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From a culture of impunity to a culture of ethics: The LIBOR Manipulation

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Abstract: LIBOR manipulation was the alleged result of a culture of impunity motivated by a perception that misconduct would be unpunished or undetected. This paper argues the regulatory responses to the LIBOR manipulations per se are insufficient. Only with a culture of ethics, working in parallel with regulations, can the industry overturn that culture of impunity. The paper goes on to analyse the significance of LIBOR and explain causes underlying the misconduct. A critical evaluation of regulatory reactions to the LIBOR manipulation determines the responses are not entirely effective. A robust culture of ethics substitutes in places where there is regulatory ineffectiveness, thus making it more likely to deter such manipulations in the future.

Introduction

LIBOR is an acronym for the "London Interbank Offered Rate," that is, the rate at "which large banks indicate that they can borrow short-term wholesale funds from one another on an unsecured basis in the interbank market."[1] LIBOR was first developed as "a contractually defined term in May 1970 to facilitate loan transactions."[2]

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[1] David Hou and David Skeie, 'LIBOR: Origins, Economics, Crisis, Scandal, and Reform'(Federal Reserve Bank of New York Staff Reports 2014) vol. 667, 1 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423387 > accessed 27 June 2016

[2] ICE LIBOR, 'ICE LIBOR Roadmap' (18 March 2016 1, 4) < https://www.theice.com/publicdocs/ICE_LIBOR_Roadmap0316.pdf> accessed 19 June 2016; The expansion of new financial instruments in the 1980s required "standardised interest rate benchmarks" which led to the British Bankers' Association to administer and publish what was called the BBA LIBOR from January 1986 to January 2014 (ICE LIBOR (n 2) 4).

LIBOR has two main functions in financial markets; firstly, as a reference rate on which "financial instruments can contract upon to establish the terms of agreement"[3] and secondly, a benchmark rate which serves as a "performance measure, often times for investment returns or funding costs."[4]

Three important aspects of LIBOR changed over time, firstly, the LIBOR question on which submission rates are based, secondly, the LIBOR administrator and thirdly, the number of rates in which LIBOR is published daily.[5]

Firstly, the LIBOR question, on which submitter banks base their submissions on, changed in 1998 "from a rate at which the submitter believed a prime bank would be offered deposits to a rate at which the panel bank itself could borrow funds."[6] The question on which rates are submitted as from 1998 is as follows: "At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?"[7]

Following the LIBOR scandal, over and above making LIBOR administration a regulated activity, the Wheatley report[8] led to a change in the LIBOR administrator in January 2014, from the British Bankers' Association to the Intercontinental Exchange Benchmark Administration (ICE Group).[9] Further, not only were submissions[10] to be based on actual transactions but there was a change in the number of LIBOR rates produced on a daily basis.[11]

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[3] Hou and Skeie (n 1) 2

[4] Ibid

[5] ICE LIBOR (n 2) 4

[6] Ibid

[7] Philip Ashton & Brett Christophers, 'On arbitration, arbitrage and arbitrariness in financial markets and their governance: unpacking LIBOR and the LIBOR scandal' (2015) 44(2) Economy and Society, 188, 189

[8] Martin Wheatley, 'The Wheatley Review of LIBOR: final report' (HM Treasury September 2012 para 1.18) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_ finalreport_280912.pdf >accessed 13 June 2016 (The Wheatley Report)

[9] Gregg Fields, 'Common cause: institutional corruption's role in the Libor and the 4pm fix scandals' (2014) 8(1)Law and Financial Markets Review 8, 11

[10] Submissions of the ICE LIBOR are made by a panel of 11 - 18 contributor banks daily and the rates are calculated "using a trimmed arithmetic mean" where submissions are ranked in descending order and "then the highest and lowest 25% of submissions are excluded for outliers before the mean is calculated." (ICE LIBOR (n 2) 4)

[11] The BBA LIBOR produced "150 rates per day using 10 currencies with 15 maturities" (Gabriela Pirana, 'The Wheatley Report on Reforming LIBOR: A step in the right direction?' (2014) 68 University of Miami Law Review 883, 886); whereas the ICE LIBOR, now "produce 35 rates per day using 5

The LIBOR manipulation was the alleged result of a "culture of impunity in many parts of the market, coloured by a perception that misconduct will either go unpunished or undetected."[12]

The objective of this paper is to show that the regulatory responses to the LIBOR manipulations *per se* are insufficient. Only with a culture of ethics, alongside regulations, will the response be effective in overturning that culture of impunity

This paper firstly, analyses the significance of LIBOR and explain the causes behind the scandal (Part 1). After, there is a critical analysis of the regulatory responses to the LIBOR manipulation showing that such responses are not entirely effective (Part 2). The next part (Part 3) explains how a robust culture of ethics, complementing regulatory ineffectiveness, will deter such manipulations in the future. The implementation of a culture of ethics will be seen as follows: firstly, the banking industry's response in enhancing standards will be assessed, secondly, how individual financial institutions can incorporate ethics within their organisations and thirdly, expectations from employees as drivers of ethical behaviour will be seen.

Transcending the debate of whether incentives or sanctions are more effective in changing the banking culture, this work aims at assessing both and suggests a united approach. In so doing, reliance will be placed mainly on conclusions and findings supported by academic references, relevant reports and published articles.

However, the limitations of this paper are two-fold. Firstly, the paper has a jurisdictional limitation as it is mainly focused on the UK jurisdiction with occasional references to other jurisdictions and secondly, since there is already a comprehensive code of conduct[13] for LIBOR (LIBOR code), this work does not aim at reviewing or criticising the code but rather making use of it as one element[14], among others, in contributing to a robust culture of ethics.

The undeniable lesson learnt from the LIBOR scandal is that "we can no longer take for granted, and, as a matter of course, the fact that our bank and its employees will automatically act lawfully, honestly and in our best interests, within the terms of the

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currencies and 7 maturities ranging from overnight to 12 months." (ICE Benchmark Administration, 'Ice Libor' < https://www.theice.com/iba/libor> accessed 18 June 2016)

[12] Fair and Effective Market Review Report (FEMR) (June 2015) < http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf> accessed 17 June 2016, 10

[13] ICE Benchmark Administration, 'Libor Code of Conduct Contributing Banks' (February 2014) < https://www.theice.com/publicdocs/IBA_Code_of_Conduct.pdf >accessed 17 June 2016

[14] See Part 3 para 3.5

lawful banking relationship between us."[15] The progress of investigations on LIBOR manipulation showed the extent to which manipulation was indeed "an industry wide practice" perpetrated by the market actors.[16] It falls to examine the significance and causes of the LIBOR manipulation, which established that culture of impunity.

Part 1

A culture of impunity: The significance and causes of LIBOR manipulation

The significance and causes of the LIBOR manipulation will show how "[u]nethical behaviour went unchecked, proliferated and eventually became the norm,"[17] creating an industry wide culture of impunity. It is therefore essential to have a coherent analysis of the evidence uncovered by the LIBOR investigations, in order to find effective solutions in deterring such manipulations in the future.

1.1 The significance of LIBOR

The significance of LIBOR and its manipulation will be examined in relation to the stock markets and on investors in the banking market.

LIBOR impacts on the stock market in three ways;[18] firstly, it impacts on the pricing of the related stocks of banks as it acts as a measure of the creditworthiness and public health of banks[19]; secondly, it acts as the basis for calculating the interest rate for LIBOR linked investments[20] and thirdly, it is used in the calculation of costs relating to futures and swap (interest rate) markets.[21]

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[15] Rowan Bosworth-Davies, 'The emergence of the criminal financial institution: can effective measures be implemented to deal with them?' (2015) Company Lawyer 307
[16] Gabriela Pirana (n 11) 906
[17] M. Carney, 'Building real markets for the good of the people' (Mansion House speech, June 10, 2015), < http://www.bankofengland.co.uk/publications/Pages/speeches/2015/821.aspx >accessed July 21, 2015 as cited in Bosworth-Davies (n 15) 308

[18] Bruce Gordon Luna II, 'Seeing through the LI(E)BOR: Reforming The LIBOR Reforms' (2014) 10(2) South Carolina Journal of International Law & Business 219, 227
[19] Ibid
[20] Ibid

[21] Post the LIBOR scandal, given the loss of faith in the LIBOR process and with heightened regulations, many LIBOR submitter institutions were hesitant as to whether they would remain submitters (Gordon Luna II (n 18) 231). However, through the intervention of UK authorities in February 2013 with warnings issued to BNP Parisbas and Rabobank not to leave as a LIBOR contributor, such discussions were put to a halt (Gordon Luna II (n 18) 231).

The ultimate outcome of the LIBOR manipulation has resulted in an atmosphere where investors and financial actors have lost faith in the banking industry: "a world where faith in the integrity of regulators and financial actors is critical for a fully functioning market."[22] As such, it is most relevant to discuss the causes of LIBOR manipulation in order to better understand how to protect the integrity of the LIBOR.

1.2 The causes of the LIBOR manipulation

Post LIBOR scandal examination shows at least 7 causal factors of LIBOR manipulation as follows:

(a) The "reputational account theory"[23]

In the wake of the crisis, with the fear of becoming "the next Lehman," banks "had a strong incentive to lie about borrowing costs in order to protect their image,"[24] and submit low rates.[25]With the aim of preventing negative publicity on its liquidity status during the financial crisis, Barclays' Bank managers were pressurising submitters to make LIBOR submissions on the lower side as high rates would be indicative of liquidity issues within the bank.[26] From the requests made to the submitters, one of them wrote to the manager the following:

> *"following on from my conversation with you I will reluctantly, gradually and artificially get my libors in line with the rest of the contributors as requested. I disagree with this approach as you are well aware. I will be contributing rates which are nowhere near the clearing rates for unsecured cash and therefore will not be posting honest prices"*[27]

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[22] Ibid 231

[23] Gabriel Rauterberg and Andrew Versteint, 'Index Theory: The Law, Promise and Failure of Financial Indices' (2013) 30 Yale Journal on Regulation 1, 30

[24] Ibid 30

[25] This theory also contributes to the idea that "no conspiracy is required" for LIBOR to be manipulated as "if each bank individually expects to benefit by submitting a false quote" though "not collusive, but it may be manipulative."(Ibid 32)

[26] Ashton and Christophers (n 7) 200

[27] Financial Services Authority, *Final notice: Barclays Bank Plc*. (27 June 2012, 24) < http://www.fsa.gov.uk/static/pubs/final/barclays-jun12.pdf > accessed 10 June 2016 as cited in Ashton and Christophers (n 7) 198

The above clearly shows that amidst that culture of impunity, there was an individual who had ethical values but unfortunately the organisational and industry's culture trumped over his individual belief and ethical values.[28]

(b) The "positional account theory"[29]

Being profit motivated, banks would earn profits from clients by manipulating the rates on which "their derivative positions were based."[30] To support that theory "in the first quarter of 2009, Citigroup reported" that "it would make $936 million in net interest revenue if interest rates would fall by 25 basis points a quarter over the next year and $1,935 million if they were to fall 1 percent instantaneously."[31]

Further, evidence through discovery of the emails showed clearly that the manipulation was highly rewarding for banks, to such an extent that moving just one basis point could trigger benefits to the extent of USD 4 million.[32] Therefore, banks had huge financial incentives to collude and rig the LIBOR rates.

