged intention over action.

The global regulatory roadshow trundled into St Petersburg overshadowed by profound disagreements on how to deal with the use of chemical weapons in Syria. The lack of concrete evidence on which faction was actually responsible, combined with geopolitical arbitrage, conspired to stave of concrete measures. The diplomatic debate was, according to the British Foreign Secretary, William Hague 'heavy going.'[12] The British Prime Minister, David Cameron, described the opposition to intervention 'frustrating,' warning that as a consequence of the failure to provide leadership 'everyone will pay a price.'[13] The absence of any reference to the conflict in final communiqué reflected those divisions. Instead the G20 focused on its core mandate, the governance of financial markets, in particular the construction of a financial architecture blueprint, first sketched out in Pittsburgh in 2009.[14] Articulating past commitment only served to highlight the lack of actual implementation.

Mark Carney, Governor of the Bank of England and the head of the Financial Stability Board, set out a progress report. Much, he claimed, had been achieved but more was required in order to allow for the orderly resolution of systemically important financial institutions.[15] These remained too inter-connected, too complex and subject to 'worryingly large differences' in the nature and quality of internal risk models.[16] With remarkable understatement, Carney argued that 'our work is not yet completed. It is crucial that the G20 stay the course in implementing reforms in a consistent manner. More remains to be done to strengthen the resilience of the institutions. The G20 should also concentrate in particular on completion of three crucial areas of reform: ending too-big-to-fail; reforming shadow banking and making derivative markets safer.'[17] Decoded, the primary causes of the GFC remain unresolved.

The policy goals articulated by the Financial Stability Board are inherently connected. The failure of prior internal risk management systems at major financial institutions magnified informational asymmetries. Market participants and regulators alike remain unclear as to the size, nature and direction of risk-profile, most notably in the derivatives markets. The regulation of the Over The Counter (OTC) sector is, therefore, a critical component in the architectural design. Given the fact that ninety per cent of the global derivatives market is driven by twelve banks credible reform of systemically important institutions necessitates global coordination. Both historically and in a contemporary sense, the global reach of major banking entities and their counterparties, provide multitudinous transmission channels for contagion. Bilateral contracts negotiated out of

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[12] BBC News, 'Hague: G20 Syria debate was 'heavy going'', *BBC* (online), 8 September 2013 <http://www.bbc.co.uk/news/uk-politics-24006522>.

[13] David Wastell and Barney Henderson, 'Syria Crisis: G20 summit – September 6 as it happened', *The Telegraph* (online), 9 September 2013 <http://www.telegraph.co.uk/news/worldnews/middleeast/syria/10295396/Syria-crisis-G20-summit-September-6-as-it-happened.html>.

[14] G20, 'The G20 leaders statement, Pittsburgh summit' (Statement, G20, 25 September 2013), available at <http://www.g20.org/documents>.

[15] Letter from Mark Carney to G20 Leaders, 5 September 2013, available at <http://www.financialstabilityboard.org/publications/r_130905.pdf>.

[16] Ibid 2.

[17] Ibid 1.

sight of the market have created tightly connected webs that span the globe. By the end of 2012 the notional value of outstanding contracts was estimated to be $633 trillion, nine times the size of global GDP, of which only $52 trillion were traded on exchanges.[18] While the value at risk is estimated at $25 trillion, it is notable that reserves for systemically important institutions have increased by only some $500 billion.[19]

The contours of how to regulate the derivatives market have, however, been in place since the 2009 Pittsburgh summit. They are based on an international consensus that the creation of a centralized infrastructure will at the very least provide data on how the market is operating. This performs both monitoring and accountability purposes. The putative framework is designed to improve market transparency, reduce systemic risk and better detect and prevent market abuse. The reform agenda involves a commitment to develop trade repositories, centralized clearing and where appropriate, subsequent trading on exchanges. In order to incentivize progress towards standardization, derivative contracts not centrally cleared are subject to higher capital charges.

