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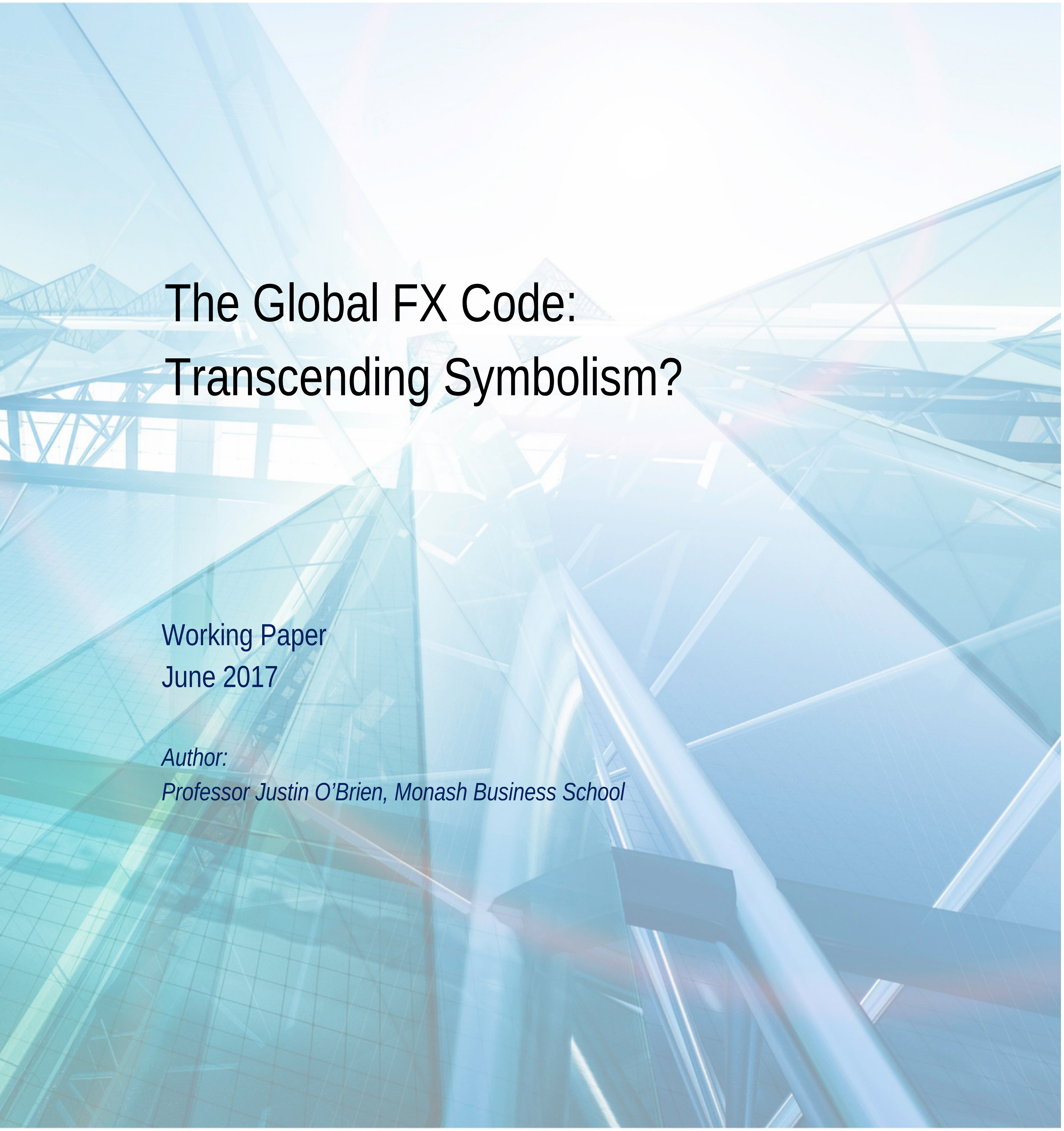

The Global FX Code: Transcending Symbolism?

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Thought Leadership in the Financial Sector

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Abstract

Following two years of negotiations, a pivotal public-private partnership has released a global code of conduct for the foreign exchange industry. Designed to address a trust deficit within and, more significantly, between it and society, the code enunciates key principles of expected behaviour with global application. While ostensibly voluntary and lacking explicit enforcement mechanisms, the FX Global Code has a number of innovative features that warrant attention. It explicitly prohibits activity subject to recent negotiated prosecution agreements in the United Kingdom, the United States and enforceable undertakings in Australia. Moreover, the (forced) recruitment of financial firms embeds common conceptions of practice within and across institutional actors by leveraging a shaming mechanism. The imaginative component is matched, however, by an almost complete lack of media and academic attention. This, it is argued, is a mistake. The reform initiative is the most significant yet in changing the culture of wholesale markets precisely because of how it interlocks with law and policy within key markets and questions prior enforcement decisions.

1. Introduction

The foreign exchange (FX) industry is an essential component of the global financial plumbing. It facilitates $5trillion in transactions daily.[1] These derive from both manual as well as (increasing and increasingly) complex algorithmic prowess. The industry is an essential lubricant for the engineering required to deliver on the integrity of the architecture of capital markets. A lack of trust in the active participants can have far-reaching consequences. A succession of scandals, involving a small number of critical players across developed jurisdictions, demonstrate a fundamental problem. This applies irrespective of the institutional domicile, or whether a 'rules' or 'principles' approach to regulatory design had been heretofore privileged in either home or host jurisdiction. Neither regulatory structure proved capable of instilling restraint.[2] In case after case, the hubris was staggering. Traders met in electronic chatrooms (itself contrary to internal procedure), deploying monikers such as 'Pirates' or the 'Cartel.' Art imitating life or life imitating art is a dubious distinction given the traders' predilection for constructing avatars linked to Martin Scorsese movies. From *Goodfellas* (1990) to *Casino* (1995) to *The Wolf of Wall Street* (2013), the latter itself financed through alleged misappropriation of funding from a Malaysian Sovereign Wealth Fund (SWF), a similar narrative was privileged. Traders glorified in being beyond the constraints of law, emphasising camaraderie; deployed base language; boasted of derring-do ambition; and, critically, demonstrated emasculated conceptions of responsibility. The traders (and by extension through neglect their managers) judged performance not by generalised adherence to law or corporate policy but particularised commitment to market practice. For the real-life traders (and, by extension, their managers) colluded to manipulate or attempt to manipulate market rates. Such action was simply yet another tool, deployed with more than a modicum of pride.[3] The long-term consequences of this normative myopia are still being worked through.

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[1] 'A New Code Aims To Clean Up the FX Market,' *The Economist*, 25 May 2017, available at http://www.economist.com/news/finance-and-economics/21722680-new-regulatory-code-relies-mainly-peer-pressure- new-code-aims-clean-up.

[2] See, for example, Treasury Select Committee, *Fixing LIBOR: Some Preliminary Findings* (Westminster, 18 August 2012); Treasury, *The Wheatley Review of LIBOR Final Report*, (London, September 2012); United States Senate Permanent Committee on Investigations, *JP Morgan Chase Whale Trades: A Case History of Derivatives, Risk and Abuses* (Washington DC, 15 March 2013)

[3] See, for example, M Corkery and B Protess, 'Rigging of Foreign Exchange Market Makes Felons of Top Banks,' *New York Times*, 20 May 2015, available at https://www.nytimes.com/2015/05/21/business/dealbook/5-big-banks- to-pay-billions-and-plead-guilty-in-currency-and-interest-rate-cases.html?_r=0.

The operational and strategic risk frameworks governing the trading room were barely understood by senior banking management, most notably within boards of directors, the controlling mind and ultimate arbiter and gatekeeper of cultural values.[4] The stated values of the institutions were subservient to short-term profit maximisation. The normative myopia was also evident in the executive suite. Moreover, the time-lag from revelation of discrepancies between elevated levels of risk and low stated costs of borrowing posted in submissions to core benchmarks, such as the London Interbank Offered Rate (LIBOR) and actual regulatory investigation and preparation of litigation, contributed to initial public unease. Just how could such a fundamental problem be allowed to hide in plain sight? Strategic miscalculations by the Financial Services Authority on how the initial fine against Barclays, the first bank to settle in the LIBOR scandal, was calculated, initial non-reporting of concern about the culture of the bank or its senior management and non-disclosure of private communication of the need for regime change, did much to undermine the authority of the agency and its eventual break-up.[5] Subsequent scrutiny of how the wider FX market was structured, governed and regulated – gradually transferred from domestic market conduct to global central banking investigation and adjudication – suggested a system almost impervious to effective control. It turned the unease into incredulity. The failings prompted an existential question. Did the ethical lapses derive from a 'perfect storm' none was capable of predicting or from a myopic confluence that signalled regulatory and legislative acquiescence and ideational capture?[6] These are not simply matters

[4] See E Talley and S Strimling, 'The World's Most Important Number: How a Web of Skewed Incentives, Broken Hierarchies and Compliance Cultures Conspired to Undermine LIBOR,' in J O'Brien and G Gilligan, *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, 2013); for failure of internal control systems, see I Chiu, *Regulating (From) The Inside: The Legal Framework for Internal Controls in Banks and Financial Institutions* (Oxford, 2016). Incredulity by middle-level wholesale about being charged in civil or criminal cases is common in trading cases.