(c) The "rogue trader theory"[33]

Traders, being profit motivated, were pressurising submitters to submit LIBOR rates that would either position them to make profits or minimise losses in relation to "interest rate derivative products: swaps and futures."[34]

The then Financial Services Authority's investigation found that such manipulations were

[28] Hence, the manipulators being involved were "not atomistic individuals, but mutually aware and mutually susceptible" individuals.(MacKenzie, 'Long-term capital management and the sociology of arbitrage' (2003) 32(3) Economy and Society 349, 371-2 as cited in Ashton and Christophers (n 7) 201)

[29] Rauterberg and Versteint (n 23) 30

[30] Ibid 31

[31] Connan Snider & Thomas Youle, 'Does the LIBOR Reflect Banks' Borrowing Costs?' April 2010 (unpublished), < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1569603 >accessed 14 June 2016, 12 and Rauterberg and Versteint (n 23) 31

[32] Pieter J. F. Huizing' 'Parallel enforcement of rate rigging: lessons to be learned from LIBOR' (2015) 3(1) Journal of Antitrust Enforcement 173, 176

[33] Rauterberg and Versteint (n 23) 31

[34] Ashton and Christophers (n 7) 198-9; Since the bank (Barclays), for which the traders work, entered in to contracts (where interest are either paid or received) which are linked to LIBOR at later dates, higher/lower submissions on those dates would benefit the traders in terms of interest amount due/received (Ashton and Christophers (n 7) 198).

going since 2005, where the culture of traders asking submitters to submit "inappropriate rates" had been normalised in the internal system of Barclays and not only were hundreds of requests being made on a regular basis, but those requests were actively given effect by the submitters.[35]

This shows how "the LIBOR scandal is not about risky bets or bad judgment of rogue traders, but the deliberate strangling of market forces in the pursuit of profits."[36] Therefore, LIBOR manipulation was not only a common accepted practice but had over the years evolved into a "culture of trading" practices based on short-termism. "Short termism also invites institutional corruption."[37]

(d) "Institutional corruption"[38]

Institutional corruption exists when "there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose, including, to the extent relevant to its purpose, weakening either the public's trust in that institution or the institution's inherent trustworthiness."[39] It cannot be disputed that one of the effects of the LIBOR manipulation has been an erosion the public trust in financial benchmarks, therefore any reform "must bear in mind that change in legal codes must be accompanied by new norms in corporate and regulatory cultures."[40]

(e) LIBOR's status as a "by-product index"[41]

LIBOR being a "by-product index," equips its provider with "structural features that make manipulation more likely."[42] The reasons being three fold: firstly, the provider relies on banks' own privately funded information which makes it more difficult to detect manipulation;[43] secondly, it is not a product index which "generate[s] revenue

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[35] Financial Services Authority (n 27) 14-18 as cited in Ashton and Christophers (n 7) 198

[36] R Vasudevan, 'Libor'ing under the market illusion' (2013) 64(8) Monthly Review 1, 10 as cited in Ashton and Christophers (n 7) 204

[37] Malcolm Salter, 'Short-Termism at Its Worst: How Short-Termism Invites Corruption … and What to Do About It' (2013) 5 Edmond J Safra Working Papers as cited in Fields (n 9) 9

[38] Ibid

[39] Lawrence Lessig, 'Institutional Corruption Defined' (2013) 41(3) Journal of Law, Medicine & Ethics 553 and Fields (n 9) 8

[40] Fields (n 9)

[41] Rauterberg and Versteint (n 22) 33

[42] Ibid

[43] Ibid

streams whose maintenance dilutes their provider's incentive to manipulate"[44] and thirdly, because LIBOR being a by-product index and is made "alongside other product lines," it creates not only "a conflict of interest" but also incentives for employees or banks to manipulate same and profit from their dealings in "loans and swaps."[45]

(f) The calculation process

Due to the fact that the top and bottom quartile of the LIBOR rates submitted are eliminated, it "is thought that it may be difficult to manipulate LIBOR."[46]Actually any individual bank's artificial submissions, without colluding with other banks, has the potential to influence the LIBOR, if the said bank's submission "moves the middle of the pack closer to the outer quartile"[47] then the average will automatically be affected.[48] For any other bank which finds itself "in the excluded outer quartile," it may have the effect of pushing "another quote in that would have previously been excluded,"[49] again depicting how any single bank may cause LIBOR to be manipulated.

(g) Behaviour encouraged by low risk of successful prosecution

The case of John Pottage, which involved the wrong use of client's money and "rogue trading" was the first test case where the then FSA tried to prosecute personally a senior manager for "inadequate supervision" but the FSA had failed because it was unable to bring evidence to show that Mr Pottage had personally committed the alleged misconduct.[50] This failure of the regulator could be said to have indirectly given a

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[44] Ibid 34

[45] Ibid; It could be proposed for LIBOR despite being a by-product to adopt a product index model. (Ibid 51). Should the new administrator of LIBOR charge for example 3 basis points, as annual fee to its derivative users, on the notional value indexed to LIBOR which exceeds $ 350 trillion (Ibid), the revenue stream generated would be large enough to provide for investments in prevention of "indexing risks" and "governance and systems to prevent employee" (Ibid) and bank LIBOR manipulation.

[46] Jacob Gyntelberg and Philip Wooldridge, 'Interbank rate fixings during the recent turmoil' (2008) BIS Quarterly Review 59, 65 and Rauterberg and Versteint (n 23) 32

[47] Rauterberg and Versteint (n 23) 32

[48] Ibid

[49] Ibid

[50] Caroline Binham and Megan Murphy, 'UK regulator loses UBS supervision test case' (*Financial Times*, 22 April 2012) < http://www.ft.com/cms/s/0/806673a8-8c83-11e1-9758-00144feab49a.html#axzz4EiLxgExn> accessed 18 July 2016

sense of unwarranted protection to rogue traders to continue their activities as they had "an accountability firewall between themselves and individual misconduct."[51]

Hence, though the causes to manipulate the LIBOR could have been several, the motives appear to be mainly financial rewards either at industry (collusion between banks) level, institutional (single bank) level or individual (rogue trader) level.

There were two immediate responses to mitigate this culture of impunity which led to the LIBOR manipulation: firstly, consultation processes and secondly, investigations. In this part, only the main proposals of the reports published, on the LIBOR scandal, will be seen.

1.3 The immediate Responses to LIBOR manipulation

1.3.1 The Consultation processes

The consultation processes led to the following reports: (a) the Wheatley Report, (b) the Parliamentary Commission on Banking Standards Report (PCBS)[52] and (c) the Fair and Effective Markets Review (FEMR).[53]

(a) The Wheatley Report

The Wheatley Report had as its aim to reform the structure and framework of LIBOR rather than investigating banks' manipulation of LIBOR.[54] The Wheatley Report made 10 recommendations for a "comprehensive reform of LIBOR" under five main headings namely "Regulation of LIBOR, Institutional Reform, The rules governing LIBOR, Immediate improvements to LIBOR and International Co-ordination."[55]

In terms of "regulation of LIBOR," the first recommendation proposed was for LIBOR to be statutorily regulated under the Financial Services and Markets Act 2000

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[51] Parliamentary Commission on Banking Standards (hereinafter referred as PCBS), *Changing Banking for Good* (2013) < http://www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/appointment-of-commission/ >accessed 15 June 2016, para 105
[52] Ibid
[53] FEMR (n 12)
[54] Wheatley (n 8) para 1.18 and Melissa Anne Conrad-Alam, 'All together now: International regulatory response to the LIBOR rate setting conspiracy' (2014) 42 GA. J. INT'L & COMP. L. 491, 502
[55] Ibid

with appropriate "supervision, oversight and enforcement regime."[56] The Wheatley Report led to the amendment of the UK Financial Services and Markets Act 2000 to enable LIBOR submission and administration to become a regulated activity and the making of misleading statements a criminal offence.[57]

"Institutional reform," through recommendations 2 and 3, were to be brought by firstly, handing over of the LIBOR administration from the BBA to a new body and secondly, the establishment of an oversight committee to ensure credibility and transparency in LIBOR administration and submission.[58] Since 2014, the LIBOR administrator, changed from the BBA to ICE Group[59] and the LIBOR oversight committee, which was created in 2013, was taken over by the new administrator.[60]

Recommendations 4 and 5 address "the rules governing LIBOR" by providing initially for "immediate compliance with the guidelines from banks for making LIBOR submissions,"[61]and subsequently, for the administrator to prepare a Code of Conduct to guide submissions of LIBOR.[62] There is already a specific LIBOR Code of Conduct[63] which has been approved by the LIBOR Oversight Committee.

Recommendations 6 to 9 provide for "immediate improvements" which have to be brought to LIBOR.[64] Further, the ICE Group now produces only 35 rates per day using 5 currencies and 7 maturities ranging from overnight to 12 months [65] and

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[56] Wheatley (n 8) Chap 2 and Conrad-Alam (n 54) 505
[57] Pirana (n 11) 895
[58] Wheatley (n 8) Chap 3 and Conrad-Alam (n 54) 505-7
[59] Fields (n 9) 11
[60]Dow Jones Newswires, 'Libor Oversight Committee Chairwoman Forced Out in July' (ADVFN, 17 December 2015) < http://www.advfn.com/news_Libor-Oversight-Committee-Chairwoman-Forced-Out- in_69743853.html> accessed 19 June 2016
[61] Wheatley (n 8) Chap 4 and Conrad-Alam (n 54) 508
[62] Wheatley (n 8) Chap 4 and Conrad-Alam (n 54) 508
[63] ICE Benchmark Administration (n 13)
[64] They are as follows: (i) for the BBA (then LIBOR administrator) to immediately discontinue calculating and publishing LIBOR rate "for any currency for which data is insufficient to corroborate the submissions," (Wheatley (n 8) Chap 5 paras 5.3-5.13) (ii)the BBA in order to curtail potential future manipulations from submitters, to publish LIBOR submissions after 3 months,(Wheatley (n 8) Chap 5 paras 5.14-5.18) (iii) other banks not on the panel of LIBOR rate submitters should be encouraged to participate in the submission process and if need be even make their participation compulsory through regulation, (Wheatley (n 8) Chap 5 paras 5.19-5.28) and (iv) the consideration by banks using LIBOR to develop "robust contingencies for the failure of LIBOR within contracts." (Wheatley (n 8) Chap 5 paras 5.19-5.28 and Conrad-Alam (n 54) 511)
[65] ICE Benchmark Administration, 'ICE LIBOR' < https://www.theice.com/iba/libor> accessed 18 June 2016

publishes submissions only three months after.