The fifth anniversary of the collapse of Lehman Brothers demonstrates, however, how little progress has been made in the wholesale funding market, 'a $4.6 trillion arena operating on trust, which can disappear in an instant.'[20] The G20 summit in St Petersburg provided crucial evidence that national imperatives continue to cloud international resolve. Warning of the continuing danger of regulatory arbitrage and fragmentation, the FSB chairman maintained that urgent action was essential in order to build a resilient global financial system, capable of withstanding future shocks. Progress, however, would be determined by verifiable domestic implementation of prior commitment. Progress, like peace, however, comes 'dripping slow.'[21]

This can be traced to the difficulties in implementation, which is in turn are determined by coordination, or more accurately the lack of it, between the European Union and the United States. Together they account for eighty per cent of the global derivatives market. The most progress to date has been in developing trade repositories, which can be used to data-mine transactions within specific markets. Japan became the first jurisdiction to implement mandatory reporting. Australia introduces (partial) reporting in October and Singapore by the end of the year, while the European Union moves towards implementation in 2014. Even this limited progress raises profoundly complicated questions over privacy and business confidentiality. Critically, however, structural changes to the timeliness and nature of reporting will count for little without credible reform to the financial benchmarks on which the derivative market is built, a fact recognized by the Financial Stability Board.[22]

It was in this context that the FSB along with the G20 endorsed the IOSCO global principles governing the setting and administration of financial benchmarks. The IOSCO

[18] Deutsche Bank Research, 'Reforming OTC derivatives markets' (Research Paper, Deutsche Bank, 7 August 2013).
[19] Mark Carney, 'A plan to finish fixing the global financial system', *Financial Times* (online), 9 September 2013 <http://www.ft.com/intl/cms/s/0/a0e95652-1960-11e3-83b9-00144feab7de.html#axzz2gcA3ag5i>.
[20] Gretchen Morgenson, 'After a Financial Flood, Pipes Are Still Broken', *The New York Times* (New York), 14 September 2013, B1.
[21] Seamus Heaney, *The Cure at Troy* (Field Day, 1991).
[22] Carney, above n 19.

principles place primary responsibility on an administering organization, with any outsourcing subject to oversight by the administrator, in conjunction with a national regulatory authority. The framework is tailored to the disclosure of any material conflicts of interest to (non-defined) stakeholders and any relevant regulatory authority, along with publication of control mechanisms, such as whistleblowing protection.[23] Nowhere, however do the principles define effectiveness. The principles further call for use of only 'prices, rates, indices or values that have been formed by the competitive forces of supply and demand, and be anchored by observable transactions entered into at arm's length between buyers and sellers in the market for the Interest the Benchmark measures. This principle recognizes that bona-fide observable transactions in markets provide a level of confidence for the prices or values used as the basis of the Benchmark are credible.'[24]

The principles also facilitate continuance of rates based on submissions, without defining how cultural change can be delivered to guarantee probity. Moreover, IOSCO calls for the development of a code of conduct for those involved in submitting rates, but does not define what is required in this process.[25] The lack of guidance on what measures could be developed to ascertain corporate culture is surprising. The requirement to have policies, rather than articulating what those policies should be and requiring evidence that they work is problematic throughout. Likewise, the key accountability provision governing complaints (Principle 16) requires only the introduction of a system rather than a requirement to demonstrate that it works. The lack of granularity makes the recommendation for external audit (Principle 17) rather weak. The relationship with regulatory agencies (Principle 19) seeks to make information available on request rather than providing for ongoing collaboration to ensure cultural change.

The lack of specificity is troubling given the evidence provided by the head of UBS to the Parliamentary Commission on Banking Standards in January: 'Regulators monitor, and control frameworks monitor and try to catch issues, *but the difference is made by the people who are on the front line*. They need to change their standards and abide by certain rules, not because they are imposed on them but because they believe in them.'[26] The question of warranted trust is, therefore, critical. The failure to address it is a fundamental flaw. The failure is magnified given the critical role played by Martin Wheatley, the head of the Financial Conduct Authority in the United Kingdom and a critical actor in the IOSCO Taskforce, which set out the principles.