[5] Parliamentary Commission on Banking Standards (PCBS), *Changing Banking for Good Volume 2* (London, 12 June 2013), 83 ('The LIBOR scandal served as the final straw for the public and Parliament because the behaviour exhibited seemed to encapsulate so much that appeared to have gone wrong in banking, before, during and after the financial crisis, reflecting both poor individual and corporate standards of conduct. The industry was not just revealed as incompetent, but appeared morally bankrupt.'). Similar comments were made by the then chair of the Financial Services Authority, see J O'Brien, Market Manipulation and the Failure of Compliance: How Barclays Destroyed the Integrity of LIBOR' Centre for Law, Markets and Regulation, UNSW Law, July 2012, available at https://clmr.unsw.edu.au/article//market-manipulation-and-the-failure-of-compliance%3A-how-barclays- destroyed-the-integrity-of-the-LIBOR ([The] degree of cynicism and greed which is really quite shocking...does suggest that there are some very wide cultural issues that need to be strongly addressed.) These were not initially addressed nor where the public details of regulator concerned shared with the general public. It was only when publicly questioned the a wider array of sanctions, including the 'voluntary' removal of Barclays Chief Executive, Bob Diamond countenanced, see J O'Brien, 'Enforcing Compliance: Barclays, LIBOR and and the Structural Flaws of Self-Regulation,' UNSW Law, July 2012, available at https://clmr.unsw.edu.au/article//enforcing-compliance%3A- barclays%2C-LIBOR-and-the-structural-flaws-of-self-regulation.

[6] See A Levitin, 'The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay' (2014) 127 *Harvard Law Review* 1, 46-55 (noting an existential choice between vulnerabilities caused by a perfect storm or a more insidious ideological problem deriving from shared assumption that led to regulatory capture and warning 'to the extent that we believe that there is a capture problem in financial regulation, reform efforts need to focus on taming politics, not technical regulatory questions. Future research should focus on identifying the most effective approaches to combat capture:' at 3). For official investigation, see IOSCO, *Principles for Financial Benchmarks Final Report* (Madrid, July 2013); Financial Stability Board, *Final Report on Foreign Exchange Benchmarks* (London, September 2014).

of historical interest. They are central to the dynamics and integrity of the contemporary regulatory system. Given the reality of global markets and national (or sub-national) regulatory structures, each governed by the complex interaction between rules, principles and social norms, much more robust restraining mechanisms were deemed necessary if the industry was to retain (or arguably) reclaim a social license to operate.

The FX Global Code, released in May 2017, attempts to transcend past limitations by reducing arbitrage within and across major wholesale markets.[7] The explicit goal is to bind market participants (both institutions and those with lawfully delegated authority within them to transact with and through the wholesale sector) to broader, if undefined, common ethical values. More importantly, it seeks to warrant actual commitment to these values through more effective – rather than merely efficient – risk management systems.[8] The re-balancing is designed to ensure the preservation of both the stated values of the institution (no longer necessarily believed at face-value) and the society it is transacting in or with (no longer acquiescing in previously settled determinations of legitimacy and authority or displaying generalised trust in the institutions charged with oversight over commitment to those obligations, whether public or private).

[7] *FX Global Code: A Set of Global Principles of Good Practice in the Foreign Exchange Market* (London 25 May 2017), available at http://www.globalfxc.org/docs/fx_global.pdf. he code should, however should not be read in a vacuum. The governance of financial benchmarks has been transformed, for example, since the emergence of the scandal. The British Banking Association was stripped of its oversight and the submission process became a regulated activity on I April 2013 (and seven further benchmarks in April 2015. Benchmarks are also subject to a EU Directive on Indices Used as Benchmarks Used in Financial Instruments and Contracts (Brussels, 4 December 2015), available at http://data.consilium.europa.eu/doc/ document/ST-14985-2015-INIT/en/pdf. In addition, Market Abuse Regulation and Criminal Sanctions for Market Abuse Directive have been amended to make manipulation of benchmarks illegal and subject to administrative or criminal sanctions. Progress is also subject to review by the International Organisation of Securities Commissions, see for example, IOSCO, *Second Review of the Implementation of IOSCO's Principles for Financial Benchmarks by Administrators of EURIBOR, LIBOR and TIBOR* (FR01/16, Madrid, February 2016), 2 (The Review saw evidence that all the administrators had developed and improved their policies and procedures in a number of areas including conflicts of interest, consultation with stakeholders and internal oversight.'). The IOSCO process is pivotal in that it embeds the operating principles across all markets and opens possibility of redress for breaches. In addition IOSCO has convened a task force to examine misconduct in the wholesale sector across six dimensions - honesty, integrity, conflicts of interest, competence, and communication and confidentiality, see IOSCO, *IOSCO Taskforce Report on Wholesale Market Conduct* (FR07/17, Madrid, June 2017), 2 (Noting the importance of the development of the FX Code, IOSCO states, 'while industry standards do not constitute legally binding rules or codes, such initiatives may be useful for providing more detailed guidance on accepted practices and help to foster private sector buy-in for improved conduct, particularly if there is publicly available information about market participants' commitments to abide by such standards, incentivizing more firms to ensure their practices comply with prevailing standards and are aligned with others in their industry').

[8] This approach mirrors a changed approach to supervision trialled by the Australian prudential regulator, see Australian Prudential Regulation Authority, *Risk Culture: A Discussion Paper* (Sydney, November 2016). This approach is agnostic on the specific culture of supervised entities. It seek, however, to ensure that the risk metrics deployed within the firm are appropriate to the level of risk that company is running in both prudential and conduct terms. Evaluating on the basis of effectiveness requires a redefinition of purpose, for philosophical underpinning, see M Carney, 'Three Truths for Finance,' (Speech Delivered at Harvard Club Dinner, Southwark Cathedral, 21 September 2015).

There can be no doubting the material need. As of March 2017, misconduct settlement costs associated with the Global Financial Crisis (GFC) and its aftermath stand at $320billion.[9] Of equal significance, the main FX and financial benchmark scandals – including the manipulation of LIBOR and its facsimiles in Europe, Hong Kong (HIBOR), Singapore (SIBOR) and Tokyo (TIBOR) – occurred after sovereign bailouts in critical western jurisdictions heralded the introduction of generic austerity measures, thereby socialising the cost of prior financial recklessness.[10] Yet, no board level executive has been prosecuted to a judicial conclusion.[11] The misfeasance and malfeasance occurred within and between many institutions whose very survival depended on overt and substantial public material support and notwithstanding public statements from the then (largely) unchanged leadership that change could be believed in.[12] The fact that the FX scandals post-dated the initial financial benchmark investigations provided further evidence of sub-optimal control. This is not a reflection of timing. Misconduct in the FX space continued notwithstanding formal investigation in functionally equivalent trading areas. The failure of senior management to take responsibility for anything more than regret was, as a consequence, to become unsustainable in theory and practice.[13] The deleterious praxis contributed, in part, to the rise of populist anger (across the political spectrum) and the derision of expertise.[14] It is of equal significance that throughout, prudential regulators had miscalculated the political risk, or deemed it not material in terms of immediate risk of banking failure. While

[9] See M Carney, 'Worthy of Trust: Law, Ethics and Culture in Banking,' (Speech delivered at the Bank of England Conference Centre, London, 21 March 2017), 2. There is, moreover, vast variation in penalties extracted through extra-judicial deferred prosecution agreements and enforceable undertakings, the result of significant gaps in legislative mandates and discretion. Australia, for example, has relatively low penalty regime with no power of disgorgement of profits.

[10] For discussion of mechanics of LIBOR manipulation, see D MacKensie, *Material Markets* (Oxford, 2011); Talley and Strimling above n4.