Lastly, recommendation 10 provided that the UK authorities should co-ordinate closely with regional and international bodies to “debate on the long term future of LIBOR” and other alternatives to LIBOR.[66]

(b) The Parliamentary Commission on Banking Standards Report

Following the LIBOR scandal, a Parliamentary Commission was appointed in July 2012 to consider, inter alia, “professional standards and culture in UK banking sector, taking account of regulatory and competition investigations into LIBOR rate setting process.”[67] In June 2013, the Commission made the following finding in its report entitled “Changing Banking for Good:”

> *“One of the most dismal features of the banking industry to emerge from our evidence was the striking limitation on the sense of personal responsibility and accountability of the leaders within the industry for the widespread failings and abuses over which they presided. Ignorance was offered as the main excuse. It was not always accidental. Those who should have been exercising supervisory or leadership roles benefited from an accountability firewall between themselves and individual misconduct, and demonstrated poor, perhaps deliberately poor, understanding of the front line. Senior executives were aware that they would not be punished for what they could not see and promptly donned the blindfolds. Where they could not claim ignorance, they fell back on the claim that everyone was party to a decision, so that no individual could be held squarely to blame…”*[68]

The PCBS report had as aim to restore trust in the banking system and two of its main proposals were firstly, to establish a Senior Managers Regime and secondly reforms in the remuneration system.[69] In light of raising banking standards in the industry, the

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[66] Wheatley (n 8) Chap 6-7

[67] PCBS (n 51) and Jenny Stainsby and Karen Anderson, ‘Making individuals accountable: new regulatory frameworks for banking and for insurers’ (2015) Compliance Officer Bulletin 1, 2

[68] PCBS (n 51) para 105 and Stainsby and Anderson (n 67) 2; The Commission also found that the Approved Persons Regime was not equipped to make individuals accountable but rather to verify that individuals were “fit and proper to take up fairly broadly-defined roles.” (Stainsby and Anderson (n 67) 3)

[69] PCBS (n 51) Executive Summary; Other proposals included a reinforcement of responsibilities and empowerment of regulators and having “a greater discipline on banks to raise banking standards.”(Ibid)

Banking Standards Board also took birth.[70] Hence, regulatory amendments led to the Senior Managers Regime and the remuneration regime, which will be critically analysed in the following chapter.

(c) The Fair and Effective Markets Review

The Fair and Effective Market Review report had as aim to "to reinforce confidence in the wholesale FICC [Fixed Income, Currency and Commodities] markets" and proposed to raise standards and improve the quality of FICC trading practices and also strengthen regulation of FICC within the UK[71] through its newly established FICC Markets Standards Board.[72]

The above depict summarily the results of the consultation processes undertaken after the LIBOR scandal. Prior to moving to the outcomes of the investigations and their effectiveness, it falls to be examined whether the regulatory amendments brought by the consultation processes represent a sufficient response to the LIBOR scandal or is it only the midway solution between that culture of impunity and a culture of ethics?

Part 2

Regulatory Responses: the midway between a culture of impunity and a culture of ethics

It can be deduced that LIBOR's manipulation through "inappropriate submissions made" was done for mainly two reasons; firstly, traders pressurising submitters to make submissions which would position them to make profits and/or minimise losses[73] and secondly, managers pushing submitters to underreport in order to show an artificial "financial good and credit worthiness" of the bank (Barclays) during the financial crisis.[74] That industry wide culture of impunity was initially responded to by consultation processes, as previously seen. Hence the limitations of the regulatory amendments resulting from the consultation processes ((a) the Wheatley Report and (b) the FEMR and PCBS) will be analysed.

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[70] Ibid
[71] FEMR (n 12)
[72] FICC Markets Standards Board, < http://www.femr-mpp.co.uk/wp-content/uploads/2015/07/FMSB- Information-Booklet-July-2015.pdf> accessed 17 June 2016
[73] Ashton and Christophers (n 7) 198-9
[74] Ibid 203

2.1 Limitations of regulatory amendments resulting from the consultation processes

a. The Wheatley Report

Despite the implementation of the Wheatley reforms and a new LIBOR administrator, it is not certain "whether these changes can truly prevent future manipulation or restore market confidence in the LIBOR calculation process."[75] The costs of implementing the Wheatley LIBOR reforms and its annual running costs were estimated at £46.3 million and £5.8 million respectively.[76] The said reform unfortunately suffers from "negative or unintended consequences."[77]

i. Discontinuation of some LIBOR rates

For contracts linked to those LIBOR currency quotes which have been discontinued[78] the contractual parties, with the risk of contract invalidation, may have to bear "an unknown cost of due diligence and additional negotiations may accrue in order to switch to a new benchmark."[79]

ii. LIBOR to be based only on actual transactions

The new LIBOR administrator will "require LIBOR calculations to be anchored to actual market rates."[80] Anchoring LIBOR to actual transactions may "became problematic during periods of high volatility or in certain markets where there is little to no trading."[81]

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[75] Gordon Luna II (n 18) 259

[76] Stephen M Bainbridge, 'Reforming Libor: Wheatley versus The Alternatives' (2013) 9 NYU Journal of Law & Business 789, 811

[77] Gordon Luna II (n 18) 259

[78] Unless the clauses in the contract provide for an alternative benchmark (Gordon Luna II (n 18) 260

[79] Gordon Luna II (n 18) 260; The "freedom to contract" of financial actors, in those discontinued LIBOR currencies has been seriously curtailed (Ibid 261). Financial actors are now forced "to trade or hedge their risks in currencies they may not desire, or that do not actually represent the underlying risks in the related transactions." (Ibid)

[80] Ibid 263

[81] Ibid 264; Otherwise, LIBOR submissions could be "arbitraged against market rates" which would allow banks to use their "expert judgment" in submissions whilst use of "market arbitrage" would act as a "hedge to prevent speculation or inappropriate exuberance from pushing LIBOR beyond what the actual market would allow"(Ibid). For LIBOR to be more reflective of the market, submissions could also include (in addition to "tenor and currency as factors") "the amount being loaned as an indicator of lending costs," (Ibid 265) and "the timing of loans" (Ibid 265). Further, during intense periods of financial stress, actual transactions may lead to a highly volatile LIBOR as "transactions may change

iii. Submissions to be kept for three months before being published

The undesired effect of having the LIBOR submissions kept confidential for three months is that it "may well prevent the discovery of future manipulation"[82] as "the initial discovery of collusion and manipulation of LIBOR came not from the LIBOR administrator …but from financial watchers who were observing the daily LIBOR submissions."[83]

iv. A LIBOR Code of Conduct

There is already a LIBOR Code of Conduct[84] which has been approved by the LIBOR Oversight Committee which provides for the methodology, record keeping, reporting, and other essential ethical aspects guiding contributing banks in their submissions. This Code, by itself is a positive initiative but it should not become a mere piece of writing where its black letter provisions are being respected as a ticking box exercise but its spirit violated.

One can safely surmise that Codes of ethics, albeit not specifically for LIBOR process, already existed within banks even prior to the LIBOR scandal but same did not prevent it. Should codes of ethics be "constructed merely to comply with regulations, they are little more than an expensive waste of time."[85] So, the real issue is not just having a code of ethics but how to make it become the norm of each institution and ultimately the ethical culture of the industry.

v. Whistleblowing procedure

A whistleblowing initiative within the regulatory structure of Wheatley's reform could deter banks from colluding with each other.[86] An anonymous whistleblowing

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drastically from one day to the next, market liquidity low and a few large banks entering or leaving the interbank lending market." (Pirana (n 11) 901)

[82] Gordon Luna II (n 18) 269

[83] Ibid; This proposal by Wheatley runs counter to the very essence of transparency which it seeks to enhance. However, the solution could be "publishing the submitted rates daily, but not including the identity of the bank which has submitted the rate." (Pirana (n 11) 905)

[84] ICE Benchmark Administration (n 13)

[85] People Risk Management, 'Managing the Risk of People Making Bad Decisions' (20 November 2015) < https://peopleriskmanagement.com/2015/11/20/barclays-another-code-of-conduct-failure/> accessed 19 June 2016

[86] John Weldon, 'The Libor Manipulation Scandal & The Wheatley Review: A Band-Aid on a knife wound' (2014) 41 Syracuse J. Int'l L. & Com. 199, 224

structure is already in place within the new LIBOR administrator.[87] The existence of such a system, though positive in its contribution, would only be effective if employees, out of their own volition, make use of it whenever future cases of manipulation are detected. It is suggested that this can only be done if the bank successfully internalise a culture of ethics within its organisation.

vi. The independence of the LIBOR oversight committee

The Wheatley report proposed that the LIBOR oversight committee, though under the aegis of the administrator, should "be able to enforce low-level sanctions with respect to participating banks"[88] and its membership should "include members beyond the ranks of the contributing panel banks" so as to improve representation and independence.[89]

In December 2015, it was reported that the Chairperson of the Oversight Committee exited the aforesaid committee and expressed concerns on its independence and said "international set of principles endorsed by all major financial regulators requires benchmark-oversight committee to be separate from the companies they oversee and to operate independently"[90] and that "Britain's financial regulations don't meet the principles."[91] The causes of the LIBOR manipulation showed that there was collusion, among traders and banks. The Wheatley Report proposed imposition of criminal sanctions and heightened transparency to address this issue.[92] Nevertheless, the Wheatley report did not give effect to the true nature of the problem, that is, "a culture was created amongst banks to collude with each other to maximise profits" whilst criminal prosecutions and transparency enhancement do not adequately respond to the true problem.[93]