The Wheatley Review of Libor is a critical cornerstone of the IOSCO Principles. The Review recommends that 'contributing banks and the rate administrator will together establish a code of conduct outlining requirements and responsibilities of individual firms.'[27] When provided with an opportunity to frame that discourse in the tender process to replace the British Banking Association as the administrator of Libor,

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[23] The Board of the International Organization of Securities Commissions, above n 1, 9–10.
[24] Ibid 10–11.
[25] Ibid 25 (Principle 14).
[26] Evidence to the Parliament Commission on Banking Standards, House of Commons, Westminster, 9 July 2013 (Andrea Orcel), available at <http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/c606-xix/c60601.html>.
[27] Martin Wheatley, 'The Wheatley Review of LIBOR: final report' (Report, HM Treasury, September 2012).

Wheatley demonstrably failed to provide leadership. That absence of leadership is also prevalent in IOSCO Principles themselves. Nowhere do they articulate what is meant by responsibility. This myopia is a fundamental flaw, made harder to understand because of the evidential information gathered but ignored by the British government and regulatory authorities, notwithstanding the clear risk articulated by Andrea Orcel of UBS referenced above.[28]

This myopic approach to regulatory design demonstrates clearly the risk associated with unthinking application of industry rhetoric that they have learnt the lessons of history. As the next section demonstrates, notwithstanding the social harm caused by past banking and regulatory practice, concern about impediments to banking profitability remains a dominant criterion of regulatory purpose, particularly in the United Kingdom itself. The net consequence of this is to reduce the capacity of the state to intervene.

BEHIND THE POTEMKIN FAÇADE

Given the centrality of the United Kingdom to the governance and administration of Libor, it is hardly surprising that the most sustained critique of bank practice and standards should emanate from Westminster. The final report of the Parliamentary Commission on Banking Standards, issued one month before the publication of the final IOSCO Principles, is a damning critique of both banking and regulatory practice in the United Kingdom. The Approved Person regime that forms the cornerstone of regulatory oversight in the United Kingdom and a critical component of the Wheatley Review is dismissed as 'a largely illusory impression of regulatory control over individuals, while meaningful responsibilities were not in practice attributed to anyone.'[29] In a damning assessment of prior regulatory design, compliance is dismissed as the key architectural innovation in the building of Potemkin villages that give 'the appearance of effective control and oversight without the reality.'[30] The fact that 'prolonged and blatant misconduct' as evidenced in the Libor and associated scandals occurred without comment, suggest to the Commission a degree of systemic institutional corruption, allied to a 'dismal' and 'striking limitation on the sense of personal responsibility and accountability' of banking leaders. Incremental change, it concludes in its final report, 'will no longer suffice.'[31]

Throughout the report there is evidence of continued suspicion of both banks and their regulators. The emphasis on better governance and the lack of confidence in the ability of boards of directors to recognize their responsibilities is manifest in the suggestion that the Companies Act should be amended 'to prioritize financial safety over shareholder interests in the case of banks.'[32] As the Commission makes clear 'it is essential that the risks posed by having a large financial centre do not mean that taxpayers or the wider

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[28] Evidence to the Parliament Commission on Banking Standards, House of Commons, Westminster, 9 July 2013 (Andrea Orcel), available at <http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/c606-xix/c60601.html>.

[29] Parliamentary Banking Standards Commission, 'Changing banking for good – Volume I' (Report, HM Parliament, 19 June 2013) 8.

[30] Parliamentary Banking Standards Commission, 'Changing banking for good – Volume II' (Report, HM Parliament, 19 June 2013) 335 [684].

[31] Ibid 294 [566].