[11] See J O'Brien, 'The Facade of Enforcement: Goldman Sachs, Negotiated Prosecution and the Politics of Blame,' in S Will, D Brotherton and S Handelman (eds) *How They Got Away with It: Lessons from the Financial Meltdown* (New York, 2012); see also B Garrett, *Too Big To Fail: How Corporations Compromise with Corporations* (Cambridge, MA, 2016). For official justification not to prosecute RBS chairman for calamitous decision to buy ABN Amro at the peak of the boom because of deference to prevailing market norms, see Financial Services Authority, *The Failure of the Royal Bank of Scotland* (London, 2011). For trenchant rejection of the FSA argument, see J Loughrey, 'Breaching the Accountability Firewall: Market Norms and the Reasonable Director' (2014) 27 *Seattle University Law Review* 989.

[12] In 2010 seventeen senior financiers from the City of London, for example, signed a public pledge that 'ultimately, it is the responsibility of the leaders of financial institutions – not their regulators, shareholders or other stakeholders – to create, oversee and imbue their organisations with an enlightened culture based on professionalism and integrity. As leaders of financial institutions we recognise and accept this personal responsibility,' see M Agius et al, 'Financial Leaders Pledge Excellence and Integrity,' *Financial Times*, 29 September 2010, *available at* http:// www.ft.com/intl/cms/s/0/eb26484e-cb2d-11df-95c0-00144feab49a.html#axzz2C8HKL1jb.

[13] See *R v Hayes* (Sentencing Remarks, Southwark, London, 3 August 2015) 9. In sentencing UBS trader Tom Hayes 14 years for the manipulation of the London Interbank Offered Rates, Mr Justice Cooke noted 'the fact that others were doing the same as you is no excuse, nor is the fact that your immediate managers saw the benefit of what you were doing and condoned it and embraced it, if not encouraged it.'), available at https://www.judiciary.gov.uk/wp- content/uploads/2015/08/r-v-tom-hayes-sentencing1.pdf. For investigation of the Hayes case, see D Enrich, *The Spider Network* (London, 2017).

[14] See J O'Brien, 'A Question of Trust: Post-Truth Paradigms and the Future of Financial Regulation' (2017) 13 *Law and Financial Markets Review* 1.

the risk of a run was and remains low, the failure to manage the politics has had a profound impact on regulatory standing. It was clear something had to change. Notwithstanding its flaws, to be detailed below, the FX Global Code offers precisely that. It gives, when read in conjunction with the panoply of regulatory intervention through to reconsideration of potential future terms of negotiated prosecutions, wholesale participants the opportunity to provide warranted assurance in market integrity and commitment to societal progress on a scale not seen since the New Deal architecture was first developed in the United States (US).[15] The strategy is not without its risks, for market participants and regulators alike.

In doubling down on the benefits of the 'associational governance' model,[16] the code can be viewed using two very different heuristic lenses. The first, privileges the benefits of technocratic neutrality, the leitmotif of the administrative state.[17] This works on the assumption that a strengthened code of conduct could and should provide warranted public confidence. The second questions the wisdom of continuing a failed approach to regulatory design. It views the reform agenda as a last gasp attempt by a self-serving elite to keep open the proverbial last-chance saloon, the (inevitable) failure of which will inevitably further erode public trust.[18] Neither heuristic appreciates the dynamics of a subtle game being played for the highest stakes possible, and for which the rules of engagement have definitively changed. The Bank of International Settlements (BIS), in conjunction with private sector interlocutors, has created a risk management tool that combines, if lopsidedly, practical, empirical and normative dimensions. The combination is crucial. It leverages public shaming and economic sanctions within what *could* become vital diagnostic and evaluative instruments. The article demonstrates how the code *potentially* unites international and domestic imperatives by reducing arbitrage and enhancing accountability. It thus makes individual institutions and those who work within them more amenable to effective market conduct and prudential oversight. The transition from

[15] See J O'Brien, *The Triumph, Tragedy and Lost Legacy of James M Landis (*Oxford, 2014). The Federal Trade Commission, for example, was exceptionally sceptical, with cause about the intentions of industry in developing codes of conduct to be authorised by the National Recovery Administration. 'There is hardly an important form of monopolistic practices which the Federal Trade Commission and the courts have endeavoured to prevent in the past, that is not authorised and more or less explicitly provided for in these codes.,' see Millard E. Hudson, 'Memorandum for the Commission: Work at the NRA,' December 6, 1933, Papers of J.M. Landis, Harvard Law School, Box 18-8.

[16] See W Streeck and P Schmitter, 'Community, Market, State – and Associations: The Prospective Contribution of Interest Governance to Social Order' (1985) 1 *European Sociological Review* 119.

[17] For original and unsurpassed formulation, see J Landis, *The Administrative Process* (New Haven, 1938).

[18] See M Edelman, 'Symbols and Political Quiescence' (1960) 54 *American Political Science Review* 695; for what happens when trust lost, see M Edelman, *The Politics of Misinformation* (Cambridge 2000); for survey data showing progressive disillusion with institutions, particularly in the aftermath of the Global Financial Crisis, see (no relation) *Edelman Trust Barometer 2017* (New York, 2017). The survey, conducted across 38 countries by the world's largest PR company since 2012, shows market declines across business, government, the media and the NGO sector.

potential to actuality depends on whether the values professed are, in fact lived. And that is by no means a foregone conclusion as history attests.

The surest way to nudge such an outcome is through progressive integration with negotiated prosecution agreements, the strength of which depend on their contractual terms. These terms, to date, have been both weak and ineffective, notwithstanding an exponential increase in headline penalties extracted. If regulators were (rightly) criticised for not paying sufficient attention in advance of the crisis, their preference for easy headlines over substantive enforcement have made them subject to ridicule, not least by the judiciary itself.[19] One does not, however, have to be locked into such a desultory path-dependency. The solution lies in fusing *ex ante* and *ex post* imperatives and using the latter to provide an evidential basis for what constitutes fealty to the former. Part 2 outlines the code's parameters and highlights the creative ambiguity surrounding its apparent voluntary nature. As will be shown, the code and adherence to it is nothing of the sort. Part 3 explores how the insertion of binding moral commitment can have major positive impacts on the culture and ethics of the sector. Part 4 suggests that the power of the FX Global Code could be further strengthened by linkage to the deferred prosecution regime adopted by regulators and prosecutorial authorities in the US, the United Kingdom (UK) and Australia to deal with financial crime can have equally positive impacts on both. Part 5 concludes.

2. Coding Restraint: Rules, Principles and Cultural Values

The Global FX Code derives from an iterative process of engagement and collaboration within and between the public and private sectors. 'There are two important points worth highlighting: first, it's a single code for the whole industry and second, it's a global code. This is not a code for just the sell side. It is there for the sell side, the buy side, non-bank participants and the platforms; it reaches around the globe and across the whole industry,' announced Guy Debelle, Deputy Governor of the Reserve Bank of Australia (RBA) and Chair of the Markets Committee of the BIS in London on 25 May 2017. The code covers both FX currency as well as derivative trading, the platforms on which such trades are executed, and benchmark execution services. Crucially, it addresses the FX market as a complex ecosystem. The public side called on the expertise of central bank representatives, drawn from the 21 largest traded currencies (chaired by the RBA with the Federal Reserve Bank of New York responsible for code design and the

[19] See J Rakoff, 'The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?', *New York Review of Books*, 9 January 2014, available at http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why- no-executive-prosecutions.

Bank of England leading the stream on adherence).[20] A Market Participants Group brought together leading practitioners from across industry. This was a critical design decision.

No successful campaign can be prosecuted without recruitment of potential allies; no war can be won with troops, voluntarily committed or dragooned. Change could only occur if approached holistically. The initial framing extended the range of stakeholders, each with a direct (if divergent) interest in changing the structure of the industry.[21] Crucially, the calibration placed the sell-side major financial institutions at a strategic disadvantage. If the rules of the game were changing, the balance of power had to also. The major banks become one set of players among many. While their power in the marketplace was not reduced, power to direct the trajectory of debate was. Sources close to the negotiating process confirmed to this author the strategic reasons for this repositioning. These centre on prior demonstrable incapacity to meet community expectations (including the community that made up the wholesale market itself).[22] In part this reflects a structural problem, the dimensions of which are often lost in discussions of culture within complex business institutions (that is, multiple cultures exist within financial institutions).

The logic of residential and commercial banking, as well as the tenor and nature of risk, differs substantially from investment banking, which can be differentiated from trading operations, and which, in turn, may have differing norms, especially if the sub-units involved are taking proprietorial positions (that is, trading on behalf of the institution and thereby placing its own reputation on the line with transaction). Universal banking brings economies of scale. It may also intensify cultural difference particularly if business is conducted on a global level.[23] The internal

[20] The choice was inspired. Australia was one of the few western countries to emerge from the Global Financial Crisis relatively unscathed. The Federal Reserve Bank of New York on the other hand, under the leadership of Bill Dudley has been an active supporter of the ethics turn within the Financial Stability Board, see for example, B Dudley, 'Opening Remarks at Reforming Culture and Behaviour in the Financial Services Industry: Expanding the Dialogue,' (Speech delivered at the Federal Reserve Bank of New York, New York, 16 October 2016). The Bank of England, in turn, under Mark Carney's leadership has led the charge that effectiveness linked to reconceived purpose rather than efficiency alone should drive conduct, see Carney, above n9; see also *Fair and Effective Market Review (*London, June 2015). Crucially, Carney also leads the Financial Stability Board.