[87] ICE Benchmark Administration, 'Whistleblowing Procedure' < https://www.theice.com/iba/governance > accessed 16 June 2016
[88] Wheatley (n 8) para 3.35
[89] Wheatley (n 8) para 3.35
[90] Juliet Samuel, 'Libor Oversight Chief Was Forced Out' (*Wall Street Journal*, 17 December 2015) < http://www.wsj.com/articles/libor-oversight-committee-chairwoman-forced-out-in-july-1450375878> accessed 19 June 2016
[91] Ibid; Even the Wheatley report made proposals in the same line. Of the 19 actual members of the oversight committee, 4 are bank submitters and 4 are from the IBA. (ICE LIBOR, 'Governance and Oversight' < https://www.theice.com/iba/libor> accessed 19 June 2016). True it is that there is a conflict of interest policy, to manage conflict of interests but in view of enhanced independence, it would be more appropriate to avoid altogether such conflicts and to give full effect to the ex-chairperson's remarks and Wheatley's recommendation.(ICE LIBOR, 'Conflict of Interest policy' < https://www.theice.com/publicdocs/IBA_conflicts_of_interest_policy.pdf> accessed 19 June 2016)
[92] Weldon (n 86) 221
[93] Ibid

Hence, if the culture is not changed, banks will only look for alternatives to generate more income in order to meet any financial penalty a regulatory body will impose[94] and treat such collusions as mere costs issues. There were two other main regulatory changes which resulted from consultation processes namely, (i) the Senior Managers Regime and (ii) amendments to the remuneration structure of bankers.

b. The Parliamentary Commission on Banking Standards Report and The Fair and Effective Markets Review's limitations

Both the PCBS and the FEMR had as aim to improve standards in the banking and FICC markets through the creation of standards' boards for each market respectively.[95] The FEMR, amongst other recommendations, endorsed both recommendations ((i) the senior Managers regime and (ii) the remuneration structure) of the PCBS and even proposed to extend those to the wider FICC markets.[96] Therefore, those regulatory amendments ought to be assessed to determine whether they suffer from any drawbacks in their implementation.

i. The Senior Managers Regime (SMR)

According to the SMR, bank employees will be divided into three groups namely, Senior Management functions, secondly, the certification regime based on "significant harm functions" and all other staff.[97] In the quest to provide more accountability, senior managers will have to map out their responsibilities and submit to the regulator a "statement of responsibilities."[98] Further in view of the limited prescribed responsibilities provided from the Responsibilities Map, it might be quite challenging for senior managers to be able to find which prescribed responsibility they precisely fall under.[99] The potential issue which may arise, when it comes to enforcement of the SMR would depend on the "interplay between individual accountability and collective decision making" as "it remains to be seen how often it

[94] Ibid 225
[95] See Chapter 3
[96] FEMR (n 12) 61-64
[97] The FCA, 'FCA publishes final rules to make those in the banking sector more accountable' < https://www.fca.org.uk/news/fca-publishes-final-rules-to-make-those-in-the-banking-sector-more- accountable> accessed 20 July 2016
[98] The FCA, 'General guidance on proportionality: The IFPRU Remuneration Code (SYSC 19A)'< http://www.fca.org.uk/your-fca/documents/finalised-guidance/remuneration-code> accessed 20 July 2016
[99] Bank of England, 'SMR: Certification Regime and Responsibilities Map' < http://www.bankofengland.co.uk/pra/Documents/supervision/creditunions/smrmapjuly2015.pdf> accessed 20 July 2016

will be possible to impute disciplinary liability to a senior individual when key decisions have been taken or ratified by a committee properly empowered in the hierarchy of corporate governance."[100] The other question, which also arises is whether middle management can now escape their supervisor's internal control. This could be avoided if there is a strong culture of personal and corporate ethics within the bank.

In addition, with the fact that the reversed burden of proof, under the SMR, was abandoned this further limits the effectiveness in the application of the regime. Simply changing the Approved Persons Regime to the SMR by itself is not "enough to bring about a keener sense of personal responsibility in the banking sector," hence, "it is time to turn to the question of culture."[101]

ii. Upholding accountability through the Remuneration structure

Remuneration structures were amended as a result of the findings of the PCBS. The new remuneration structure proposed was for the variable component of the remuneration to be deferred.[102] The new remuneration regime aimed at bank staff who were "material risk takers" and total yearly remuneration exceeded the threshold amount.[103] Unfortunately, the remuneration structure suffers from the following weaknesses: Firstly, there is a bonus cap of 200% on the amount of bonus, in relation to the fixed salary.[104] Should banks decide to circumvent the deferral of variable remuneration and increase the fixed component, this will lead to increase in fixed costs and "banks will lose agility to cut their costs quickly when times are hard and capital bases are under stress."[105]

[100] Bob Ferguson, 'The personal accountability of bankers' (2015) 9(1) Law and Financial Markets Review 40, 44
[101] Ibid 44

[102] The FCA (n 98)
[103] The threshold amount being £500,000 (FCA (n 93) para 5.3). The remuneration is usually broken into fixed and variable components where the variable component consists of bonus, commission or stockholdings or similar kind instruments. The deferral of the variable component, that is the bonus, takes the form of shares or like financial instruments which value reflect the company's value over time. (Ferguson (n 100) 45). For those holding senior management functions, they cannot be vested with their deferred salary within the first three years of the deferral (minimum deferral period), after which payments can be made in equal instalments until the end of deferral period which can be either five or seven years. (Ferguson (n 100) 46). However, bonus deferred and not yet vested to the employee can be reduced or cancelled "contingent on the non - emergence of latent problems referable to the actions of that individual or a wider group," (*malus*) (Ferguson (n 100) 45) or if the bonus has already been vested in the employee there can be the recovery of bonus paid through claw-back procedures up to seven years after payment (Ferguson (n 100) 46).
[104] Ferguson (n 100) 46
[105] Ibid; In addition, the operation of *malus* in case employees change employment or take up jobs outside the UK

However, those were not the only responses to the LIBOR scandal. Having analysed the limitations of regulations, which resulted from the consultation processes, we shall now turn to post investigatory responses. Investigations were also carried out and sanctions were imposed. Therefore, it is important to assess whether regulatory enforcement, whether sanction based measures can act as effective deterrent or are their effectiveness compromised?

2.2 Post investigation responses

As from the year 2011, "government regulators around the world, including the US, Switzerland, Japan, the UK, Germany, Canada, the EU, the Netherlands and Singapore, publicly disclosed their investigations into allegations of LIBOR manipulation"[106] The LIBOR scandal led to global investigations and punishments involving at least 27 regulatory authorities and 12 jurisdictions.[107]

The ultimate aim of preventing and punishing LIBOR manipulations is "to ensure market integrity and enhance public confidence"[108] in the banking sector. Various sanctions in the form regulatory, administrative (fines, disqualification orders) and criminal sanctions (custodial sentence) are being used to punish and deter the LIBOR manipulation. As such, it is most relevant that the effectiveness of the aforesaid sanctions be assessed in order to determine whether they are sufficient in restoring integrity in the market. Hence, (a) fines, (b) disqualification orders (c) civil liability, and (d) imprisonment will be assessed

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or within the EU, there will be the expectation of the new employer to buy out the deferred bonus of the new employee (Ibid). Lastly, there is an inherent defect in the modus operandi of the system of *malus* and claw back in that, there is a strong probability that decision making power of applying the aforesaid regimes remain in the hands of those very seniors who took the wrong decisions for the company and that only others lower in the hierarchy may suffer from the consequences. (Ibid)

[106] Jacob Hamburger, 'Crowding the market: is there room for antitrust in market manipulation cases?' (2015) International Trade Law & Regulation 124

[107] Huizing (n 32) 174; The response adopted by domestic (UK and US) and regional (European Commission) jurisdictions varied according the evidence disclosed by their relative investigations. Both UK and US adopted the regulatory/administrative justice and criminal justice approaches whilst the European Commission proceeded on competition law breach (collusion). Over and above the traditional public law enforcement, there were also civil liability suits by victims of the LIBOR manipulations (Ashton and Christophers (n 7) 197). In 2012 the Barclays Bank was fined by the UK Financial Services Authority and US agencies namely the CFTC and the Department of Justice (Ashton and Christophers (n 7) 197). Later, investigations were also carried on other banks such as UBS and RBS. In addition, specific persons were criminally investigated upon and prosecuted as a result of the LIBOR manipulations. In May 2014, three banks were fined for having formed a cartel with the purpose of rate fixing by the European Commission (Ashton and Christophers (n 7) 197).

[108] European Commission, 'Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation' COM (2011) 654 final as cited in Jacob Öberg, 'Is it 'essential' to imprison insider dealers to enforce insider dealing laws?' (2014) 14(1) Journal of Corporate Law Studies 111, 112

accordingly.

a. Assessing the effectiveness of fines as sanctions

As at 2015, the fines imposed for LIBOR manipulations by European, UK and US authorities totalled €4708 million with banks like "UBS with a total penalty of €1156 million, followed by the Royal Bank of Scotland (€ 844 million), Rabobank (€ 772 million), Deutsche Bank (€725 million), Société Générale (€ 446 million), and Barclays (€ 362 million)"[109]

Fines are said to be ineffective for the following reasons; firstly, the decision makers, that is, the management have the potential to "hide assets, divert income, overstate expenses, or otherwise reduce the amount of the fine" fading its deterrent effect;[110] secondly, it would be "unfair," "perverse and contrary to the principles of equality and justice" to apply the "optimal deterrence argument," that is, "fines to be reserved for white collar (corporate) offences [only]."[111] This unfairness and inequality is explained by the fact that wealthy persons who are white collar (corporate) offenders will be only fined whilst "non-affluent [non corporate] offenders should be imprisoned."[112]

b. Assessing the effectiveness of disqualification orders as sanctions

Disqualification orders are yet another form of sanction which have "preventative and punitive" functions.[113] Such orders prevent individuals from holding post of director in the sector concerned thereby affecting the livelihood of the director[114] and serve as a "monetary penalty for those defendants who have no ability to pay a substantial fine."[115] Ultimately, such orders "arguably express social stigma and may lead to a

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[109] Huizing (n 32) 181
[110] Öberg (n 108) 131
[111] Ibid

[112] Ibid; Further, in deciding whether to undertake punishable ethical breaches such as collusion, banks will undertake a cost benefit analysis and if the probability of detection and the financial penalty are both low enough, "it [will make] sense to take all necessary efforts to survive in the market, as the risk outweighs potential damages."(Samuel Konchar, 'The 2012 LIBOR Scandal: An Analysis of the Lack of Institutional Oversight and Incentives to Deter Manipulation of the World's Most Important Number' (2014) 23 Transnational Law and Contemporary Problems 173, 184)
[113] Öberg (n 108) 132
[114] Jayne W Barnard, 'When is a Corporate Executive "Substantially Unfit to Serve"?' (1992) 70 North Carolina
Law Review 1489, 1494-95 as cited in Öberg (n 108) 132
[115] Martin F McDermott, 'Occupational Disqualification of Corporate Executives: An Innovative Condition of Probation' (1982) 73 Journal of Criminal Law and Criminology 604, 615-616 as cited

tarnished reputation"[116]