[32] Parliamentary Banking Standards Commission, above n 29, 11.

economy are held to ransom.'[33] Unless the lessons of history are learnt, however, banks will inevitably fail, hence the need for stringent oversight as 'many banks remain too big and too complex to manage effectively.'[34] By extension, it infers, they are too complex to regulate. In a critical passage, the Commission warns against the myth that the problem in British banking is the result of individual failure or that banking has indeed learnt form its mistakes, thus requiring no further action. Specifically, it rejects any suggestion that robust intervention could threaten the future of the industry. 'If the arguments for complacency and inaction are heeded now, when the crisis in banking standards has been laid bare, they are yet more certain to be heeded when memories have faded. If politicians allow the necessary reforms to fall at one of the first hurdles, then the next crisis in banking standards and culture may come sooner, and be more severe,' it warns.[35]

At the same time, the Commission remains cautious about the stated ambition of the banking industry to develop a professional standards body. While seeing potential value, it is exceptionally concerned that this too could become an exercise in regulatory gaming. 'There are also very substantial risks of duplication between the powers and role of a professional standards body and those of regulators as well as risk that the creation of such a body could become a focus of public policy, diverting attention from the changes that are urgently needed within the existing regulatory framework,' it argues.[36] The proposals for a professional body run the additional risk that power is stripped away from regulators at the very point it is most needed. It is a risk that the Commission is not prepared to countenance: 'On the basis of our assessment of the nature of the banking industry, we believe that the creation of an effective professional body is a long way off and may take at least a generation.'[37] The reform of British banking remains, therefore a work in progress. The Potemkin facade has been pierced not yet demolished.

The failure to address an evidential dossier can be most clearly seen in the 84-page official government response to the Commission, which rejects many of the concrete proposals and leaves discretion at the hands of the new regulatory authorities, privileging a headline grabbing but unlikely ever to be used new charge of recklessness. The response carries the imprint of the Treasury and Department of Business, Innovation and Skills and, therefore, the imprimatur of the Liberal Democrats as well as the Conservatives. That Vince Cable, the avuncular Business Secretary, could sign up to such a sweeping rejection in substance of the Commission's proposals is, on surface, as surprising as it is disappointing. At the Liberal Democrat conference in September 2010 Cable famously asked rhetorically 'what is it like being in bed with the Tories? First, it's exhausting; it's exhausting because you have to fight to keep the duvet. But to hold our own we need to maintain our party's identity and our authentic voice.'[38] Holding its own included holding the City to account. 'I make no apology for attacking spivs and gamblers who did more harm to the British economy than Bob Crow could achieve in his wildest Trotskyite fantasies, while paying themselves outrageous bonuses underwritten by the taxpayer. There is much public anger about banks and it is well

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[33] Parliamentary Banking Standards Commission, above n 30, 83 [8].
[34] Ibid 118 [86].
[35] Ibid 192 [273].
[36] Ibid 306 [598].
[37] Ibid 307 [601].
[38] Vince Cable, 'Speech delivered at the Liberal Party conference' (Speech delivered at the Liberal Party Conference, Liverpool, 22 September 2010), available at <http://www.bbc.co.uk/news/uk-politics-11390365>.

deserved,' he then said.[39]

> The Government's agenda is not one of laissez-faire. Markets are often irrational or rigged. So I am shining a harsh light into the murky world of corporate behaviour. Why should good companies be destroyed by short-term investors looking for a speculative killing, while their accomplices in the City make fat fees? Why do directors sometimes forget their wider duties when a cheque is waved before them? Capitalism takes no prisoners and kills competition where it can, as Adam Smith explained over 200 years ago.[40]

The speech foreshadowed Cable's decision in June 2011 to set up the Kay Review of UK Equity Markets and Long-Term Decision Making, which like the PCBS highlighted the significance of culture. For Kay, 'trust and confidence, or their absence, are the product of the prevailing culture [with decisions taken] in line with the values and aspirations of the environment in which they find themselves.'[41] On this account changing structures without dealing with incentives and the way of viewing obligation will be insufficient, a fact acknowledged by Mr. Cable himself in evidence to the Business, Innovation and Skills Committee in March 2013. Reminded by the Committee of the 2010 speech Cable was asked directly about the lack of progress. 'We had the sound and fury of your speech and then the somewhat less robust response from the Government. Just now many prisoners of capitalism do you think will be released as a result of this?' asked Andrew Bailey.[42] Cable replied 'probably quite a lot over a long period of time. As you know, a party conference does induce poetry that we perhaps lack in our everyday discourse but I do not, in any sense, retract the principles that I was talking about.'[43] For Cable discourse necessitated the kind of forensic review of practice highlighted in the Kay Report which would, in turn, 'ensure that the whole complex chain of equity financing becomes much more transparent and operates on the basis of trust, which had largely broken down.'[44]