[21] The code is limited to the wholesale market. Similar initiatives are underway in relation to the retail market; see O'Brien, above n14. Unless the agenda of both the retail and wholesale sectors combine, however, there is a profound danger of compartmentalisation, undermining the efficacy and integrity of each and both. This exceptionally important given the size the scale of the industry. In Australia, for example, financial services accounts for 10% of the total economy and employs 417,000 people, with financial institutions accounting for 35% of the capitalisation of the ASX, see K O'Dwyer, 'Citibank A50 Australian Economic Forum,' (Speech delivered at Sydney Opera House, 10 February 2017).

[22] The rationale for establishing codes of conduct is subject to an extensive literature, see for example, I Mamic, *Implementing Codes of Conduct: How Business Manage Social Performance in Global Supply Chain Management (*Sheffield, 2004), 23-65; for application to the banking sector, see J O'Brien, 'Culture, Codes of Conduct and the Limits of Enforcement' (2014) 8 *Law and Financial Markets Review* 1; see also O'Brien, above n15. An additional fear is that the preference for industry driven codes of conduct lack the resources and power of the state and privilege symbolism over substance, see M Edelman, *The Symbolic Uses of Politics* (Urbana, 1964).

[23] The classic failure is in HSBC, which self-consciously markets itself as the world's local bank. Compliance failure in retail and commercial operations in the US, Mexico as well as wholesale problems in both the UK and Switzerland revealed a structural

control systems proved impervious to guaranteeing effective oversight through voluntary codes of conduct or compliance with formal (mandatory) licensing requirements.[24] The imposition of ever increasing fines were ineffective in shifting this dynamic, in part because the penalties were written off as part of the cost of doing business. In part, the failure also reflected a lack of calibration of reform initiatives (including mandated external supervision of corporate governance and risk management systems) to the needs and realities of how specific communities of practice operate, most notably within the trading rooms themselves. More direct forms of accountability were, therefore, required to address what Gillian Tett has pithily described as the problem of 'social silences.'[25]

Ascertaining the nature and justification of these silences is critical. They provide the underpinning heuristic framework that governs practice. It is a truism, for example, that people influence culture and culture, in turn, influences people. The policy question is how to render an alternative framework operational in a systematic, dynamic and responsive way. To be successful, regulatory efficacy needs to balance specific economic efficiency (that is, benefits to business) along with the awarding of rights to self-governance with the explicit proviso that society should not be held responsible (or liable) for the failures of the former.[26] In summary, the design needs to be capable of evaluating the calculative, social and normative reasons for behaving in a more (or less) ethically responsible manner: it requires reciprocal obligation from each institutional actor to maintaining (and certainly not contributing, through omission or commission, to the erosion of) the integrity of governance arrangements. At a systemic level, these must articulate common understandings of what constitutes the core ethical problem. Moreover, it must generate a framework in which subsequent disputes over interpretation can and should be resolved in a manner that is proportionate, targeted, and, ultimately, conducive to

problem associated with expansion through acquisition, see J O'Brien, 'HSBC: Will the Sword of Damocles Fall' (2015) 9 *Law and Financial Markets Review* 63; for discussion of the Mexico failures see J O'Brien, 'The Sword of Damocles: Who Really Controls HSBC in the Aftermath of its Deferred Prosecution Agreement with the Department of Justice' (2012) 63 *Northern Ireland Legal Quarterly* 533.

[24] For discussion of the multiplicity of cultures within organisations and the regulatory problems this causes, see J O'Brien, *Crashing Ashore: Scandal and the Future of Financial Regulation,* available at http://www.iosco.org/ media_room/?subsection=audiovisual. The failure of licensing to achieve accountability has prompted the introduction of a 'senior manager' regime in the UK as well as a rhetorical commitment to a (undefined) social licence to operate, see J O'Brien, G Gilligan, A Roberts and R McCormick, 'Professional Standards and the Social Licence to Operate: A Panacea for Finance or an Exercise in Symbolism' (2015) 9 *Law and Financial Markets Review* 222.

[25] G Tett, *The Silo Effect*: *The Peril of Expertise and Breaking Down Barriers* (New York, 2016) 45; see also P Bourdeiu, *The Logic of Practice* (Cambridge, 1990); for importance of ideationally-framed mindsets, see D Awrey and D Kershaw, 'Towards a More Ethical Culture in Finance: Regulatory and Governance Strategies' in N Morris and D Vines (eds), *Capital Failure: Rebuilding Trust in Financial Services* (Oxford, 2014).

[26] For application to business as an intangible asset, see J Petrick and J Quinn, 'The Challenge of Leadership Accountability for Integrity Capacity as a Strategic Asset' (2001) 34 *Journal of Business Ethics* 331; for original formulation of the model, see J Petrick and J Quinn, 'The Integrity Capacity Construct and Moral Progress in Business' (2000) 23 *Journal of Business Ethics* 3.

the building of warranted trust in the operation of the financial sector. As John Kay has astutely noted, 'the most powerful mechanism for establishing a culture of trust and respect is for intermediaries and market participants to impose it on each other. Conversely, the contagious effect of failure to observe these standards at any point in the investment chain undermines them at every point in the market and regulatory system of control.'[27] These more exacting criteria, therefore, are critical if one is to rebuild *warranted* trust in the trustworthiness of market participants.

Trust is at the core of the FX Global Code. It is informed by an explicit linkage of moral commitment – rather than legal obligation alone – to market integrity. Equally, no single institution could realistically be excluded, given that misconduct was systemic (although individuals subject to regulatory or criminal investigation could be in order to protect the integrity of the process. A vetting procedure was used on more than one occasion to reduce potential reputation damage if individuals intricately involved became subject to formal investigation). The framers placed essential first principles of honesty and fair-dealing. In some ways, this is not surprising. The principles constitute the 'non-calculative social contract' that underpins associated transaction, governance and legal frameworks, which is consistent with the lost normative foundations of institutional economics.[28] To be effective in a design with global application, however, these principles had to be universal and, therefore, capable of transcending discrete political, religious or cultural norms as well as demonstrable past failures to internalise the meaning of these principles.

From the beginning the framers found a receptive audience outside the major institutions that heretofore had driven both the operation of the market *ex ante* and *ex post* dispute resolution systems. From crony to casino capitalism to the impact of state capital on capital markets to the meltdown associated with the GFC, and irrespective of political culture, a common interest emerged in minimising price manipulation and limiting the transactional imperatives of the wholesale market. Given the complexity and the variegated nature of these transactions, along with divergent legal systems, there was recognition that confidence cannot be achieved by rules alone; rather, it requires the common and substantive commitment of repeat players to principle

[27] J Kay, *The Kay Review of Equity Markets* (London, July 2012), 47. According to Professor Kay, this necessitates a move away from short-termism, as 'trust and confidence are the product of long-term commercial and personal relationships: trust and confidence are not generally created by trading between anonymous agents attempting to make short term gains at each other's expense': at 5, available at http://bis.gov.uk/__assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf.

[28] See O Williamson, 'The New Institutional Economics: Taking Stock, Looking ahead' (2000) 38 *Journal of Economic Literature 595, 597.*

criteria that transcend legal obligation.[29] It is this common ground that provided much-needed industry support for reform. Sovereign Wealth Funds and State-Owned Enterprises may have deep pockets. They are also aware of their own vulnerability should political winds change in core markets.[30] Initial contestation over SWF activity, so apparent at the time of the bubble inflation leading to the GFC, dissipated with the need for liquidity to such an extent that the publication of the Santiago principles, allowing active shareholder engagement, received little scholarly, public or academic interest. In a way, this is not surprising. Questioning over state-owned enterprise involvement in capital markets was always, primarily, a geo-political question of how to deal with the rise of China.

