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So foul and fair a day: the prosecution of Standard Chartered, state-federal relations and the return of Banquo's ghost

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The State Government of New York has re-emerged as a pivotal broker of financial regulation. Enforcement action taken by the Department of Financial Services against Standard Chartered for violations of sanctions against Iran, as well as subpoenas issued by the State Attorney General to banks implicated in the manipulation of the London Inter-Bank Offered Rate ("LIBOR)", reflect independent power. The unresolved question is whether its exercise demonstrates opportunistic deployment of extortionist impulses. The paper evaluates the impact on state-federal relations across mandate, process and agency. It argues that while the return of New York reflects opportunism, the opportunity has been caused by a systemic failure of regulation first identified by Eliot Spitzer, the proclaimed Sherriff of Wall Street, a decade earlier.

Macbeth: So foul and fair a day I have not seen
– William Shakespeare, *Macbeth, Act I, Scene III*

Following the announcement that Standard Chartered had agreed to pay a $340m fine to settle claims brought by the New York State Department of Financial Services ("DFS") that the London-headquartered bank had violated sanctions imposed on transacting with Iranian entities, the New York Governor, Andrew Cuomo, released a short statement. The settlement, he proclaimed, demonstrated, the value of a tough and fair regulator for the banking and insurance industries. "This state and nation are still paying the price for a failed regulatory system and that must not happen again. This result demonstrates the effectiveness and leadership of the new Department of Financial Services, and I commend the state legislature for creating a modern regulator for today's financial marketplace" (Cuomo 2012). Left unstated was whether the failure resulted in the actions (or lack thereof) of the Office of the Comptroller of the Currency ("OCC"), with which the Governor had been long embroiled in a bitter dispute over the parameters of state-federal relations in regulating and policing the financial markets.

With one notable exception, the New York settlement received scant public attention in Washington, D.C. It received enthusiastic backing from Senator Carl Levin (D-Mich), the influential chair of the Senate Sub-Committee on Investigations. The timing and content of the intervention was far from accidental. The previous month Senator Levin had handed down a damning report into the failure of another London-headquartered banking conglomerate, HSBC, to install effective anti-money laundering controls (Senate 2012). He had also found critical failures in federal oversight. Levin's investigation noted the OCC had been aware of substantial anti-money laundering control failures within HSBC but had failed to either investigate them or bring the bank to account (Senate 2012, 293-317). The report concludes: "systemic weaknesses in the OCC's AML oversight model require correction" (Senate 2012, 317). In reviewing the Standard Chartered investigation, the Senator argued that the New York agency "showed that holding a bank accountable for past misconduct doesn't need to take years of negotiation over the size of the penalty; it simply requires a regulator with backbone to act. New York's regulatory action sends a strong message that the United States will not tolerate foreign banks giving rogue nations like Iran hidden access to the US financial system" (Levin 2012).

Despite the lack of commentary from either the White House or federal executive agencies, the Standard Chartered investigation–and the manner in which it was handled–is certain to reignite the festering feud over how to regulate finance. This has deep and complex roots. They trace back to the tenure of Eliot Spitzer as State Attorney General ("SAG"). How to resolve the conflicts were last, partially, adjudicated by the Supreme Court in 2009 in a case that owes its origins to Spitzer's questionable use of executive authority (*Cuomo v Clearing House Association L.L.C.* 2009).[i] The Supreme Court then struck down attempts by the OCC to preclude any state enforcement action against national banks. Simultaneously it upheld the federal agency's sole "visitorial" or supervisory rights, rights that have once again been called into question (see Wilmarth 2010).