However, disqualification orders' effectiveness as a deterrent is threatened in a number of ways; firstly, they do "not preclude a convicted director from serving as a consultant, or having a spouse replacing the convicted director in the board"[117] and unless they "are combined with conditional sentences or imprisonment" they may not by themselves "communicate sufficient censure."[118]

c. Assessing the effectiveness of civil liability as sanction

Civil liability sanctions allow the "enforcer to prosecute more cases successfully than criminal safeguards would allow."[119] Nevertheless, the civil liability sanctions suffer from the following major drawbacks; firstly, "imposing civil liability claims against individuals because of their lack of resources or because of litigant's preference to sue firms, the deterrent effect of civil penalties may be diluted,"[120] secondly, it may not have the desired deterrent effect as "civil penalties provide weak social stigma"[121]

Having assessed the sanctions under the regulatory justice system, the effectiveness of criminal law sanction of imprisonment will be analysed critically. Prior to embarking on the assessment of the effectiveness of custodial sentences, a comparison between (i) the regulatory justice system and the criminal justice system is called for.

d. The criminal law sanction of imprisonment

i. Regulatory Justice v/s Criminal Justice

The regulatory justice system plays a vital role in "relieving some of the pressure on an overburdened criminal justice system."[122]In some instances, having recourse to criminal prosecutions can be seen as a "disproportionate and inappropriate response when legitimate businesses fail to comply with laws."[123]

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in Öberg (n 108) 132
[116] Öberg (n 108) 132
[117] Ibid 133
[118] Ibid 134
[119] Ibid 127
[120] Ibid 128
[121] Ibid

[122] Lucy Clark, 'The Rise of Regulators' (2014) 178 Criminal Law & Justice Weekly 393,

[123] Clark (n 122) 394; Investigations undertaken by regulatory bodies are also "less financially draining and more expedient than criminal investigations"(Ibid). Regulatory authorities possess an arsenal of

In deciding whether to undertake criminal prosecution of corporate bodies, the regulator has to consider "the prospect of lengthy trials, unclear legal frameworks, a very high evidentiary burden as well as the fact that banks' byzantine structure and complex reporting lines make it hard to pursue criminal claims farther up the chain of command"[124] and "the costs of failed prosecution."[125] The choice of criminal law prosecution has the potential of leading to imprisonment together with fines and disqualification orders, as will be seen below.

ii. Assessing the effectiveness of imprisonment as a sanction

The aforesaid sanctions (fines, disqualification orders and civil liability) are not fully effective in deterring financial crimes. The alternative is imprisonment. In order to achieve its deterrence effect, criminal sanctions rely on the assumption that individuals are "rational actors" which means, "they must have the capacity to evaluate the risks associated to that behaviour."[126]

However, even "[p]sychological research suggests that the rational choice theory cannot fully explain white-collar crime."[127] Therefore, one of the failures of the rational choice theory is that "not all individuals have the capacity to properly identify illegal behaviour, assess risks or make a rational calculation."[128]

The sentencing of Tom Hayes is an example of a convicted rogue trader. Over and

penalties ranging from warnings, fines, disqualifications, civil sanctions or even undertaking criminal prosecutions (Ibid). It is primordial, in view of the increase in the number of regulations and criminal offences that compliance and legal departments of financial institutions "maintain an active awareness of the regulatory system and the criminal justice system, in addition to the overlap between both realms" (Ibid 395).

[124] Ashton and Christophers (n 7) 208

[125] Ibid; In the United States, deterrence takes the form of "negotiated settlements" (Deferred Prosecution Agreements or Non – Prosecution Agreements) rather than criminal prosecutions.[125] Unfortunately, "the amount repeat offenders" show that such form of punishments do not actually lead to any "meaningful behavio[u]ral change."(Justin O'Brien & Olivia Dixon, 'The Common Link in Failures and Scandals at the World's Leading Banks' (2013) 36 Seattle University Law Review 941, 942); In the UK, it was even more difficult to prosecute an institution because of the application of the "identification doctrine" for prosecution and prior to the SMR "it was difficult to hold any individual accountable."(Ibid 942)

[126] Öberg (n 108) 122; The deterrence effect of imprisonment is "achieved through the educative function of criminal law," in that it shows that certain behaviours "are taken very seriously by society" and "are regarded as unacceptable"(Ibid 115). Further through the "social stigma" linked with a criminal sanction it acts as a strong disincentive to commit crimes (Ibid).

[127] Ibid 123

[128] Ibid 122

above a sentence of imprisonment of 11 years, Hayes will "face a confiscation order, suffer a lifetime prohibition from employment in the financial services sector."[129]

There are other issues which arise as regards the effectiveness of imprisonment as a deterrent, and they are as follows: "how much did senior management condone or encourage Hayes' conduct; how common… was LIBOR fixing; how long had it been established practice, which Hayes merely inherited and developed?"[130] Recently, three other LIBOR manipulators were found guilty of manipulation and in their defence banks "suggested that they had never schooled the traders in the rights and wrongs of LIBOR setting."[131]

There is also the question of the real impact of the sentence of Hayes, especially the offence occurred years back in a different era and such manipulation in that form may not repeat itself until "people forget about bad times, and new forms of misconduct are invented" to meet the institutions' profits and bonuses.[132]

It seems clear that the "era of being tough on banks is nearing its end, and the regime of tough financial regulation briefly put in place by Martin Wheatley, who was recently sacked as CEO of the Financial Conduct Authority, will be transformed into a regulation-lite package by his successor …[and] bankers can dream of new more – or – less honest ways to make super-profits and big bonuses."[133]

Having assessed the effectiveness of various sanctions and the likely direction the UK will be embarking in regulating banks in the future (i.e "regulation-lite packages"), the question arises as to whether those regulatory sanctions can really promote effectively "the institution of compliance as an institutional and regulatory norm."[134] However, all these sanctions taken together, at multi-jurisdictional and multi-agencies level, as it has been applied in the LIBOR scandal, could lead to 'over-deterrence' instead of credible deterrence.

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[129] David Kirk, 'Fraud sentencing: the Tom Hayes effect' (2015) Journal of Criminal Law 301; The sentencing of Hayes also raises the issue of whether the Serious Frauds Office should have "prove[d] any loss suffered by identifiable individual or entities" and "should the judge have guesses or should he have excluded from his calculations any element of the sentence based on the size of that loss."(Kirk (n 129) 301)
[130] Ibid 302
[131] Jane Croft, 'Three Former Barclays bankers found guilty over LIBOR rigging' (*Financial Times,* 4 July 2016)
[132] Kirk (n 129) 303
[133] Ibid
[134] Ashton and Christophers (n 7) 207

iii. The risk of over-deterrence

Regulatory and criminal justice punishment are expected to act as credible deterrents. However, the multi-jurisdictional aspect of the LIBOR scandal's prosecutions and fines could have counter-productive effects. Not only do excessive penalties breach the proportionality principle but also may hamper significantly the capacity of companies to compete on the market and "over deterrence" may cause companies to become "overcautious in their actions."[135]

The use of financial penalties and criminal prosecutions may prevent individuals, to a large extent, from acting unethically, but it is highly doubtful that these alone would be sufficient to "deter an entire industry from acting together and colluding to evade existing regulations."[136]

The major weakness of criminal law is that it "generally fails to create internalized social norms necessary to foster compliance."[137] "Sanctioning individuals that are embedded in influential and deviant sub-cultures, without endeavouring to tackle the powerful culture that influences individuals to deviance, will not deter other individuals from being similarly influenced by such cultures."[138]

2.3 Regulatory responses – the midway between a culture of impunity and a culture of ethics

Prior to the regulatory reforms, banks were protected by the government and prosecution agencies, and clear acts of criminality paved the way for "young and easily suggestible employees to believe that committing crimes in relation to the markets they trade and the benchmarks they have been habitually manipulating is not a crime, and when they have been repeatedly rewarded by managements, all of whom benefit from the criminal profits being made."[139]

Both the PCBS and the FEMR made proposals for more regulations. However, regulations can only set "standards of conduct below which one must not fall rather

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[135] Huizing (n 32) 190; Therefore, to ensure "effective, coordinated and proportionate punishment" in such "cross border and multi-agency investigations," there should be information sharing between the agencies across jurisdictions through a cross border "inter agency task force" and "authorities should pursue simultaneous settlements or sentences that take into account the desired level of overall punishment and deterrence."(Huizing (n 32) 204)

[136] Pirana (n 11) 908

[137] Geraldine S Moohr, 'An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime' (2003) 55 Florida Law Review 937 as cited Öberg (n 108) 125

[138] Moohr (n 137) 963, 966, 968, 973 as cited in Öberg (n 108) 125

[139] Bosworth-Davies (n 15) 307

than to which one should strive."[140] Such a "sanctions based approach" "will condemn the bad but not necessarily develop the good."[141] In addition, the more rules and regulations increase in number, there can be a greater risk that they are perceived as "complete or that they leave no time for anything beyond compliance."[142] Over and above the impossibility of enacting regulation to cover all sorts of misconduct, "over prescription gives rise to compliance difficulties as well as a sense of diminishing returns."[143]

Improved regulations will undoubtedly curtail incentives for manipulations, but the real concern is for "how long will market participants, traders, and banks alike discover a new way to beat the system and allow greed to take over, and in turn find new ways to manipulate rates to their advantage?"[144] "Regulation cannot directly deliver an outcome whereby industry serves its clients in a way that society deserves and expects."[145] True it is that "supervisors and regulators cannot determine culture"[146] but it does not mean the regulator should just drop any review or monitoring of banks' culture as done by the FCA.[147]

Inspiration could have been drawn from the model of supervision of the Dutch Central Bank (DCB) in managing "behavioural risks" in the banking industry.[148] The system proposed by the DCB is based on three stages namely; firstly, "the identification stage" where cultural risks are compiled, secondly, "the assessment stage" where the board is assessed and determine whether the culture can be changed and the risks attached

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[140] Sir William Blair, Sir Ross Cranston FBA, Sir Robin Knowles CBE and Dr Costanza Russo, 'Fair and Effective Markets Review, Consultation Response by the Law and Ethics in Finance Project' (February 2015) < http://www.bankofengland.co.uk/markets/Documents/femr/lefp.pdf> accessed 17 June 2016, para 9

[141] Ibid

[142] Ibid para 10

[143] Ibid; In view of the above analysis of the responses to the LIBOR scandal, doubts are expressed as to whether a structural reform of LIBOR processes "will rid the processes of all unethical practices and restore the benchmark to its original integrity-based systems." (Pirana (n 11) 905)

[144] Pirana (n 11) 908

[145] The FCA, 'Culture in Banking'< https://www.fca.org.uk/static/documents/foi/foi4350-information-provided.pdf> accessed 17 June 2016, 2

[146] Group of 30 (G-30), *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform* (July 2015) < http://group30.org/images/uploads/publications/G30_BankingConductandCulture.pdf> accessed 23 July 2016, 15

[147] FCA (n 145)

[148] Alastair Tyler, 'Behavioural risk and banking: the Dutch Central Bank approach' (***ifs** University College* Insights, 6 April 2016) < http://www.ifslearning.ac.uk/ifs-insights/ifs-insights/2016/04/06/behavioural-risk-and- banking-the-dutch-central-bank-approach> accessed 23 July 2016

and thirdly, the “mitigation stage” where “mitigants from raising awareness to enforcement action” are undertaken.[149]

Regulatory deterrence and enforcement are primordial but “insufficient and possibly retrospective” and a regulatory-centric focus should not prevent a culture of ethics from working alongside regulations.[150] Therefore, regulatory deterrence, being only partially successful in addressing that industry wide culture of impunity represents the midway between the latter and a culture of ethics.