He told the Committee that change necessitates 'voluntary compliance and if we can get that right, it will make a big difference over time.'[45] He committed, however, to tracking implementation. 'It is not just a question of getting a report, sticking it on a shelf and vaguely hoping that people comply with it…there is always a danger of nice reports that just never happen.'[46] Cable was convinced that change would be delivered because as he put it 'the financial services industry, particularly banking, has been rather humbled by the experience of the last few years and will probably be rather less aggressive now than it used to be.'[47] Critically, he argued, 'we are not waving big sticks and that would go contrary to the Kay philosophy, which was about building up trust.'[48] In concluding his

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[39] Ibid.
[40] Ibid.
[41] John Kay, 'The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report' (Report, HM Government, July 2012) 5.
[42] Evidence to the Business, Innovation and Skills Committee, House of Commons, Westminster, 26 March 2013, 1 (Adrian Bailey, Chair), available at <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/uc969-v/uc969.pdf>.
[43] Ibid (Vince Cable, Secretary of State for Business, Innovation and Skills).
[44] Ibid 2.
[45] Ibid.
[46] Ibid 3.
[47] Ibid.
[48] Ibid 4.

evidence, he noted that while he did

> use strong language [in his Liverpool party conference speech] because there are some serious abuses, but that does not mean that the whole system of private enterprise in general and of institutional investors, as another, is corrupt, rotten and falling apart, because it is not. There are some bad examples and we need to deal with them…. My approach to all these things is to try the voluntary approach and try to build up trust with the practitioner. If it fails we can adopt more aggressive solutions, but let us try the voluntary approach first.[49]

Reliance on voluntary compliance as articulated by Vince Cable, however, will be insufficient. The real danger here is that far from tearing down the Potemkin façade of accountability in financial markets the government appears intent on building on it. Having had the foresight to commit to an evidence-based approach underpinned by the Kay Review and the Parliamentary Commission on Banking Standards, the coalition government is now endorsing a regulatory design of spurious quality that continues to leave Britain vulnerable. Nowhere is this more clearly seen than in the decision to award the contract for the administration of Libor to NYSE-Euronext at the same time that the Government released its response to the banking standards commission final report.

On one level the decision represents shrewd short-term politics. Given the fact that trillions of dollars in derivative contracts benchmark Libor, how it is calculated, monitored and enforced is critical to rebuilding trust and confidence in market integrity. Handing control of oversight of the 'world's most important number' to an entity about to be taken over by International Continental Exchange, the world's largest derivative contract facilitator links the benchmark to those with a vested interest in protecting its probity. It also raises a hornet nest of questions over how the entity is to manage inherent and extensive conflicts of interests.

The rate will continue be administered in London through a subsidiary to be registered with the Financial Conduct Authority. Ultimate ownership in the United States has the capacity to integrate its governance those mandated by the Commodity and Futures Trading Commission. The CFTC is on record as wanting to replace Libor as soon as possible. A benchmark that becomes 'untethered' from reality becomes 'vulnerable to all sorts of misconduct,' argued Gary Gensler, the chairman of the CFTC in an interview with the *Financial Times* in April.[50] In the event that the CFTC establishes concrete rules in the United States, there is room to develop coordinated policies on benchmark governance, which can then be applied simultaneously in London and New York.

The NYSE-Euronext contract, which it secured for a nominal sum of £1, allows for a continuance of hypothetical submissions when the new operator takes over the administration of Libor next year. The operator will work closely with the Financial Conduct Authority to develop new governance and operating procedures, including the move towards observed rates. It remains, unclear, however, what form these governance and operating procedures will take. And it is on this basis that the conflicts issue moves comes into sharp focus.