The ruling left unresolved three critical policy questions. First, would or could state-based authorities risk judicial questioning of whether the exercise of enforcement capacity provided by subpoena power amounted to a "fishing expedition" rather than a focused with cause investigation? As Justice Scalia warned in *Clearing House,* discovery limitations are designed to limit "unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice"

(*Cuomo v. Clearing House*, 9). Second, would the states limit resources to the prosecution of past violations of the law or seek to mould the substance of current and future corporate governance and risk management systems, the key innovation associated with Spitzer's settlement strategies? Again, as Justice Scalia noted in the majority Supreme Court opinion, the state has authority as law enforcer, a formulation that limits capacity to effect regime change. Third, notwithstanding the position of New York as a global financial hub, would enforcement take into account the collateral consequences? The settlement with Standard Chartered provides partial answers to each. More fundamentally, it re-opens a series of questions over authority, mandate, bureaucratic processes and use of discretion in financial services regulation at a time when the federal authority and legitimacy have come under sustained criticism.

The release of the HSBC report and its damning assessment of the OCC provided perfect cover, therefore, for the fledgling New York regulatory agency, led by Governor Cuomo's former chief of staff, Benjamin Lawsky. A lawyer with substantial experience prosecuting white-collar crime at state and federal level, Lawsky was appointed to the non-elected role of Superintendent of Financial Services to guide its creation and steward its agenda, which, ostensibly, concentrated on consumer protection and reduction of the regulatory burden. The fact that its first major regulatory outcome is a re-opening of how to embed restraint in global finance was as unexpected as it was inevitable give the failure of federal oversight.

While the return of New York to the politics of financial regulation reflects opportunism, this has been caused by a systemic failure of federal regulation. The decline in federal authority reflects a catastrophic failure of governance and the deleterious effect of inculcating a culture of oversight incapable of identifying or dealing with what amounts to a systemic ethical malaise. Failure is not, however, limited to the Washington D.C-New York City beltway. A similar problem afflicts the nexus between practitioners and regulators within the City of London. The systemic inability to curtail the manipulation of the London Interbank Offered Rate ("Libor") has exposed similar failings (Treasury Select Committee 2012). Crucially, it has opened a second line of attack from New York. Following the Treasury Select Committee hearings in London, the SAG issued subpoenas to the contributing banks with operations in New York to release non-public compliance information relating to the operation of Libor. As with the DFS, the broader problem of a lack of integrity and institutionalized deviance is identified but not comprehensively addressed.

In order to ascertain whether the re-emergence of New York helps or hinders the search for a solution, it is necessary to examine the mandate, processes and use of discretion within and across five core dimensions of oversight: Compliance, Ethics, Deterrence, Accountability and Risk. As this paper was submitted, it is far from clear to what extent the muscularity is the first stage of an exercise to privilege substantive reform or a tired replaying of a derivative script? While the conflict has all of the ingredients of an epic Shakespearian play, it may also provide confirmatory evidence of the classic political epigram that history repeats first time as tragedy, the second time as farce (Marx 1869).

Staging the Scottish play in Manhattan

Banquo: Good Sir, why do you start; and seem to fear things that do sound so fair?
– *Macbeth*, *Act I, Scene III*

William Shakespeare's *Macbeth* remains one of the most forensic explorations of political power ever written. At its heart is the struggle to attain and retain power and what to do with it. At the beginning of the play, Macbeth and Banquo convene with a coven of witches. It is prophesized that Macbeth will ascend to the throne; Banquo will not achieve that honor but will sire a royal lineage. Paranoid that Banquo remains a threat while alive, Macbeth orders his assassination and then presides over a banquet at which the slain general's ghost appears, visible only to the king. In possession of full power, Macbeth presides over a brutal dystopia informed by a complete loss of moral compass. The play ends with Macbeth murdered by Malcolm, a man born through a Cesearian section, thus fulfilling the prophecy that he could not be killed by a man born from a woman. Absent the physical bloodshed, the power struggle for control of banking regulation and how to change its culture finds remarkable parallels in the classic Shakespearean tale. As with Banquo's ghost, the specter of Elliot Spitzer looms large.