A culture of ethics can incorporate regulatory standards and translate them in “behavioural terms.”[151] By adopting a culture of ethics through a code of conduct, for instance, the bank can not only incorporate the regulations/laws of the industry but can also by virtue of the “ethical spirit” of the corporate culture promote conduct that goes beyond mere regulatory compliance.[152]

Therefore, a culture of ethics alongside regulatory compliance can “create a desire to aspire to best conduct than simply avoid falling foul of a regulatory requirement.”[153] “Culture drives individual behaviours which in turn affect day-to-day practices in firms and their interaction with customers and other market participants.”[154]

Part 3

Only a culture of ethics has the power to end a culture of impunity

The LIBOR scandal has shown that previous “regulatory design” lacked the elements that would embed or “operationalise” concretely a culture of integrity in dictating behaviours of financial actors.[155]

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[149] Ibid
[150] Sir William Blair and al (n 140) para 23
[151] Sir William Blair, Sir Ross Cranston FBA, Sir Robin Knowles CBE ,Dr Costanza Russo and al, ‘The Banking Standards Review Consultation Paper by the Law and Ethics in Finance Project’ (May 2014) < http://www.ccls.qmul.ac.uk/news/2014/132630.html> accessed 17 June 2016, para 24
[152] Ibid para 25
[153] Ibid para 25
[154] The FCA (n 145) 1
[155] Justin O'Brien, George Gilligan and Seumas Miller, ‘Culture and the future of financial regulation: how to embed restraint in the interests of systemic stability’ (2014) 8(2) Law and Financial Markets Review 115; The concept of culture, “going further than legal obligation,” originate from the firm’s values or “institutional purpose” which in turn guides conduct of all stakeholders. (Ibid 117)

3.1 Unethical decision making of financial actors explain the LIBOR scandal

At the very core of the LIBOR scandal lies dishonesty. Dishonesty is not only an element of criminal or regulatory offences, "but also a culturally defined psychological construct."[156]

Applying the money intelligence theory[157], research depicts that "[h]igh love-of-money individuals have higher machiavellianism"[158] and therefore "are more likely to use manipulative strategies, take high risks, and engage in unethical behavio[u]r than their low love-of-money counterparts."[159] In addition, ethical breaches may arise for three reasons; (i) error ("good people making mistakes (out of confusion or ignorance)"), (ii) weakness ("good people having weakness of will"), and (iii) vice ("bad people choosing to do evil").[160] Hence, a culture of ethics could potentially prevent "error", overcome such "weakness" (submitters who felt forced to comply with superior orders) and punish the "wrongdoers."[161]

3.2 Defining the terms: Culture of ethics

The terms, culture of ethics, will be explained by defining each term, that is, (a) culture and (b) ethics within a corporate organisational structure.

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[156] Thomas Li-Ping Tang and al, 'Monetary Intelligence and Behavioral Economics: The Enron Effect—Love of Money, Corporate Ethical Values, Corruption Perceptions Index (CPI), and Dishonesty Across 31 Geopolitical Entities' (2016) Journal of Business Ethics 1, 2; Research has shown that individual's intentions are affected by several "levels of environment" namely "financial resources, experiences, and culture at the individual, organization, and entity levels [that] shape our deeply rooted monetary beliefs and values which provoke or curb self-interest and incite unethical or ethical behavio[u]rs." (O¨zbek M F, Yoldash M A, & Tang T L P, 'Theory of justice, OCB, and individualism: Kyrgyz citizens' (2015) Journal of Business Ethics as cited in Tang and al (n 156) 4)

[157] "Monetary intelligence theory asserts that individuals apply their money attitude to frame critical concerns in the context and strategically select certain options to achieve financial goals and ultimate happiness." (Tang and al (n 156) 1)

[158] Tang, T L P & Chen Y J, 'Intelligence vs. wisdom: The love of money, Machiavellianism, and unethical behavior across college major and gender' (2008) 82 Journal of Business Ethics 1–26 as cited in Tang and al (n 156) 5

[159] Kish-Gephart, Harrison D A & Trevin˜o, L K, 'Bad apples, bad cases, and bad barrels: Meta-analytic evidence about sources of unethical decisions at work' (2010) 95 Journal of Applied Psychology 1–31 as cited in Tang and al (n 156) 5

[160] Christopher Meyers, 'Institutional Culture and Individual Behavior: Creating an Ethical Environment' (2004) 10 Science and Engineering Ethics 269, 270

[161] Ibid 270

a. The notion of culture

Culture, in the functionalist view, is defined as "an integrated social system which promotes the effectiveness of the organization and the well-being of all its stakeholders."[162] Corporate culture is defined as "assumptions, beliefs, goals, knowledge and values that are shared by organizational members."[163]An institution's culture is so powerful that it defines its "employees, customers, suppliers, and competitors, and how a firm will interact with these key actors."[164] The functions of a corporate culture are numerous.[165]

However, corporate culture can be a double edged knife, that is, if the culture of a financial institution is a purely business culture based on short termism then it is this very culture that will lead to benchmark manipulation. Should that corporate culture be one of ethics, this can be highly beneficial for the institution and prevent frauds such as LIBOR manipulation.

b. The notion of ethics

The term "ethics" is a "philosophical term derived from the Greek word 'ethos' meaning character or custom [and] refers to a set of standards governing behavio[u]r"[166]within "a group, a profession or members of an organization," whilst distinct from morality which "deals in general with principles of right or wrong conduct."[167]

[162] Aliza D Racelis, 'Relationship between Employee Perceptions of Corporate Ethics and Organizational Culture:
An Exploratory Study' (2010) 15(2) Asia Pacific Management Review 251
[163] Schwartz H and Davis S, 'Matching corporate culture and business strategy' (1981) 10 (1) Organizational Dynamics 30-48 as cited in Racelis (n 162) 252

[164] Barney J B, 'Organizational culture: Can it be a source of sustained competitive advantage?' (1986) 11(3) Academy of Management Review 656-665 as cited in Racelis (n 162) 251
[165] Firstly, the culture sheds light on the key values on the company and channels the management towards the "shared values, beliefs and norms" of the organisation (Racelis (n 162) 252). Secondly, culture acts as a "social glue" and prevents "fragmentation, conflict, tension" and makes "organi[s]ational life … characterized by consensus, harmony and community" (Ibid). Thirdly, as a "social control system," corporate culture is beneficial as it "represents the behavio[u]r patterns … that …persist over time and that new employees are somehow automatically encouraged to follow by their fellow employees, thus clarifying what they should do or say in a given situation."(Ibid). Therefore, bigger than any individual's interests, culture gives a "sense of identity" and commitment to employees within the same organisation and the more well defined the values are the more committed are the employees to the company's mission and purpose (Ibid 253).
[166] Sims R, 'The challenge of ethical behavior in organizations' (1992) 11(7) Journal of Business Ethics 505-513 as cited in Racelis (n 162) 253
[167] Racelis (n 162) 253

Organisational ethics refers to "standards of behaviour and are designed to respond to the particular dilemmas presented by that context."[168] In the wake of the LIBOR manipulation, the Governor of the Bank of England, Mark Carney recognised that there has been an "ethical drift and abdication of responsibility within the industry for guaranteeing financial stability"[169] and advocated for "higher standards" and "cultural change."[170]

Therefore, firstly, the banking industry's response through the Banking Standards Board and the FICC Markets Standards Boards' limits will be examined. Secondly, a culture of ethics can only be successfully implemented if the banks, which make up the banking industry, individually internalise ethical values through their (i) formal organisational structures and (ii) informally through a culture of ethics.

3.3 The limits of the Banking Industry's Response

The PCBS enquired into the ethical failures in the banking industry and concluded that the banking industry "is long way from being an industry where professional duties to customers, and to the integrity of the profession as a whole trump an individual's own behavioural incentives and therefore proposed an "enhancement of professional standards."[171]

Along with the creation of a Banking Standards Board, there was also the establishment of the FICC Market Standards Board though being a "useful addition" does not provide for disciplinary procedures in the event of ethical conduct breaches, hence a major failure.[172]

Further, the membership to these Boards are at a corporate level rather than an individual level and these "may raise standards but do not professionalise the industry

[168] Sinclair A, 'Approaches to organizational culture and ethics' (1993) 12(1) Journal of Business Ethics 63-73 as cited in Racelis (n 162) 253; Unethical decision - making occurs simply because the organisation does not "institutionalise ethical values," for instance, promotes a culture to make profits at the expense of "moral or ethical values." (Meyers (n 160) 269**);** Then, even good people's decision which will be in line with the culture of the firm, despite being culturally "correct," would fall to be unethical, when assessed from "outside the organisation." (Meyers (n 160) 270)

[169] M Carney, 'Inclusive Capitalism: Creating a Sense of the Systemic', speech delivered at the Inclusive Capitalism Conference, London, 27 May 2014 as cited in Justin O'Brien, George Gilligan, Alex Roberts & Roger McCormick, 'Professional standards and the social licence to operate: a panacea for finance or an exercise in symbolism?' (2015) 9(4) Law and Financial Markets Review 283

[170] O'Brien and al (n 169) 283

[171] Ibid 286

[172] O'Brien and al (n 169) 286

itself and therefore fail to provide a route map to the transformation" of the industry's culture of impunity into one of ethics.[173]Hence in order to professionalise the banking sector it is essential to involve individual players, that is, banks and their employees in changing from a "business culture"[174] to a culture of ethics.