Without effective harmonisation, however, there are profound risks of regulatory arbitrage.[31] In such circumstances, credible reform necessitates coordination and broad agreement on both the end goals and credible sanctions in the event on substantive non-compliance. To date, market participants (including, especially, the most powerful actors within the system) tend to rail against externally-imposed rigid restraints.[32] All too often, imposed without adequate consultation, these reforms can deepen contestation and entrench adversarial legalism, often

[29] See, for example, J O'Brien, 'On Culture, Ethics and the Extending Perimeter of Financial Regulation' in N Dorn (ed), *Controlling Capital: Public and Private Regulation of Financial Markets* (London 2016), 21-40 (outlining the power of the Nevada Gaming Control Board relative to the Financial Stability Board); for discussion of use of shaming, see B Richman, 'How Community Institutions Create Economic Advantage: Jewish Diamond Merchants in New York' (2006) 31 *Law and Social Inquiry* 383; B Richman, 'The Antitrust of Reputation Mechanisms: Institutional Efficiencies and Concerted Refusals to Deal' (2009) 95 *Virginia Law Review* 325. The essential point to consider is not that the diamond merchants are any more of less moral, rather they have found a way to use shame to transact around the compartmentalisation ethos in contemporary business life, see A MacIntyre, 'Social Structures and Their Threats to Moral Agency (1999) 74 *Philosophy* 311 ('Compartmentalization occurs when a distinct sphere of social activity comes to have its own role structure governed by its own specific norms in relative independence of other such spheres. Within each sphere, those norms dictate what kinds of consideration are to treated as relevant to decision-making and which are to be excluded:' at 322).

[30] See, for example, M Bowman, G Gilligan and J O'Brien, 'Foreign Investment Law and Policy in Australia: A Critical Analysis' (2014) 8 *Law and Financial Market Review* 65; M Bowman, G Gilligan and J O'Brien, 'Regulatory Contest in a Federal Context: Foreign Investment Regimes in Australia and Canada' (2015) 57 *Canadian Business Law Journal* 143.

[31] The classic example is how Ireland opposed and then used early adoption of EU directive on reinsurance to position itself as the leading venue for transactions that had the effect of manipulating earnings in major corporations from Australia to the United States, see J O'Brien, 'Dublin-Based Rogue Financier Brought to Book….in the US,' *Irish Times*, 19 February 2009, available at http://www.irishtimes.com/opinion/dublin-based- rogue-financier-brought-to-book-in-the-us-1.787655.

[32] The classic example is opposition to *Wall Street Reform and Investor Protection Act 2002* (Sarbanes-Oxley), described by Treasury Secretary Hank Paulson as introducing a thicket of regulation and threatening to reduce the attractiveness of New York vis-a-vis London; see Department of Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (Washington, DC, March 2008). The onset of the Global Financial Crisis forestalled the simplification agenda put forward by Treasury but not the simplification put forward by a grandiose Committee on Capital Markets, co-convened by high-profile academics at Harvard and Columbia, which did not foreground the source of funding for empirical research (Paulson himself). The loss of attractiveness privileged successive reports even as the system (and argument) collapsed under the weight of its own contradictions. The Committee now has a broad-ranging industry membership (although still includes a sprinkling of Harvard and Columbia academics. Its latest report suggests 'excessive regulation of US banks is the most significant deterrent to US growth,' see CCMR, *Roadmap for Regulatory Reform* (Cambridge, MA, May 2017), 4. Moreover, the CCMR suggests the addition of a mandatory comment process before signing up to international regulatory initiatives and no permission to sign unless empirically justified [from a cost-benefit perspective]: at 5.

itself the result of prosecutorial overreach.[33] Equally problematic, however, are alternative models of associational governance.[34] Participation in regulatory design does not necessarily deliver actual commitment to stated shared goals. To excuse the pun, concessions are merely banked. Protestations of change and lessons learnt are also, unfortunately, no longer enough. Ideational commitment or belief, moreover, may not trump the cold logic of empirical falsification.[35] It is in this context that the vaunted ambition of an attempt to use peer pressure to enhance the cultural underpinning and ethical and professional standing of the FX industry must be judged.

3. Transcending Myopia and Shepherding Trust

Media interest in and curiosity about how the FX Global Code could address the fundamental problem of what constitutes 'fair' treatment and 'effective' enforcement was notable by its absence. The settlement of 'historic' (2007-2013) FX abuse by BNP Paribas traders operating in New York, London and Tokyo who unselfconsciously self-described themselves as a 'cartel' twenty-four hours prior to the launch did little to inspire confidence (or, indeed, coverage).[36] Outside single articles in the *Financial Times*,[37] and *The Economist*,[38] the broadsheet press ignored a two-year negotiation to protect the fragile but critical FX ecosystem. Notwithstanding the importance of the City of London to the British economy, neither government nor opposition saw advantage in highlighting an unproven model in the run-up to a closely watched bitterly contested general election. The international news wires were equally underwhelmed at what may be perceived as mere tinkering at the margins of a discrete mode capitalism that subverts the stated purpose of finance to enrich society by facilitating with through and for its clients transactions that benefit the real economy.[39] Even national pride, recent settlement of FX market

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33 See J O'Brien, Redesigning Financial Regulation: The Politics of Enforcement (Chichester, 2007).

34 See Streeck and Schmitter, above n16.

35 See Levitin, above n6 at 55 (noting 'the real challenge for financial regulation is not in perfecting technical details such as the precise amount of capital required, but in taming the politics of financial regulation. Until and unless the capture problem in financial regulation is addressed, it is hard to believe that the financial regulatory system will produce the right technical answers.')

36 BNP settled allegations of 'almost unfettered misconduct' for $350m just twenty-four hours before the launch, see B McLannahan, 'NY Bank Regulator Hits BNP Paribas with $350m Fine in FX Case,' *Financial Times*, 25 May 2017, available at https://www.ft.com/content/f6bd1e49-cbdc-355c-a4f4-682c192bf7f7 . The statement of claim points out that the misconduct took place between 2008-2013 in New York and also involved employees in London and Tokyo as well as co-conspirators in other banks. According to the DFS Superintendent, Maria Vullo, BNP 'paid little or no attention to the supervision of its foreign exchange trading business, allowing … traders and others to violate New York State law over the course of many years and repeatedly abused the trust of their customers.'

37 K Martin, 'BIS Issues New Code of Conduct for Foreign-Exchange Trading,' *Financial Times*, 25 May 2017, available at https://www.ft.com/content/a4e122f3-be26-36ec-92a6-813656b28231.

38 *The Economist*, above n1.

39 See C Lagarde, 'Economic Inclusion and Financial Integrity,' (Speech delivered at Inclusive Capitalism Conference, London, 27 May 2014), 2 ('If inclusive capitalism is not an oxymoron, it is not intuitive either, and it is more of a constant quest than a definitive destination.').

manipulation charges and interlinked questions about why ongoing litigation involving three of the most influential domestic banks in alleged manipulation of the domestic Bank Bill Swap Rate (BBSW, the key benchmark in the Australian market) remained on the federal docket, could not raise the Australian media from its torpor.[40] This myopia, it is argued, is a mistake.

The code's aim is to promote 'robust, fair, liquid, open and appropriately transparent' markets within an infrastructure that allows for effective transactions at competitive prices 'informed by available market information and in a manner that conforms to acceptable standards.'[41] In a preamble, the Foreign Exchange Working Group makes clear the code 'does not impose legal or regulatory obligations on Market Participants nor does it substitute for regulation, but rather it is intended to serve as a supplement to any and all local laws, rules, and regulation by identifying global good practices and processes.'[42] Here again, one can excuse initial cynicism, particularly if one has an appreciation of history.[43] The FX Global Code structure, however, delivers much more than generic platitudes. It is designed to augment a journey of active reflection. It is underpinned by commitment to other-regarding impulses (assented to and asserted by the leaders of financial institutions themselves through personal certification).[44]

The code itself is split across six cross-cutting sections that include execution, information sharing, risk management and compliance, and confirmation and settlement. These are supported by an

[40] Similarly, the imposition of a levy on the major banks in Australia, announced in the budget, was justified by the Treasurer, Scott Morrison, not on risk or implicit subsidy but on the gauche rationale of public suspicion and derision. Public odium is not a credible basis on which to base policy, see O'Brien, above n14.The state government of South Australia followed suit by imposing its own levy on the major banks, a move condemned by the Australian Bankers Association as an unprincipled tax grab.

[41] *FX Global Code,* above n7, 1; for discussion of how these codes form a form of 'soft-law,' see M Eisenberg, 'Corporate Law and Social Norms' (1999) 99 *Columbia Law Review* 1253; for application to the Global Financial Crisis, see Loughrey, above n11.

[42] Ibid. In an explanatory aside the framers make clear compliance does not bind individual regulators nor provide a defence to applicable national law.