In the Manhattan rendition, the DFS, a hybrid agency created in 2011, performs the role of Malcolm, whose existence until the moment of execution was seen as unthreatening to Lord Macbeth and his allies. The establishment of the DFS was regarded as uncontroversial by most observers (see, however, Macey 2011). First mooted in the 2011 State of the State Annual Address, the stated objective of merging the banking and insurance departments was to improve the efficiency and effectiveness of regulation (Cuomo 2011). A report issued to the Governor as late as December 30 2011 noted the importance of creating a modern unified structure governed by "regulators who are more accessible, flexible and responsive than their federal counterparts due to a greater understanding of their home markets" (Lawsky 2011, 10). There is a passing reference to the fact that "given its position as the world's financial capital, it is essential that New York be among the leaders in creating modern, effective and balanced regulation" (Lawsky 2011, 15). There was no indication, however, that the new regulatory agency would seek oversight beyond the narrow confines of consumer protection.

It is precisely for this reason that the action taken against Standard Chartered caught both the policy and academic as well as media community so off guard. This included the advisors to Standard Chartered itself, which had voluntarily provided the information contained in a damning critique of its governance that summoned the bank to attend a meeting at which the Superintendent of Financial Services would determine whether or not to revoke its license to operate (DFS 2012). Its status as an international bank was a further complication. From the perspective of the New York authorities, it did not fall within the precedent set by the Supreme Court in *Clearing House*. This provided an opportunity for New York to again question the policy settings of the OCC. It had used the federal courts from 2005-2009 to justify the preemption of state capacity through regulatory rule making. As noted above, the publication of the Senate Sub-Committee on Investigations report into the OCC's catastrophic failure to exercise discretion over HSBC provided essential political cover for a strike that was executed with clinical precision.

The case against Standard Chartered

Banquo: And when we have our naked frailties hid that suffer from Exposure, let us meet
And question this most bloody piece of work to know it further
– *Macbeth, Act II, Scene III*

On August 6, 2012, the New York State Department of Financial Services ("DFS") accused Standard Chartered of leaving the US financial system "vulnerable to terrorists, weapons dealers, drug kingpins and corrupt regimes" (DFS 2012, 1). According to the order, from 2001 through to 2010 Standard Chartered facilitated transactions for Iranian entities valued at $250 billion, "which generated hundreds of millions of dollars in fees" (DFS 2012, 1). The investigation, it was claimed, was based on an examination of "more than 30,000 pages of documents, including internal SCB emails that describe willful and egregious violations of law" (DFS 2012, 1). Undisclosed, was the fact that the investigation was one in which the bank had itself completed and voluntarily provided to a range of financial regulatory authorities in the United States, including the DFS. Standard Chartered worked on the erroneous assumption that a global settlement would be reached. It was a huge miscalculation, intensified by the failure to secure agreement on how the material would be treated, its confidentiality and the status of legal privilege (see Reuters 2012a).

The order and its heavily footnoted references to internal emails prompted a rigorous initial public response from Standard Chartered. In a statement the London-headquartered bank said it "strongly rejects the position or the portrayal of the facts as set out in the order" (Standard Chartered 2012). Standard Chartered advanced a three-pronged defense. It highlighted the historical nature of the claims. It argued that the US government had not designated any of the account holders "a terrorist entity or organization." Third, it argued "resolution of such matters normally proceeds through a coordinated approach by such agencies…The Group was therefore surprised to receive the order from the DFS, given that discussions with the agencies were ongoing. We intend to discuss these matters with the DFS and to contest their position" (Standard Chartered 2012).