The promotion of ethical conduct can be based on (i) organisational factors (external factors) and/or (ii) employees as drivers of ethical behaviour.[175] "Organisational factors" impacting on the ethical behaviour of employees include two elements, firstly (i) the formal structures of the institution and secondly (ii) the "informal" one or the "organisation's culture."[176]

3.4 Promoting ethical behaviour through formal organisational structures

The organisation's formal structures consist of mainly three "distinct but related" constituents: firstly, (a) the rewards' structure, secondly, (b) the performance monitoring/evaluation of employees, and thirdly, (c) decision making process of employees.[177]

a. The rewards' structure

A "poorly designed" structure of "monetary and non-monetary rewards" may incentivise employees to undertake wilful or unintended unethical actions,[178] whereas an organisation's internally, carefully designed rewards structure, can help counter constructive compliance exercises and promote the true purpose of the company.[179]

b. The performance monitoring/evaluation of employees

Poor performance monitoring processes "will not only fail to detect unethical conduct, but will inadvertently encourage such behaviour by creating expectations that unethical behaviour is tolerated or necessary to achieve corporate goals."[180]

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[173] Ibid
[174] Ibid 289
[175] Harvey S. James Jr. 'Reinforcing Ethical Decision Making through organizational Structure' (2000) 28(1) Journal of Business Ethics 43
[176] Ibid 44
[177] Ibid 45
[178] James Jr. (n 175) 47 and G-30 (n 146) 13
[179] ICE Benchmark Administration (n 13)
[180] James Jr. (n 175) 49; "Performance evaluation processes" are important as they affect the "ethical sensitivities
and behaviours of [employees] because they are the primary means of informing the [employees] what is expected from them." (James Jr. (n 175) 49)

Further, the G-30 also proposes "three lines of defense," namely "the first line" consisting of all bank staff who ought to behave in ethical ways, the "second line" made up of compliance or risk management functions to advise the staff and "set the standards," and the "third line" consists of auditors to "test adherence to the stated standards."[181] If applied effectively, these "lines of defense"[182] would represent the internal system of control of the bank. Should there have been proper internal controls and accountability, the LIBOR manipulation could be prevented.

However, the G-30 recommendations have been criticised in as much as they "appear to lack a quantitative evidential basis for its conclusions" and "the correlation between the opinion-based information and the report's recommendations is opaque."[183]

c. Decision making process of employees.

Sometimes, employees may "feel compelled to act unethically" because they are hierarchically ordered to do so and do not have the decision making power to choose "ethical alternatives."[184] and research has shown that middle management is "more likely to take unethical actions than top management" because they have "little power or control over decisions."[185] An example would be the submitter who, by email, informed his manager that he was not agreeable to post dishonest prices for LIBOR but reluctantly did so.[186]

As a result, each organisational formal "structural element" distinctly and relatively impact on the "organisational environment" and affect employees' ethical decision making processes.[187]

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[181] G-30 (n 146) 14
[182] Ibid
[183] Shazia Khan Afghan, 'The Alchemy of the G-30 Report on Banking Conduct and Culture' (2016) < http://sevenpillarsinstitute.org/case-studies/alchemy-g-30-report-on-banking-conduct-culture> accessed 23 July 2016
[184] Waters J. A. and F. Bird, 'Everyday Moral Issues Experienced by Managers' (1986) 5 Journal of Business Ethics 373-384 as cited in James Jr. (n 175) 51
[185] Waters and al (n 184) as cited in James Jr. (n 175) 51; As to whether an employee will behave unethically subject to, incentives arising from the organisation's reward system or from the defective performance evaluations processes, will depend on the degree of control and rights the employee has over decision making process ("centralised or decentralised decision making responsibilities") (James Jr. (n 175) 51).
[186] See para 1.2(a) above
[187] James Jr. (n 175) 45; Since the abilities of employees to solve "ethical dilemmas" often depend on their motives which are usually "a confusing and complex mixture of selflessness, self- interest and selfishness," only the formal structures provide objectively verifiable and uniformly applied tools for shaping the ethical attitudes and behaviour of employees (James Jr. (n 175) 45).

The organisational structures are those on which the management has most control, whereas it has "least control over the internal motives driving [employee's] behaviour, [and] can only 'channel' workers on the ethical route" but cannot "force workers to internalise ethical principles."[188]

Formal structures promote ethical conduct through incentives such as rewards or "threat of punishment" but never become "motivators unless the individual integrates the message they convey into a personal belief system" through a corporate culture of ethics.[189]

3.5 Promoting ethical behaviour informally through an organisation's culture of ethics

The organisation's culture would usually consist of "the shared and espoused values and beliefs of organizational members, group norms, embedded skills, heroes, rituals, myths, and language of the organization."[190] The internalisation of an ethical corporate culture will be separated in two broad categories: (a) the establishment/communication of ethical values and (b) Maintenance/enforcement of ethical values through proper (i) detection, (ii) punishment and (iii) deterrence metric.

a. The establishment and effective communication of ethical 'values'

The establishment and effective communication of ethical values may be achieved in the following ways: (i) Ethical Leadership, (ii) Mission, value- driven, (iii) Process Integrity, (iv) Code of ethics, (v) Recourse to Ethicists and Corporate Ethics Training, (vi) The role of the Human Resources Department, (vii) Managing conflicts of interests.

i. Ethical Leadership

The culture of ethics within a corporate organisational set up ought to come from the top management (the Board) if the company is to assume an ethical "corporate character,"

[188] James Jr. (n 175) 46
[189] Vidaver-Cohen D, 'Motivational Appeal in Normative Theories of Enterprise' (1998) 8(3) Business Ethics Quarterly 385-407 as cited in James Jr. (n 175) 53
[190] Reidenbach, R. E. and D. P. Robin, 'A Conceptual Model of Corporate Moral Development' (1991) 10 Journal of Business Ethics 273-284 as cited in James Jr. (n 175) 44

> "Corporate character matters — and *employees take their cues from the top*. In our experience, the character of the CEO and other top officers is generally reflected in the character of the entire company. *If a CEO is known for his integrity, integrity becomes the corporate norm*. If, on the other hand, a company's top executives are more interested in personal enrichment at the expense of the shareholders, […] employees will follow suit."[191]

In addition, effective leaders should not fall prey of "retaliation" behaviour when ethical issues arise, that is, the leader should not "shoot the messenger" but rather "gather the facts and take action."[192]

ii. Mission and value- driven

The mission and values of a company ought to be the central part of an ethical organisational culture and "and flow freely and systemically throughout the organization to become the genesis of operational norms"[193]Research depicts that an ethical organisational culture would tend to define the "purpose of business" as putting "mission above profit and long-term over short-term."[194]

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[191] Linda Chatman Thomsen, Director, Division of Enforcement, Securities and Exchange Commission as reported in Lee Biggerstaff, David C. Cicero, Andy Puckett, 'Suspect CEOs, unethical culture and corporate misbehavior' (2015) 117 Journal of Financial Economics 98; The perpetration of "extensive corporate malfeasance" is not the manifestation of only the behaviour of top executives but can only be possible through an indissoluble collaboration of employees. (D Langevoort 'Opening the blackbox of 'corporate culture' in law and economics' (2006) 162 Journal of Institutional and Theoretical Economics 80–96 as reported in Cicero and Puckett (n 191) 99).In the LIBOR manipulation scandal, it was seen that both managers and traders were pressurising submitters to submit false rates.

[192] Alexandre Ardichvili, James A. Mitchell and Douglas Jondle, 'Characteristics of Ethical Business Cultures' (2009) 85 Journal of Business Ethics 445, 450; At any rate the success of implementing an ethical corporate culture can only be measured if such a culture "permeate[s] throughout all aspects of the business from top management to the frontline employee and throughout all functional systems of the firm."(Ardichvili and Jondle (n 192) 450)

[193] Ardichvili and Jondle (n 192) 449

[194] Ibid; The study further explains that the stakeholder balance is about effective leadership, in the longer term, acting in the interest of all stakeholders, including customers (acting in their best interests), employees ("respectful treatment and fair compensation" as they are the ones who deliver service to the customers) and with respect to the global community (environment and social responsibility) (Ibid). This would therefore defeat short termism, one of the causes of the LIBOR manipulation. Adopting an ethical business culture in no way means that the rifts between stakeholders will disappear, but, rather create an environment for consideration of all stakeholders' interests in the strategic decision making and operations of the firm, thereby "redefining the purpose of business."(Ibid 450)

iii. Process Integrity

Process Integrity is about the implementation of the corporate ethical values in the behaviour of all its members and in the firm's processes such as recruitment, dismissal, compensation, promotion.[195] In order to achieve a successful ethical corporate culture, the "organisational culture" and "individual behaviour" must be focused on long term interests of the firm.[196]

iv. Code of ethics

The code of ethics "should reflect values instead of merely a compliance approach to ethics."[197] A value- based approach commits employees to ethical behaviour and acts as a motivator for them to act according to the organisation's shared ethical values,[198] whilst a compliance approach is based "on detecting, preventing and punishing breaches of the rules."[199]

Therefore, a redrafting of corporate codes so that they do no longer reflect only legal provisions but also the ethical foundations behind that law ("substantive ethics") can be beneficial.[200] The new LIBOR code is an example of a Code of Conduct which includes market conduct rules, remuneration practices and providing ethical awareness through training, whistleblowing procedures, and conflict of interest management policies.[201] Therefore, the LIBOR code has to be implemented in its letter and spirit.

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[195] Ibid 450

[196] Meyers (n 160) 269; For instance, if traders who were involved in the LIBOR manipulation were promoted because they increased the profits of the institution while other traders who refused to adopt such manipulations were seen as incompetent, this would taint the whole process integrity of the institution.

[197] Pieter Nel, Liza Nel and Andries du Plessis, 'Implications for human resources and employment Relations practice with regard to the integration of Corporate ethics programmes into the culture of Organisations' (2011) 17(2) International Employment Relations Review 55, 59

[198] Trevino L K & Nelson K A, *Managing business ethics, straight talk about how to do it right.* (5th edn, John Wiley & Sons, USA, 2011) as cited in Nel and al (n 197) 60

[199] Nel and al (n 197) 60

[200] Mark S. Blodgett, 'Substantive Ethics: Integrating Law and Ethics in Corporate Ethics Programs' (2011) 99(1)
Journal of Business Ethics 39, 45; Same will enhance compliance statements and help financial actors to unambiguously understand the ethical considerations of laws, thereby enhancing the normative expressive function of ethics, and preventing any ticking box exercise of compliance function in the future (Blodgett (n 200) 46).