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[49] Ibid 19.

[50] Brooke Masters and Philip Stafford, 'CFTC's Gensler says Libor 'unsustainable", *Financial Times* (online), 22 April 2013 <http://www.ft.com/intl/cms/s/0/f5d2c816-ab4b-11e2-ac71-00144feabdc0.html#axzz2gcA3ag5i>.

The tender process revealed both the high level of discretion provided to the administrator and the potential it has to shape the regulatory agenda. In submission guidelines, the independent tendering body, which is dominated by key city figures, notes that 'this debate and the implementation of the solutions developed will take time. The new administrator will be able to play a key role in this debate, including through focusing on further steps which could be taken to strengthen Libor.'[51]

Eleven criteria were taken into consideration. The proposed methodology, governance and oversight of conduct and operations accounted for 16 per cent of the evaluation. Tenderers were mandated to include detailed explanations of 'how you will discourage and detect manipulations and errors in submission to Libor; and will maintain the sustainability of Libor through monitoring for and responding appropriately to risks.'[52] In addition, there was a requirement to provide declarations of business relationships with Libor panel submitting banks and other relationships with organisations with an interest in Libor e.g. organisations whose products use Libor as components of their interests' along with 'details of how conflicts will be managed.'[53] A further consideration involved an articulation of a plan to 'assume, maintain and enhance the codes of conduct for persons involved in Libor.'[54] This accounted for 8 per cent of the evaluation. No guidance was provided on the parameters of that code of conduct. In addition, an overall assessment of the Tenderer's ability to restore credibility to the management of Libor accounted for a further 20 per cent.

Given the extent to which NYSE–Euronext and ICE itself have deeply embedded relationships with contributing banks and routinely price contracts on the basis of Libor ascertaining how the entity answered these criteria would make for very interesting reading indeed. Already a senior CFTC commissioner, Bart Chiltern was expressed scepticism about the decision. 'We had a fox guarding the henhouse issue here and we should learn from that,' Mr. Chilton told the *New York Times*. 'I firmly believe that having a truly neutral third-party administrator would be the best alternative, and I'm not sure that an exchange is the proper choice.'[55]

The tender process in London reflects a continued belief in market ordering. Whether the belief is justified in another matter entirely. It cannot be assured by virtue of a rather opaque tendering process. In sharp contrast Singapore has adopted a much more invasive approach to scope and police the development of codes of conduct. The approach is much more likely to produce beneficial outcomes, not least because this innovative approach to regulatory engineering is specifically designed to protect the integrity of the benchmark as a public good.

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[51] Hogg Tendering Advisory Committee for LIBOR, 'Invitation to Tender' (Tender, Hogg Tendering Advisory Committee for LIBOR, 17 April 2013) 5, available at <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/194276/hogg_tendering_advisory_committee_for_libor_invitation_to_tender.pdf>.

[52] Ibid 18.

[53] Ibid.

[54] Ibid.

[55] Nathaniel popper, 'NYSE EuroNext to Take Over Administration of Libor', *The New York Times* (online), 9 July 2013 <http://dealbook.nytimes.com/2013/07/09/nyse-euronext-to-take-over-libor/>.

The investigation by the Monetary Authority of Singapore into the attempted manipulation of key financial benchmarks in the city-state has profound implications internationally. Notwithstanding the fact that no evidence of actual success has been proffered, Singapore has moved quickly and decisively to change the domestic and international regulatory battleground. The regulatory change is based on the very loose principles articulated by IOSCO. Its articulation of global principles, although purposively vague, was designed to demonstrate both the timeliness and efficacy of international coordination. In fleshing out these principles in a radical redesign, Singapore is providing a much needed route map to navigate two pressing hazards. The first of these is how to handle the investigation and enforcement process. The MAS action has foreclosed individual investigation and the piecemeal erosion of trust associated with periodic disclosure of individual institution misconduct. Instead it opted for a comprehensive settlement. The second and potentially more significant navigational aid is how the settlement forcibly enlists the industry in protecting the integrity of the rate-setting process.