Left unstated but strongly implied was that political gamesmanship had colored and, therefore, undermined both the authority of the narrative and the legitimacy of the overarching claim. The skepticism infused prominent commentaries in the financial press, which reported high-level communication between British regulatory authorities and politicians and their US counterparts, concerned that the scandal and its interpretation by the DFS would damage not only the reputation of the bank but the efficacy of regulatory strategy in both New York and the City of London (see Gongloff 2012). As a consequence, the narrative gradually changed towards one informed by the danger to the global financial system from unilateral action (Weidner 2012; see also *The Economist* 2012). It suggested that the primary domestic and international problem was now errant regulators. The Dean of the Lee Kuan Yew School of Public Policy at the National University of Singapore, Kishore Mahbubani, was particularly forthright. He was prepared to wager that "not a single other G20 member will support the US in defending Mr Lawsky's action. This would add weight to the view that Mr Lawsky has behaved as a rogue regulator. To prevent a recurrence, the G20 should then work out a code of conduct to constrain rogue regulators. And if the G20 fails do this, it should close shop immediately" (Mahbubani 2012).

For the bank, if not the media, shooting the messenger represented a high-risk strategy. The New York state government had the right to revoke Standard Chartered's license without reference to federal authorities – and clearly threatened to do just that unless a credible explanation for past behavior could be explained, justified and outrage calmed (DFS 2012, 22). The inability to gain political traction in Washington, coupled with the fact that the DFS had no track record on which to base a calculation of intention, meant that the bank and its advisors found themselves unable to read an exceptionally complex power play. Eight days after the DFS threatened to revoke its state license, and one day before it was scheduled to appear at a hearing on the matter, Standard Chartered caved.

The bank's voluntary provision of documentation circumvented disclosure protections and gave the agency just cause to consider terminating its state license. The only way to avoid such a catastrophic outcome was acquiescence. Standard Chartered negotiated a fine of $340 million, one of the largest ever for an individual regulator in an anti-money laundering case. It has agreed to permanently install appropriately credentialed staff to oversee and audit offshore money laundering due diligence and monitoring. More significantly, a DFS-vetted external monitor is to be appointed. The monitor will have responsibility for ensuring ongoing compliance with anti-money laundering controls. The monitor will report directly to the DFS. In addition, the DFS has been given authority to place examiners on site within the bank (Lawsky 2012). This looks very like the kind of supervisory power that the Supreme Court had invalidated in *Clearing House*, at least insofar as it applies to national banks. Irrespective of whether one agrees with the outcome, there can be no doubting the success of its execution. The terms of the settlement, which in financial terms are on a par with previous agreements (see DOJ 2012a; DOJ 2010), do little to advance the coordinated cause advanced by Professor Mahbubani. In this regard, the terms give the DFS an early win. The State of New York is back in the federal prosecutorial game with a vengeance and with additional firepower. Whether it uses it to advance its own position or safeguard the integrity of the financial system is another matter entirely.

Managing power: The ghost appears

Macbeth: Avant and quit thy sight, let the earth hide thee, thy bones are marrowless thy blood is cold
Thou hast no speculation in those eyes which thou doest glare with
– Macbeth Act III, Scene IV

There are striking parallels between the management of the Standard Chartered case and the methods used by Elliot Spitzer. As with the initial conflicts of interest investigations that had made Spitzer's reputation, liberal use was made of damning internal emails. These fashioned a claim written for immediate transposition into copy for media outlets. In 2003-2005, Spitzer's initial aim was as much to demonstrate that the conflicts represented an abuse of power as well as a violation of consumer protection. Analysts had routinely described financial products in the most derogatory terms. One research report from Merrill Lynch described an internet stock as an "attractive investment," while privately Henry Blodget, its leading internet analyst, noted that "I can't believe what a POS (Piece of Shit) that thing is" (O'Brien 2003, 135). Another was privately described as "a piece of junk" that was a "powder keg" while retaining a top external investment rating. The strength of the emails, therefore, lay in how exposure impacted on immediate negotiation power to force a regulatory settlement rather than a direct evidential chain capable of judicial judgment. When plaintiffs subsequently attempted to use the material in a class action it was dismissed by Judge Milton Pollack on the grounds that they "would have this court conclude that the federal securities laws were meant to underwrite, subsidize and encourage their rash speculation in joining a free-wheeling casino that lured thousands obsessed with the fantasy of Olympian-style riches but which delivered such riches to only a scant handful of lucky winners" (cited in O'Brien 2005, 456).