[43] Investment banking, for example, recruited the National Recovery Administration in the New Deal to ward off more invasive oversight from the Securities and Exchange Commission by making early concessions that faltered to deceive. For detailed discussion of the regulatory battles over codes of conduct in the New Deal, see O'Brien, above n15, 37-60. Similarly currently in Australia the Australian Bankers Association is calling for active endorsement of the regulator for its putative code of conduct, a call that should be treated, at this stage, with more than a modicum of salt, see O'Brien, above n14. This reservation should not be taken as fundamental opposition. Rather it is the absence of tangible promises the sector is prepared to make and credible mechanisms to ensure those promises are in fact kept.

[44] For a theoretical justification of other-regarding preferences, see L Stout, *The Shareholder Myth* (San Francisco 2012). Stout builds on the communitarian conception of the corporation and ultimately sides with Merrick Dodd over Adolphe Berle in the classic debate over duties and responsibilities, see M Dodd, 'For Whom Are Corporate Managers Trustees' (1932) 45 *Harvard Law Review* 145; see also A Berle, 'Corporate Powers as Powers in Trust' (1932) 44 *Harvard Law Review* 1049. Berle was later to admit that Dodd was correct, see A Berle, 'Foreword' in C Mason (eds) *The Corporation in Modern Society* (Boston, 1959). In many ways it is the defining problématique of corporate law and capital market regulation, see E Mason, 'Introduction' in E Mason (ed) *The Corporation and Modern Society* (Boston, 1959), 19 ('[T]he fact seems to be that the rise of the large corporation and attending circumstances have confronted us with a long series of questions concerning rights and duties, privileges and immunities, responsibility and authority, that political and legal philosophy have not yet assimilated.'). For industry assertion of responsibility to society and having a larger social and moral purpose than that which pertains in the trading room, Agius et al, above n12.

over-arching reliance on ethics and governance, namely: 'Market participants are expected to behave in an ethical and professional manner to promote the fairness and integrity (Principle 1),' and 'to have a sound and effective governance framework to provide for clear responsibility for and comprehensive oversight of their FX activity and to promote responsible engagement in the FX Market (Principle 4).'[45] Within this framework individual traders and units are expected to exercise 'care' in execution, promote 'clear and accurate' information, maintain a robust control and compliance environment consistent with organisational risks and promote predictable, smooth and timely settlement.[46] As Guy Debelle pointed out at the launch in London, 'the principles are written in plain language and should be easily read and understood by market participants. The principles are, in turn, supplemented by a suite of examples to illustrate their practical application.'[47] The examples do not represent an astatic rulebook. Rather, they begin a process of ongoing deliberation and calibration. This, in turn, is designed to develop more granular best practice guidelines germane to the mores of geographic markets and the micro-cultures of specific institutions operating within them. Iteration, therefore, is essential to the integrity and innovation behind the code design.

All too often codes can privilege generic statements impossible to disagree with. They can lack the granularity to guide practical decision-making within complex, fast-changing environments. This problem is a subset of a broader debate over whether rules or principles are more efficacious in instilling restraint. Both are essential, as is an understanding of the cultural mores of actual practice. It is important to note, for example, that even in at the peak of its dominance, the Financial Services Authority's use of high-level principles was undergirded by detailed regulatory guidelines.[48] On one level, this is not surprising. Values inform political choices. In some ways the electoral turn to populism reflects a return to the certainty of values in a time of fragmentation, instability and unpredictability. The problem is that the values expressed (or lived) by political parties and their operatives (and those who fund them) are not necessarily shared (or believed) by the populace. Electorates, not surprisingly given ongoing disappointment in regulatory capacity to deal with

[45] *FX Global Code*, above n7, 2.
[46] Ibid, 3 ('The term ["Market Participant"] includes any personnel [operating for or} on behalf of a Market Participant).
[47] G Debelle, 'Opening Remarks' (Speech delivered at the FX Global Code of Conduct Launch, London, 25 May 2017), available at https://www.rba.gov.au/speeches/2017/sp-dg-2017-05-25.html.
[48] See J Braithwaite, 'Rules and Principles: A Theory of Legal Certainty' (2002) 27 *Australian Journal of Political Philosophy* 47 (noting that rising complexity lowers the capacity of rules to influence or constrain behaviour); see also J Braithwaite and P Drahos, *Global Business Regulation* (Cambridge, 2000), 19-20 (noting that globalisation necessitates building frameworks on agreed foundational principles); see also R Baldwin, 'Why Rules Don't Work' (1990) 53 *Modern Law* Review 321.

systemic problems, are attracted to those pledged to uphold a return to lost traditional values (even if the candidates appear personally unlikely standard-bearers).[49]

As a consequence of this puritanical turn in contemporary politics, foundational principles can and should be articulated with more precision.[50] They must also be calibrated to address the specific tasks (and risks) facing specific communities of practice. As noted above, the culture of financial institutions, like so many other organisations, is not monolithic. Thirdly, fealty to those principles must inform remuneration policies. There is little point in rewarding people for breaking either the letter or underpinning purpose of the operating framework if one is seeking to demonstrate to a sceptical public that lessons have been learnt.[51] Of primary importance, as Mark Carney, Governor of the Bank of England, has caustically pointed out, 'codes are of little use if nobody reads, follows, or enforces them.[52] Finally, for the principles to have value in strengthening deliberative governance, they must be believed in.[53] Otherwise they privilege symbolism over substance.[54] It is to the credit of the code that all of these factors have been incorporated. This, in itself, is an advance.

[49] Neurologically, this can be reduced a nurturant parent or strict father framing, the first requiring consensus the second the erection of eternal barriers, see G Lakoff, *Moral Politics: How Liberals and Conservatives Think* (Chicago, 1996). The insight, ignored then remains ignored, see P Rosenberg, 'Don't Think of a Rampaging Elephant: George Lakoff Explains How the Democrats Helped to Elect Trump,' *Salon*, 15 January 2017, available at http:// www.salon.com/2017/01/15/dont-think-of-a-rampaging-elephant-linguist-george-lakoff-explains-how-the- democrats-helped-elect-trump/. Lakoff's insights inform recent ethnographic analyses of the US presidential election, see A Hochschild, *Strangers in Their Own Land: Anger and Mourning on the American Right* (New York, 2016); JD Vance, *Hillbilly Elegy: A Memoir of a Family and Culture in Crisis* (New York, 2016); A Goldstein, *Janesville: An American Story* (New York, 2017).

[50] Take, for example, the formulation put forward by Derek Parfit that it is essential to integrate utilitarian and categorical imperatives on ethical formulation: 'An act is wrong just when such acts are disallowed by the principles that are optimific, uniquely universally willable, and not reasonably rejectable,' see D Parfit, *On What Matters* (Oxford, 2011). While Parfit's formulation is highly abstract and, therefore, in need of appropriate contextualisation in terms of specific institutional purposes, standards and requirements, nevertheless it does describe moral parameters which are more or less universally acknowledged to be fundamental to the design of morally acceptable and socially sustainable human institutions, including markets; for discussion, see J O'Brien et al, 'Culture and the Future of Financial Regulation: How to Embed Restraint in the Interests of Systemic Stability' (2014) 8 *Law and Financial Markets Review* 115.

[51] For the rationale behind this approach, see Dudley, above n20 ('Incentives drive behavior, and behavior establishes the social norms that drive culture. If the incentives are wrong and accountability is weak, we will get bad behavior and cultures. This implies a role for both firms and supervisors. Firms need to continually assess their incentive regimes so that they are consistent with good conduct and culture. When they are not consistent, the incentives need to be changed. Supervisors should also play a role in assessing firms' incentive structures. How is compensation determined? In particular, is questionable conduct—such as compliance violations—consistently reflected in decisions about compensation and promotion? Do risk managers have the appropriate authority to challenge frontline revenue producers and prevent activity that is questionable? When that occurs, are there appropriate negative consequences for the frontline revenue producers? When people speak up to point out potential conduct issues, how are they treated? Are they held up as examples to emulate, or are they discouraged or even penalized? The answers to these questions should indicate whether incentives must be changed in order to foster the appropriate behaviors and culture.')

[52] Carney, above n9, 4.

[53] D Kennedy, 'Form and Substance in Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685.

[54] See J Landis, *Report Regulatory Agencies to the President Elect* (December 1960) 5 ('It must be remembered that we cannot regard our government as simply a government of laws and not of men, but rather a government of laws by men. Although the mechanisms we create for administration may be more or less well adapted to a particular task, the individuals that operate them singly or as a group have the ultimate responsibility of guidance and control. The results of their operations will thus reflect not only

It is unfortunate, however, that what constitutes the appropriate standards underpinning ethics and governance do not, at this stage, warrant substantive exploratory investigation, not least because purpose and justification for action above and beyond legal obligation lie within these domains. They remain deeply contested. It is no longer sufficient, for example, to suggest commitment to 'fairness' or 'integrity' the definition of which depends on the degree of expansiveness involved and purposive reading by regulators (and not necessarily the judiciary given the preference for settlement over judicial determination).[55] Acting within the law may well constitute acting with integrity. It may not. What constitutes professional conduct is disputatious, within recognised professions, never mind those who aspire to such an exulted status.[56] Likewise, the code calls for sufficient knowledge of applicable law, sufficient relevant experience, technical knowledge and qualification and evidence of applying with competence and skill.[57] Nowhere does it define what constitutes relevant knowledge, experience or evidence. Moreover, suggesting that conflicts of interest if not capable of being eradicated must be managed (and only if not managed effectively necessitate disclosure to a counter-party)[58] is part and parcel of a failed and failing regulatory paradigm.