A total of 133 traders in no less than 20 banks were found to have engaged in conduct which if not illegal did provide evidence of a lack of professional ethics that necessitated the introduction of radical remedial measures.[56] In contrast to the piecemeal evidentiary approach adopted by regulators in the United Kingdom and the United States, Singapore made a calculated decision to tackle the problem in a holistic manner. Critical to its reasoning is the belief that the 'end' of market integrity cannot be vouchsafed unless three interlinked criteria are measured and evaluated. First, obligation needs to be specified. Second, ongoing conduct must be subject to external review. Third, responsibility to protect the public interest of the benchmark must be internalized by both individuals and their institutions through a calibration of risk management systems. The framework is set out in a consultation paper released at the same time as the investigation into professional misconduct, which has got nowhere near the amount of attention it deserves.[57] The paper, which should be read in conjunction with the MAS investigation, has the capacity to reframe discourse on benchmark creation and ongoing evaluation. The proposed framework has four coercive components.

First, criminal and civil sanctions are to be introduced (in line with recommendations made in the United Kingdom). The consultation paper proposes that 'the prohibition will cover the manipulation of any financial benchmark administered in Singapore, regardless of whether the offender is located in Singapore or overseas; and manipulation by any person in Singapore of any financial benchmark administered in Singapore or overseas.'[58]

Second, specific legal power is provided to the MAS to designate key benchmarks subject

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[56] Monetary Authority of Singapore, 'MAS Proposes Regulatory Framework for Financial Benchmarks' (Press Release, 14 June 2013), available at <http://www.mas.gov.sg/News-and-Publications/Press-Releases/2013/MAS-Proposes-Regulatory-Framework-for-Financial-Benchmarks.aspx>.

[57] Monetary Authority of Singapore, 'Proposed Regulatory Framework for Financial Benchmarks' (Consultation Paper No P007-2013, Monetary Authority of Singapore, June 2013).

[58] Ibid 5.

to formal regulation taking into account their systemic importance, susceptibility to manipulation and degree to which doing so is in the public interest. It specifically includes the Singapore Interbank Offered Rate and Swap Offer Rate, both of which were reviewed in the investigation of professional misconduct as examples of such benchmarks. So too are the Foreign Exchange benchmarks, which the MAS believes are subject to too much discretion and could 'benefit from enhanced governance and control.'[59]

Third, regulatory authorities will be provided compulsion powers to force entities to contribute to the rate setting and administration process through the introduction of a licensing regime. The administrating body must satisfy residence criteria and directors subject to fit and proper testing. Moreover, the MAS is given visitation rights to conduct testing of the submission and surveillance processes, including the management of actual and potential conflicts of interest and establishment of procedures to encourage whistle blowing. The administrating body must develop a code of conduct, which in turn has to satisfy the MAS. An oversight committee is to be established, which must include at least one third independent experts as well as stakeholders from industry. The membership of the committee is to be vetted by the MAS. There is a requirement for immediate disclosure if there is mere suspicion of misconduct. In addition there is to be external audit of adherence to the policies and procedures, which is to be submitted directly to the MAS. This invasive oversight also applies to the submitting organizations. They are to be mandated to comply with the code of conduct and also notify the MAS of any suspicion of misconduct. Each submitting entity must also conduct a specific external audit of compliance with the policies and procedures and provide it directly to the MAS. Moreover, the MAS is to be given authority to compel entities to submit rates 'should the need arise in order to ensure the reliability of benchmark construction.'[60]

Fourth, granular best practice guidelines are to be introduced (which draw upon but develop principles articulated by IOSCO) for those benchmarks not directly regulated, with clear guidance not to rely upon them unless their governance is in turn consistent with the IOSCO framework. The aim is to ensure the principles trickle down into all areas of practice. Moreover, MAS reserves the right to bring these benchmarks into formal oversight if practice does not improve.