It was a lesson in framing that Benjamin Lawsky understood well. The investigation was structured to reveal what appeared to be a similar disdain for the legal framework in the United States. This time, however, the scale of the problem had magnified. So too did the class of victims and those who could and should be held accountable for it. In contemporary America, in the context of an ongoing war on terror and a bitterly divisive political contest that pits Wall Street against Main Street, the direct focus on national security, complicity of the directing minds of the corporation and implicit criticism of federal oversight simultaneously catches and exploits a zeitgeist.

The internal logic of the argument is captured in the release of notes taken by a New York-based employee of the reaction of the Group Executive Director to the imposition of restrictions on trade: "You f---ing Americans. Who are you to tell us, the rest of the world, that we're not going to deal with Iranians" (DFS 2012, 8). The order, which concludes that Standard Chartered operated as a rogue institution, uses the results of internal reviews designed to show

how compliance gaps have been filled to suggest a deliberate plan to evade compliance restrictions: "Led by its most senior management, SCB designed and implemented an elaborate scheme by which to use its New York branch as a front for prohibited dealings with Iran – dealings that indisputably helped sustain a global threat to peace and stability. By definition, any banking institution that engages in such conduct is unsafe and unsound" (DFS 2012, 22). Left unstated in the order–and the resulting settlement–was how such a perilous state of affairs could have occurred. The statement provided by Andrew Cuomo provided the first public hint of who in his view was ultimately responsible. Such corruption could only occur with the help of handmaidens, who like the infamous Lady Macbeth, acquiesced in a failure of oversight and could not the spot out.

Visitorial and Prosecutorial Power: *Cuomo v Clearing House* Revisited

Ross: Alas, poor country, almost afraid to know itself
– *Macbeth, Act IV, Scene III*

Eliot Spitzer's long running–and largely effective–campaign to force settlements from major financial services institutions was based on the stated need to leverage state and federal resources to combat financial crime (O'Brien 2003; 2005). The centrality of New York as a global financial hub was critical in gaining the traction to influence national and international trajectories. The imposition of external monitors, ongoing oversight and in the case of Maarsh & MacLennan, the forced departure of executive team, were signature innovations that distinguished this vision of invasive oversight (see O'Brien 2005, 451-453). In the process he also cemented his own political career in a paradigmatic example of what Colin Provost (2003) has termed the power of the SAG to act as a 'political entrepreneur'. In 2005 he was stopped in his tracks by the federal court in a case involving federally chartered banks that effectively stymied the use of similar tactics. At that stage, however, Spitzer had secured his ambition. The battle for influence was joined by his intellectual progeny, Andrew Cuomo, whose equally combative relationship with the federal authorities stems from taking carriage of what had been Spitzer's most ambitious entry into the financial regulation space.

In 2005 as the then SAG, Spitzer began an investigation into discriminatory lending practices within the nationally chartered banks. Under executive authority, he sent formal letters 'in lieu of a subpoena' requesting non-public information about lending practices. In sharp contrast to earlier settlement negotiations, the banks refused. It was an indication that Spitzer's reform agenda constituted invasive oversight that far exceeded federal penalties. Moreover, the exercise of such power was deemed to be illegitimate. Through an industry association, Clearing House, they filed suit in the federal court. They argued that the *National Banking Act* (s.484(a)) preempted New York State's "visitorial" or supervisory authority. The OCC joined the action. It cited regulatory authority (7.4000), which states that "State officials may not exercise visitorial powers with respect to national banks, such as conducting examinations, inspecting or requiring the production of books or records of national banks, or prosecuting enforcement actions, except in limited circumstances authorized by federal law." The federal Southern District of New York Court upheld the Clearing House argument.[ii] The US Court of Appeals for the Second Circuit sustained the injunction.[iii] The Supreme Court, however, held that it was unreasonable to preclude state officials from enforcing the general law. Two caveats, however, were introduced. First, the process must be governed by judicial procedures rather than executive norms. Accountability, it reasoned is ensured if the informational advantage provided by administrative subpoena is undercut by forcing the state to meet pre-suit requirements. This would prevent "fishing expeditions" or "undirected rummaging through bank books and records for evidence of some unknown wrongdoing." (*Cuomo v. Clearing House*, 9) As Justice Scalia put it "if a State chooses to pursue enforcement of its laws in court, then it is not exercising its power of visitation and will be treated like a litigant. An attorney general acting as a civil litigant must file a lawsuit, survive a motion to dismiss, endure the rules of procedure and discovery, and risk sanctions if his claim is frivolous or his discovery tactics abusive." (Id.)