Governance principles are similarly vague. Principle 4 encourages 'independent control functions and mechanisms to assess whether activities are conducted in a manner that reflects the Market Participant's operational risk and conduct requirements. Such functions should have sufficient stature, resources, and access to the body or individual(s) that is ultimately responsible for the Market Participant's FX business strategy and financial soundness.' It does not mandate that the governing body has itself (or should have) the requisite skill to evaluate the nature of those risks or the efficacy of the internal control mechanisms.[59] Principle 6 addresses the issue of remuneration but falls short of calling for positive incentive structures to not engage in particular transactions. Principle 7, likewise, privileges a somewhat mechanistic approach to risk management. External reporting reflects that the systems are in operation not whether they work. Equally, it is unclear

efficiency or inefficiency but more importantly the ideals and goals that within the framework of the basic law can fairly be achieved.'), available at https://www.ratical.org/ corporations/linkscopy/LandisRpt1960.pdf; see also Edelman, above n22.

[55] See n7 above.

[56] PCBS, above n5, 306 ('It is questionable whether the business of banking possesses sufficient characteristics of a profession to lend itself to direct control through a professional body.').

[57] FX Global Code, above n7, 7. This fails, in particular, to deal with the question of creative compliance, conduct which has legal support that while technically permissible derogates from undermining spirit of law and policy, see D McBarnett, 'After Enron: Corporate Governance, Creative Compliance and the Uses of Corporate Social Responsibility' in J O'Brien (eds), *Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets* (Chichester, 2005), 213; for application to the GFC, see D Kershaw and R Moorhead, 'Consequential Responsibility for Client Wrongs: Lehman Brothers and the Regulation of the Legal Profession' (2013) 76 *Modern Law Review* 26.

[58] *FX Global Code*, above n7, 7-8.

[59] Ibid, See also Principle 24: at 29. It is progress, however, that the Code while not invalidating strongly discourages review systems in which those invigilated set the compensation of the risk management or audit team.

whether the requirement for independent investigation of improper conduct is or should be independent from the firm in terms of setting the parameters of the investigation.[60]

Notwithstanding the lack of detail on ethics and governance there is considerable merit in the overarching design. The critical value rests on the potential provision of a database of how the actual governance structures of individual institutions mutate. While not explicitly stated, this normative dimension is critical. Guy Debelle outlines the normative arguments for self-regulation but bases it on the need for actual commitment by the industry to an agreed sense of purpose: 'Ultimately the success of the Code in promoting integrity and restoring confidence in the wholesale FX market lies in the hands of its participants.'[61] Moreover, important work has been done socialising the imperatives and dynamics of the process with more than 120 industry associations and key market infrastructure providers. This generates further pressure for substantive compliance by the main institutional actors. In the annexes a generic statement of institutional commitment is provided on the grounds that 'firms are more likely to adhere to the Code if they believe that their peers are doing so too.'[62] The BIS, in recognising the benefits of clothing power with a velvet glove, is, as a consequence, leaving little to chance. As previously signaled, central banks – essential counter-parties in the FX markets – will not transact with institutions that do not sign up to the code. While it is anticipated that the code's efficacy will be reviewed on an ongoing basis, it remains unclear what criteria is going to be used or whether performance of institutions or jurisdictions will be ranked. Arguably, however, nowhere can this be more effective than in the rejuvenation of the negotiated prosecution mechanism. Doing so is likely to enhance the accountability and responsibilities of each.

4. Enlisting Judicial Support in Regulatory Design

Deferred Prosecution Agreements (DPAs), Non-Prosecution Agreements (NPAs) and Enforceable Undertakings (EUs) have emerged as the preferred regulatory tools to deal with international financial institutions in the aftermath of the GFC. In some ways this is unsurprising. The externalities in terms of potential job losses associated with licence revocation mandate such an approach, notwithstanding the obvious structural compromises, the results of which were revealed from the collapse of Enron onwards but which the policy appeared powerless to address.[63] In part because

[60] See also Principle 25.
[61] Debelle, above n47.
[62] Debelle, above n47.
[63] See J O'Brien, *Wall Street on Trial* (Chichester, 2003), 272-273 (citing a 2003 interview with Robert Morgenthau, the legendary Manhattan prosecutor, that 'the system of corporate governance has broken down. In the past you had a guy acting largely on his own. Now you have a lot of people involved and that's the lawyers, accountants, executives, the board of directors. The kindest thing

of the revenue raised and the capacity to avoid costly legal battles with uncertain outcomes, the UK introduced a DPA regime, underpinned by the *Crime and Courts Act 2013* (the "Act"). The legislation received royal assent on 25 April 2013 and DPAs became an operational reality on 24 February 2014.[64] In January 2017, the President of the Queen's Bench Division handed out the third such agreement in a case involving Rolls Royce, making it explicit that the risk to employment was a decisive feature in allowing a DPA to proceed, notwithstanding the scale of corruption and bribery revealed (and how long it had been tolerated by the then senior management).[65] Australia has been experimenting with a similar form of deterrence – EUs – since the 1990s (although the voluntary payments to charities, which track the maximum penalties imposed in legislation for individual breaches, dwarf those in other jurisdictions, not least in the most recent benchmark and foreign

you can says is that they have all been asleep at the wheel. Regulators have to take some of the responsibility for not analysing what is going on.'). The passage of Sarbanes Oxley did little to address the problem as the focus on audit become a rent-seeking opportunity for the accountancy profession rather than a wake-up call. For discussion of how regulatory authority ebbed in the aftermath of the conflicts of interest and accounting scandals at the turn of the millennium, see O'Brien above n33.

[64] While the United States has gained prominence in the debate, the alternative approach canvassed by the United Kingdom offers subtle refinements, which may have the effect of dealing with a real accountability deficit. First, only organisations are eligible for DPAs unlike the US, where both individuals and organisations may be eligible. Second, and from the perspective of enhanced accountability, in the US the judiciary plays a limited role. Under the UK regime, an organisation and prosecutor must appear in a private hearing in Crown Court to gain judicial approval for DPA negotiations. The UK DPA Code has four core purposes. It provides guidance on how to negotiate with potential defendants; how to navigate the interaction with the judiciary; how to evaluate whether the mechanism is in fact fulfilling its objectives; and what to do in the event that the agreement is not seen as effective (i.e. should the terms be varied or should the agreement be voided and the case move direct to judicial adjudication). Among the critical questions raised by the code are whether the evidential and public interest tests are appropriate? What factors should a prosecutor consider and is the proposed level of disclosure appropriate? Should an external monitor be deployed and under what circumstances? These remain unresolved although the overriding emphasis on speedy and full disclosure is a key mediating factor, see *Serious Fraud Office v Rolls Royce PLC and Rolls Royce Energy Systems*, 17 January 2017, available at https://www.judiciary.gov.uk/wp-content/uploads/2017/01/sfo-v-rolls-royce.pdf.

[65] Ibid. According to Leveson P, 'it can properly be described as devastating and of the very greatest gravity that the conduct of this institution should fall to be examined within the context of a criminal investigation and that the investigation (in very large part conducted and voluntarily revealed to the SFO by Rolls-Royce itself) should reveal the most serious breaches of the criminal law in the areas of bribery and corruption (some of which implicated senior management and, on the face of it, controlling minds of the company:' at Para 4).

exchange investigations).[66] It is in the US, however, that the mechanism has been used to most significant impact in terms of headline penalties extracted.[67]

The entire process is not without its critics on both technical and normative grounds.[68] Can or should regulators seek to be more pro-active in guiding industry in advance of the external detection of misconduct? Should enforcement be used for wider demonstration effect, 'nudging' towards more granular articulation of how internal processes ensure stated values are indeed lived? In summary, can or should regulators seek *ex ante* to promote higher ethical standards or rely on *ex post* detection of malfeasance? And if the former, how does one measure effectiveness and ensure accountability? More practically, can regulatory and other prosecutorial agencies coordinate when, how and under what conditions they deploy the mechanism? Does the scale of the fine or granular articulation of what constitutes remedial reform enhance confidence? How does one ascertain whether this is taking place and is ongoing external oversight a pre-condition of success? In addressing the limitations associated with technical commitment to but derogation from the underpinning spirit of the law – creative compliance – what, ultimately, are the costs and benefits of creative enforcement in practical, normative and policy terms?