[201] ICE Benchmark Administration (n 13); An effective organisational ethical culture also demands regular evaluation and criticism so that the organisation is equipped with proper ethics training in assessing "alternative actions" to problem evaluations, "values clarification, conceptual analysis and complex reasoning." (Meyers (n 160) 274)

v. Recourse to Ethicists and Corporate Ethics Training

It is proposed for firms to have recourse to "external ethicists"[202] who would undertake "practical ethics educational programs" and "pay far greater attention to empirical skills and methods."[203] Therefore, in training bank submitters, traders and managers, due consideration should be given to the practicalities involved in the LIBOR rigging while positively promoting the LIBOR Code so as to prevent further LIBOR manipulations. Training is essential as recent Barclays traders who have been convicted pleaded in the defence that they "had never been schooled in the rights and wrongs of LIBOR setting."[204]

vi. The role of the Human Resources Department (HRD)

The HRD has a very important "role in the formulation, monitoring, communication and enforcement of an organisation's ethics programme"[205] Further it is proposed for HRD to have recourse to experts in the fields of ethics and psychology and devise techniques to carry out profiling of candidates at recruitment process itself. Not only is there a need for a culture of ethics but "individuals need to be more accountable for their actions," hence the necessity "to ensure that when employees are fired, their history is known to those considering to hire them."[206]

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[202] Meyers (n 160) 274; Recourse to "external ethicists" for two reasons; (i) the culture may have become an "integral part of that employee's identity" to such an extent that the internal ethicist may be defining himself "via that culture" and therefore difficult for him to see beyond and criticise and improve same and (ii) the problem of "co-option," when the livelihood is at stake; "one's primary social group is the targeted organization; when one is granted authority and prestigious status within the institution, one becomes less inclined" to be effectively critical being an in house ethics officer (Ibid).

[203] P Werhane, 'The Normative/Descriptive Distinction in Methodologies of Business Ethics' (1994) 4 The Business Ethics Quarterly 175-180 as reported in Meyers (n 160) 275 and See G-30 (n 146)

[204] Croft (n 131); It is also believed that "the first training session should be led by the CEO to enhance the programme's credibility among employees, because it may be unsuccessful without the involvement of senior leadership." (Zhou Y, Zhang Y & Sanchez A M, 'Utilitarianism or romanticism: The effect of rewards on employees' innovative behaviour' (2011) 32(1) International Journal of Manpower 81-98 as cited in Nel and al (n 197) 59)

[205] Mellahi, K, Morrell K & Wood G, *The ethical business challenges and controversies (*2nd edn Palgrave MacMillan, England, 2010) as cited in Nel and al (n 197) 58

[206] M Carney, 'Three Truths for Finance', speech delivered at the Harvard Club UK, Southwark Cathedral, London, 21 September 2015 as cited in O'Brien and al (n 169)283

vii. Managing conflict of interests

So as to minimise the risk of use of networking and fraudulent cooperation between submitters of LIBOR and traders, there could be a "Chinese wall" ("Ethical wall/ screen" or "Insulation wall") to "isolate the LIBOR submitters from pressure and prevent them from providing information about submissions to traders."[207] It is noteworthy that the LIBOR code along with the FCA Market Conduct Sourcebook do provide for the implementation, maintenance and management of conflict of interests.[208]

b. Maintenance/enforcement of ethical values

To complement the above incentives' system, the maintenance and enforcement of ethical values within an organisation may be achieved through (i) detection and (ii) punishment and (iii) deterrence metric.

i. Detection through a culture of Intolerance/Whistleblowing

True it is that traditionally "whistle-blowers" were seen as "disloyal or misguided traitors" but "increasingly, this stereotype is being broken down."[209] Most of the times the real issue is not to prevent a majority of individual financial actors from behaving in an ethical manner but instead it is to create an appropriate culture of intolerance towards fraudsters working in banks.[210] The internal design of whistleblowing structures should be independent of management and "anti-corruption" units should be created so as to protect good faith "whistle-blowers."[211]

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[207] Bainbridge (n 76) 807 (note 100)

[208] ICE Benchmark Administration, 'Libor Code of Conduct Contributing Banks' (February 2014 paras 4.1- 4.12) < https://www.theice.com/publicdocs/IBA_Code_of_Conduct.pdf >accessed 17 June 2016

[209] Janine Pascoe and Michelle Welsh, 'Whistleblowing, Ethics and Corporate Culture: Theory and Practice in Australia' (2011) 40 Common Law World Review 144, 146

[210] Justin O'Brien, George Gilligan and Seumas Miller, 'Culture and the future of financial regulation: how to embed restraint in the interests of systemic stability' (2014) 8(2) Law and Financial Markets Review 115, 125; It could even go a step further by having internal laws that passive contributors, guilty of wilful blindness, will be sanctioned, thereby, incentivising reporting through fear of sanctions and promoting group collective behaviour (Ibid).

[211] O'Brien, Gilligan and Miller (n 210) 125; The incorporation of whistle blowing programmes within banks will provide the institution with further tools to deal with "risk management and frauds" and prevent same from being "victim of otherwise undetected crimes." (Pascoe and Welsh (n 209) 146)

ii. Punishment

The corporate culture should reward ethical behaviour and punish unethical behaviour.[212] Deterrence and incapacitation can be achieved through punishment of unethical acts "as third parties become aware of the consequences of not following ethical norms."[213] Further, all of the above should be incorporated "with the employment relations and HR policies in an organisation."[214]

iii. Deterrence metric

Since financial actors value their reputation in the market, there could be the creation of a "reputation index," made up of metrics depicting the "ethical health" of the firms, which could be used in a competitive market as a comparative tool in determining the reputation risks the firm is facing.[215] This could act as a deterrence and detection metric for unethical breaches by banks.

Secondly, there is no universally accepted definition of "conduct costs" so far.[216] As wide as it is, "conduct costs" include any measure "be it balance sheet, bank reputation and sustainability or stakeholder sentiment" related to misconduct.[217] Hence, a new approach to conduct risk management can use "conduct costs" as a metric within firms and across the industry for peer reviews ("professional conduct and competence benchmark") in a manner that "informs the connection between firm- ethics and culture and the frequency and severity of misconduct."[218]

Ultimately, the aim of a culture of ethics in an organisation is to positively influence employees in behaving ethically. But there are certain expectations from employees themselves for there to be a successful culture of ethics.

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[212] Zhou Y, Zhang Y & Sanchez A M, 'Utilitarianism or romanticism: The effect of rewards on employees' innovative behaviour' (2011) 32(1) International Journal of Manpower 81-98 as cited in Nel and al (n 197) 60

[213] Nel and al (n 197) 60

[214] Segon M, 'Managing Organisational Ethics: Professionalism, Duty and HR Practitioners' (2010) 5(4) Journal of Business Systems, Governance and Ethics 13-25 as cited in Nel and al (n 197) 60

[215] O'Brien, Gilligan and Miller (n 210) 126 and See G-30 (n 146) 13 para 2c

[216] Roger McCormick and Chris Stears, 'Banks: conduct costs, cultural issues and steps towards professionalism' (2014) 8(2) Law and Financial Markets Review 134, 137; However, it "capture[s] behaviour that impugns the integrity and good standing of the bank, on an objective basis." (Ibid 137)

[217] Ibid

[218] Ibid 141

3.6 The expectations from employees as drivers of ethical behaviour

An organisation consists mainly of its employees and for the firm to implement an ethical culture, employees will need to possess three important virtues: (i) "have practical wisdom," that is, "be able to analyse problems,[identify] best means to achieve [ethical] results [and] where to seek advice" (ii) honesty with oneself ("to avoid self- deception") and with colleagues and customers and (iii) be courageous enough to face "peer or managerial pressure" and "do the right thing."[219]

Furthermore, "[h]onesty is needed to truthfully appraise the degree to which one has become embedded in the script [organisation's culture]; *phronesis* is needed to know what good ethics demands instead; and courage is needed to act accordingly."[220]

Hence, it is primordial that the industry as a whole along with the banks, their employees together with public authorities engage continuously in order to "reverse the tide of ethical drift"[221] and deter any such benchmark manipulation in the future. "Establishing a perfect system is likely impossible; however, it is the responsibility of authorities and regulators to cabin all opportunities and incentives for manipulation of a once credible benchmark."[222]

Conclusion

In 1960, when LIBOR was initiated, "an unregulated system to set the world's largest benchmark for lending may have been acceptable,"[223] but in view of not only isolated unethical acts of individuals but an "industry wide manipulation," structural and organisational changes are primordial.[224] The LIBOR manipulation's investigation clearly showed "systemic governance failures" that question the "structural integrity of current models of financial regulation."[225]

It has been shown that the LIBOR manipulation was the result of an ongoing culture of impunity and a failing regulatory system. Regulations ought to be dynamic and

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[219] Meyers (n 160) 273; To implement ethical decision making in the everyday activities of employees in an
organisational culture involves not only the expectation from them to "discern right from wrong" but to surpass that minimum threshold and make the ethical choice when "all choices seem right."(Ardichvili, Mitchell and Jondle (n 192) 445)
[220] Meyers (n 160) 274
[221] O'Brien and al (n 169) 284
[222] Pirana (n 11) 899
[223] Weldon (n 86) 225
[224] Ibid
[225] O'Brien & Dixon (n 125) 941

"responsive" to the corporate institutional behaviour and professional behaviours of employees.[226]

The regulatory responses to the LIBOR scandal were analysed and found tainted with limitations and it is proposed that only a culture of ethics would be powerful enough to reverse that culture on impunity.

It cannot be denied that even prior to the LIBOR scandal that firms' ethical considerations were already "explicitly" designed, but were simply "ignored" and reduced to "pious noises about values" and treated as "an unreachable attainment of ideal standard" which no credible no specific accountability and deterrent mechanism to promote and prevent ethically incorrect behaviours.[227]

If the LIBOR manipulation is to be deterred, it is important for regulated banking entities to have "substantive conceptions of compliance, rather than mechanical conceptions that are easily transacted around,"[228] in addition to have "warranted commitment to ethical standards rather than a stated aspiration that lacks granularity to be enforceable."[229] Benchmark manipulations like the LIBOR can only be stopped if there is a genuine commitment from top management to put ethics before short-term profits. The debate is no longer which would be a better approach: sanctions or incentives to combat that culture of impunity. Rather both complement each other and there is a need for a unified application.

Nevertheless, it would be a fallacy to say that a regulatory system with a culture of integrity is a "guaranteed zero-failure" as "failure is inevitably a component of risk", which ought to be reduced to a minimum.[230] Therefore, in order to successfully mitigate to a minimum the risk of any further LIBOR manipulation, all stakeholders including regulatory authorities, banking institutions and their employees should have a firm commitment to promote a robust culture of ethics to end that culture of impunity.

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[226] O'Brien, Gilligan and Miller (n 210) 122
[227] Ibid 119
[228] O'Brien & Dixon (n 125) 941
[229] O'Brien & Dixon (n 125) 941
[230] O'Brien, Gilligan and Miller (n 210) 119

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