The Supreme Court viewed the supervisory mandate as the critical point of differentiation.

While upholding deference to the authority of the OCC under properly constituted regulation, the Supreme Court found it possible to "discern the outer limits of the term 'visitorial powers; even through the clouded lens of history. They do not include, as the Comptroller's expansive regulation would provide, ordinary enforcement of the law.' (*Cuomo v. Clearing House*, 3) It was therefore unconstitutional for the Comptroller to restrict the enforcement of valid, non-pre-empted laws against national banks. Indeed Justice Scalia finds explicit support in *First National Bank in St. Louis v Missouri* (1924) to support the proposition that "to demonstrate the binding quality of a statute but deny the power of enforcement involves a fallacy made apparent by the mere statement of the proposition, for such power is essentially inherent in the very conception of law."[iv]

A thornier issue is the question of how the supervisory mandate is itself exercised. The expansive prudential power of the Comptroller as legal visitor, is according to the Supreme Court, rooted in precedent. As primary supervisor of the corporation, the agency delegated visitorial power on behalf of the sovereign has since *Dartmouth v Woodward* (1819), theoretically at least, the power "to amend and repeal its statutes, remove its officers, correct abuses, and generally superintend the management of [its] trusts."[v] Indeed, the compromise advanced by the Supreme Court appeared at the time to be a sensible balancing of responsibility (see Wilmarth 2010). As the Court reasoned, "channeling state attorneys general into judicial law enforcement proceedings (rather than allowing them to exercise "visitorial" oversight) would preserve a regime of exclusive administrative oversight by the Comptroller while honoring in fact rather than merely in theory Congress's decision not to preempt substantive state law." (*Cuomo v. Clearing House*, 14) As Wilmarth (2010) has cogently inferred, the *Clearing House* opinion was decided and delivered in the midst of the financial crisis. It is predicated on enhancing the checks and balances on federal authority because of failed oversight. Fealty to federal discretion, as set out in *Chevron USA Inc v Natural Resources Defense Council* (1984)[vi] has become problematic for a range of agencies involved in financial regulation. Past failure to investigate and limited use of discretion to change the balance of power have found resistance in the federal court.[vii] It is in this context that the release of the material provided by Standard Chartered becomes so problematic from a policy perspective. The Standard Chartered power play is, however, merely the prologue. The second more destabilizing Act centers on the national and global implications of the manipulation of the London Interbank Offered Rate.

The LIBOR Investigation

Lady Macbeth: *Out damned spot, out I say!…*
What need we fear who knows it, when none can call our power to account -
Yet who would have thought the old man to have so much blood in him.
- Macbeth, Act V, Scene 1

Working in conjunction with his Connecticut counterpart, the current New York State Attorney General, Eric Schneiderman, has sent subpoenas to a number of the major banks that contribute submissions to the global benchmark. These include banks such a JPMorgan and Citigroup, which are determined by the Supreme Court to fall within the federal system of oversight. It is noteworthy that the leaking of the SAG investigation and its use of subpoenas to garner further evidence followed the Standard Chartered settlement. Multiple interests are served by the leaking of the investigation. It can be used to infer internal jockeying for position within the state government, an agenda designed to raise concerns about New York's re-emergent muscularity or force the banks under investigation to settle with the federal authorities. Since the initial leak, it has emerged that both Britain's RBS and Italy's UniCredit are now under investigation (see Protess 2012). Standard Chartered provides an indication that their interests (if not necessarily that of the public) may be served by submitting to federal oversight. What is clear, however, is that the subpoena process, is itself a complex negotiation game.