Underpinning all of this is a core normative argument. The MAS argues that 'it takes a serious view of the need to uphold high standards of integrity in the industry and expects banks to foster a culture of ethical conduct among all their employees.'[61] As Teo Swee Lian of the MAS put it, 'the industry must also play its part in enhancing the robustness of financial benchmarks and in cultivating high standards of professional integrity and ethics.'[62] This includes the explicit suggestion that blacklisting should occur by notifying the market of anyone suspected of misconduct. The Singaporeans have transcended the limitations of compliance and the heretofore dominance of risk management systems designed in terms of minimizing the risk to the institution. Instead, it has very consciously aligned the 'end' - market integrity - with the 'purpose' of risk management - protecting the public interest. Firms are assessed on their demonstrable capacity to

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[59] Ibid 7.
[60] Ibid 15.
[61] Monetary Authority of Singapore, above n 56.
[62] Ibid.

protect the public interest. This very clever exercise in regulatory engineering, combined with demand to report suspicion rather than evidence of wrongdoing and power of compulsion, creates a Panopticon effect. It may also lead to warranted confidence in banking industry exhortations that they are committed to professional integrity. It is a framework that is deserving of attention and emulation.

What is also required, however, is much more accountability of the regulatory authority and the internalization of responsibility within the banking industry itself. Sustainable reform cannot survive through coercion alone. It has to be negotiated. The critical question is how to operationalize it. One possibility is through the development of what I have termed CEDAR (an acronym for Compliance, Ethics, Deterrence, Accountability and Risk). It is in the interests of the regulator and the regulated to ensure substantive rather than technical compliance. Both can only deliver confidence on the basis of warranted commitment to ethics, effective deterrence and enhanced accountability leading to a reduction in risk to an individual corporate or regulatory entity and the system as a whole. Progress towards achieving these goals is in the self-interests of all participants in the market. How they achieve them are determined by specific mandates, processes and the use of discretion. This allows for a comprehensive mapping of the regulatory system as a whole. The critical advantages of CEDAR is that it delineates rights, duties and responsibilities and rebuilds trust, without which stated commitment to market integrity remains at the symbolic rather than substantive level. It is predicated on the principles of effective consultation - continuous, targeted, appropriately managed in terms of timelines, accessible, transparent, consistent and subject to ongoing evaluation and review.

This approach is designed to be an exercise in experimental governance. Industry has, correctly, complained for some time that they are laboring within a regulatory framework over which they have no ownership. If they want this to change they must take a degree of responsibility. Operationalizing the financial benchmark reforms provides industry and regulatory authorities at national and global level to develop that partnership. It is in their interests and that of society that they do.

CONCLUSION

Public concerns about the integrity of Libor have been evidenced from as far back as 2008 with the publication of series of articles in the *Wall Street Journal*. Regulators have been slow to act. Although three major banks have settled, investigations into other contributing institutions are continuing. As can be seen from the investigation in Singapore, which implicated North American banks, it is only a matter of time before the Libor scandal crosses the Atlantic. The timing could not be worse. The United States is now in countdown to the mid-term elections. As such, reform of financial benchmarks is likely to take place in a politically hostile environment. Notwithstanding the fact that IOSCO wishes to see implementation of its principles within a twelve-month timescale, the vagueness of the principles, coupled with on going litigation, makes implementation difficult.

The process is further complicated by the complete absence of leadership demonstrated by Martin Wheatley and the Financial Conduct Authority in the United Kingdom. As with the British government, the key market conduct regulator appears to have not taken seriously the evidence provided by the banking standards commission. This failure is evident in a remarkably flawed tendering process for a replacement to Libor.

In sharp contrast Singapore has adopted an innovative approach to benchmark governance that re-engineers risk management towards the protection of the public good. In so doing it is forcing industry to accept its responsibility in protecting market integrity and providing a mechanism to hold them to account in the event that practice does not change. Such an approach is much more likely to result in socially beneficial outcomes than reliance on the stated but unlived values of a financial services industry that has lost the right to self-regulate. For values to be restored, a little coercion is required. The Singapore Sling if imbibed in moderation does not have to lead to a hangover. It just may be just the elixir both industry and society require.