By deferring to court adjudication the SAG risks accusations of frivolous if not capricious conduct. As noted above, a critical justification for the Supreme Court *Clearing House* compromise centered on judicial capacity to mediate mere "fishing exercises" by dismissing claims advanced without evidence. In so doing the Supreme Court placed the reputation of the

SAG on the docket, curtailing what had been viewed as the extortionist impulses of Spitzer at the turn of the millennium. The evidential base for just cause, however, has been strengthened by the investigation into the manipulation of Libor, which extends far beyond the territorial mandate of either state or federal government. The investigation saw Barclays admit to charges of manipulation and pledge ongoing cooperation (DOJ 2012b). Crucially, unlike Standard Chartered, neither the implicated banks nor the federal regulators involved–in this case the Commodity and Futures Trading Commission and the Department of Justice–shared the information with the New York authorities. Evidence aired at a parliamentary inquiry conducted in London by the Treasury Select Committee (2012) provides additional information to justify the launching of a formal investigation.

The Westminster interim report uses the term "culture" no less than fifty times in a forensic review of corrupting practice. It holds "the culture of an organization is demonstrated by how people behave when no-one is watching. In this case, however, the culture of the Barclays allowed people to do the wrong thing quite openly over a long period, with the attempted manipulation being shouted about across the dealing room floor" (Treasury Select Committee 2012, 110). Of even more significance, the British parliamentarians hold that "the standards and culture of Barclays, and banking more widely, are in a poor state. Urgent reform, by both regulators and banks, is needed to prevent such misconduct flourishing (Treasury Select Committee 2012, 106), a remarkably similar conclusion to that reached by the Senate Sub-Committee on Investigations in relation to the flaws in the OCC oversight model (Senate 2012, 323). The critical unresolved issue in the final act, therefore, is whether the exercise of state power reflects more effective litigation bargaining skill or opportunistic deployment of extortionist impulses that distort rather than improve market behavior.

Assessing Effectiveness: Opportunity or Opportunism?

Malcolm: *What needful else that calls upon us, the grace of Grace,*
We will perform in measure, time and place – Macbeth, Act V, Scene VIII

The Global Financial Crisis had and continues to have a profound impact on nations, communities and individual citizens. Much of what occurred was, while irresponsible, legal (see O'Brien 2009; 2011a; Seabright 2010). Restraining forces failed at all levels. Short-term thinking was pervasive. Non-executive directors were unwilling or unable to hold managers to account. The capacity of institutional shareholders to take ownership obligations seriously was revealed to be a chimera. External gatekeepers, including lawyers and auditors proved at best ineffective at worst complicit (McBarnett 2010). Neither rules nor principles based regulatory frameworks proved responsive enough to anticipate or ameliorate the disintegration of integrity (Sants 2009; 2010). The inculcation of 'group-think' blinded policymakers and practitioners alike to the toxicity of irresponsible innovation (Borio 2009; Rajan 2010). Nowhere has this been more tellingly revealed than in the operation of the OCC. Ceded almost complete power in 2005 until reined in by the *Clearing House* decision in 2009, it failed to exercise discretion. These failings were not highlighted in settlements with a number of banks involved in breaching sanctions, including Barclays, until the exposure of its involvement in the Libor scandal and the HSBC report. Indeed, the publication of the Senate investigation prompted the judge who signed off on what he termed a 'sweetheart deal' for Barclays to ask the Department of Justice to evaluate whether it invalidated the terms of its non-prosecution agreement (see Reuters 2012b). In the United States at a federal level the passage of extensive regulatory reform through the *Wall Street Reform and Consumer Protection Act* (2010), is mired in controversy. The courts have questioned the constitutionality of how the Securities and Exchange Commission has interpreted its mandate to make new rules (*Business Roundtable v Securities and Exchange Commission*).[viii] The result is likely to be a further expansion of negotiated prosecutions. They have been used to enforce change in Goldman Sachs, Citigroup as well as JP Morgan. The mechanism relies on informal, ad hoc direction into the internal corporate governance of individual firms. It raises significant accountability problems. As such it is vulnerable to claims of regulatory overreach at a time when the reform agenda has once again become hostage to the exigencies of the electoral calendar.

The reemergence of state authority does not necessarily equate to inevitable and demonstrable improvements in the quality of oversight

The unfolding scandals draw attention to the vulnerability of our institutions to a breakdown in trust (Taylor 2007; Warren 2001). The dominant paradigms of corporate governance and financial regulation have not only lost effectiveness. They have also lost intellectual coherence. Providing a warranted basis on which to trust necessitates a comprehensive recalculation of corporate and market purpose. It also requires the design and implementation of more granular mechanisms to measure and evaluate regulatory value and performance.

This last component offers a necessary corrective to reduce the speed and severity of the pendulum shifts between regulatory incapacity and authority (O'Brien 2007; 2009). The capacity and obstacles–structural and managerial–to achieving the objectives of substantive commitment to compliance, warranted commitment to higher ethical standards, effective deterrence, enhanced accountability and reduced risk are critical to effective evaluation of financial services regulation. It is essential to integrate a review of the overarching framework–legislative requirements, regulatory powers, oversight arrangements–with the processes individual regulatory agencies use. Regulatory practice and performance must, therefore, be evaluated against both the structural environment and the processes and practices that shape that environment. It is an agenda that should inform the evaluation of New York's enforcement. As we have seen from the Spitzer era, legitimacy and authority must be evaluated on the basis of how it changes practice rather than how it builds political careers.

Conclusion

As with Banquo, in office Spitzer and his successors posed a huge risk to federal authority to police the markets. The victim of a self-imposed assassination (in a departure from the original script), Spitzer is now a news anchorman for a fringe New York television station, where he has been using his media profile to query the complicity of federal authorities in the unfolding failures of compliance across the banking sector (Spitzer 2012; O'Brien 2012b). It is his successors, however, that have been provided with an unique opportunity to re-engineer the future of financial regulation. As this paper has highlighted, the performance and the overall efficacy of a given system can be enabled or constrained by a range of factors, including the number of agencies involved, scope, remit, resources, independence and discretion. New York State authorities may have regained the independence and will to exercise discretion. Whether they have capacity to govern with restraint is another matter entirely. As the investigation continues, the abiding truth of the Shakespearian adage remains. "So foul and fair a day." Let us hope it does not end in farce.

Note

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Endnotes

[i] Cuomo v Clearing House Association L.L.C., 129 S. Ct. 2710 (2009).
[ii] Clearing House Ass'n v. Spitzer, 394 F.Supp.2d 620. (S.D.N.Y. 2005).
[iii] Clearing House Ass'n v. Cuomo, 510 F.3d 105 (2007).
[iv] 263 U. S. 640, 660.
[v] Trustees of Dartmouth College v. Woodward, 4 Wheat. 518, 676, 681 (1819).
[vi] 467 U.S. 837.
[vii] Judge Jed Rakoff has argued that such settlement agreements without an admission of wrongdoing privilege the façade of enforcement (SEC v. Bank of America, 653 F. Supp. 2d 507, 510 (S.D.N.Y. 2009). In November 2011 he refused to provide judicial assent to an agreement between the SEC and Citigroup, a corporation he dismissed as a recidivist offender (*Securities and Exchange Commission v Citigroup Global Markets Inc* 11 Civ. 07387 (JSR) (28 November 2011). The SEC has appealed the decision on the grounds that it amounted to an unacceptable intrusion into agency discretion.

[viii] 647 F.3d 1144 (2011).

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