In practical terms, the deployment of the mechanism is straightforward. In contexts where a regulatory agency might take a civil action, or prosecution is invoked using the criminal code against

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[66] The issue of optimal penalty size has been a source of intense but unresolved debate in Australia; see S Mitchell, Australia 'Paradise' for White Collar Criminals Says ASIC Chairman Greg Medcraft,' *Sydney Morning Herald*, 21 October 2014, available at http://www.smh.com.au/business/australia-paradise-for-whitecollar-criminals-says-asic-chairman-greg-medcraft-20141021-119d99.html. A systematic review of the financial architecture conceded the need for 'substantially higher civil and criminal penalties' but vague as to by how much, see *Financial System Inquiry Final Report* (Canberra: Commonwealth of Australia, November 2014), 236. See Senate Economic References Committee, *Lifting the Fear and Suppressing the Greed: Penalties for White Collar Crime and Corporate and Financial Misconduct in Australia* (Canberra, March 2017) para 6.55-6.57 (recommending increase of civil penalties in line with comparable jurisdictions with capacity to be set in relation to multiples of the gains - or losses - of misconduct along with disgorgement powers). An ASIC Enforcement Review Taskforce was announced on 19 September 2016 and augmented by an Expert Panel, which is to table its recommendations in September 2017 (presumably its evaluation will be consistent with the IOSCO taskforce, see IOSCO (FR07/17), above n55, 3-4 (which determine efficacy on the following basis: 'Expectations of individual conduct are contained in jurisdictions' regulatory frameworks that comprise firm-level obligations, licensing and registration, regulatory supervision (including monitoring) and enforcement. In these frameworks, authorization, enforcement and supervision perform independent and mutually reinforcing functions. Integrating these different functions into a comprehensive regulatory framework is how market regulators deter, detect and respond to misconduct.'). Such rationality may, however, be too much to expect from what in Australia is a very politicised regulatory environment, made more so by the fact that the litigation against three of the major banks for alleged manipulation of the BBSW is scheduled to commence in the Federal Court in Melbourne in October 2017, one week before Medcraft steps down. The Commissioner responsible for running the case, Cathie Armour, has recently agreed to serve another term.

[67] See Garrett, above n11; see also A Barkow and R Barkow (eds), *Prosecutors in the Boardroom* (New York: New York University Press, 2011).

[68] Among those most virulently opposed to its application are those who most vigorously deployed it while in employ of the Department of Justice; see Evidence to the US Senate Sub-Committee on Crime and Drugs, 'Examining Enforcement of the Foreign Corrupt Practices Act,' 30 November 2010 (A Weissman), 5-6; see also J Copland, *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements* (New York, 2012); M Koehler, 'The Facade of FCPA Enforcement' (2010) 41 *Georgetown Journal of International Law* 907.

a target company, the agency can decide after consultation and agreement with that potential defendant, to not proceed, to suspend or dismiss any prosecution if agreed conditions are met. In most situations, the regulatory agency and the target company agree a history of the relevant events. Generally, a program for improved internal corporate governance is agreed, sometimes under the oversight of an external independent monitor (who may, or may not operate within publicly reviewable guidelines).[69] As a negotiating tactic, the mechanism can make sense for both the regulatory agency and the corporation alike. It does, however, run the further risk that the agreement is perceived as a cost of doing business rather than a substantive apology for ethical failure.

As a regulatory enforcement tool, the DPA/NPA has three key benefits to the regulatory agency. First, it has the capacity, if carefully designed, to change the behaviour of organisations.[70] This is achieved by mandating remedial action that can be subject to ongoing external review and in extreme cases regime change.[71] Second, it can be cost-effective. It forces an early resolution to complex litigation, thereby conserving resources. Third, as the UK has acknowledged, it can provide substantial income, which may or may not be dispersed to misled investors, or in the case of Australia revert to consolidated income or facilitate 'voluntary' payments to designated and agreed charities. On the other hand, however, there are three significant potential problems. First, the main criticism in the US is that these settlements have not tended to include an admission of wrongdoing, creating a two-tiered system of justice, although this is changing.[72] Such mechanisms can risk privileging what Judge Jed Rakoff of the Southern District of New York has termed the 'façade of

[69] See C Ford, 'Towards a New Model for Securities Law Enforcement' (2005) 57 *Administrative Law Review* 757, 797-802 (noting the mergence of the monitor as an agent of behavioural change); see also D Hess and C Ford, Corporate Corruption and Reform Undertakings: A New Approach to an Old Problem' (2008) 41 *Cornell International Law Journal* 307, 341 (noting the importance of industry experience but emphasising the necessity of being 'structurally and psychologically independent from the corporation' and having 'own repetitional capital at stake.'). The UK system is much more explicit about the independence of the monitor and the requirement to privilege it unless mitigating circumstances apply.

[70] In one of the most significant DPAs, involving KPMG's involvement in abusive tax shelters for high net-worth individuals the professional advisory firm was forced to pay a $494m fine, agree to imposition of an external monitor and exit that segment of the market, see O'Brien, above n33, 129-63.

[71] Regime change has rarely been pursued, for exception see the pursuit of the New York Attorney General Eliott Spitzer of the insurance company Marsh McLennan, examined in J O'Brien, 'The Politics of Enforcement: Eliott Spitzer, State-Federal Relations and the Redesign of Financial Regulation' (2005) 35 *Publius: The Journal of Federalism* 439.

[72] See Office of Senator Elizabeth Warren, Rigged Justice: 2016: How Weak Enforcement Lets Corporate Offenders Off Easily (Senate, Washington, DC, January 2016), 1 ('If justice means a prison sentence for a teenager who steals a car, but it means nothing more than a sideways glance at a CEO who quietly engineers the theft of billions of dollars, then the promise of equal justice under the law has turned into a lie.'). available at https://www.warren.senate.gov/files/documents/Rigged_Justice_2016.pdf; see also R Nadar, 'Open Letter to Attorney General Loretta Lynch: Prosecution of Guilty Pleas for Corporate Crime,' 10 January 2017 ('The recent trend of settling major corporate crime cases with deferred or non-prosecution agreements has undermined the criminal justice system and sent a message that we live in a society with a two tier system of justice – deferred and non prosecutions for the powerful, guilty pleas and jail for the powerless.'), available at https://blog.nader.org/2017/01/10/open-letter-to-attorney-general-lynch-prosecution-or-guilty-pleas-for-corporate-crime/. The following day the Attorney General announced that individual senior executives at Volkswagen would be indicted and the company accept criminal wrongdoing as part of $4.3bn deferred prosecution agreement, see L Lynch, Remarks at a Press Conference Announcing Criminal and Civil Actions Against Volkswagen' (Speech delivered at the Department of Justice, Washington, DC, 11 January 20127).

enforcement.'[73] The design problems identified by Judge Rakoff in 2009 were magnified in a case involving Citigroup in 2012, during which he refused to endorse the settlement. He complained that Citigroup was a 'recidivist' offender and in an influential article criticised the entire prosecutorial response to the GFC.[74] Second, the restraining influence of a negotiated prosecution depends on its contractual terms. This may reflect negotiating acumen or the lack thereof. Discrepancies in power, status and experience among the primary attorneys involved in negotiating outcomes are also relevant in this regard. Sharp deviance may also reflect the absence of or adherence to clear guidelines, notwithstanding repeated attempts by the Department of Justice to calibrate the methods used to prosecute corporations.[75] Thirdly, the capacity to effect meaningful change is, if not lost then certainly missed, if doubts can be expressed about a lack of accountability in the usage of the mechanism. Headlines do not a long-term reputation make or sustain in the absence of coherent and cohesive application of policy.[76]

With these problems and potential benefits in mind, it is appropriate to explore application in the case of financial benchmark and financial manipulation schemes. Here the evidence of efficacy is decidedly mixed. To date four NPA agreements have been brokered in relation to LIBOR manipulation (Barclays, UBS, RBS, Rabobank). A DPA was agreed with Deutsche Bank, with a subsidiary admitting guilt. Foreign exchange manipulation brought further guilty pleas and corporate probation agreements with RBS ($350million) JP Morgan Chase ($550million), Barclays ($650million), and Citicorp ($925million). [77] In the same litigation UBS was seen to have breached the terms of its earlier NPA in relation to LIBOR manipulation, and it agreed to plead guilty to the initial charge and accepted a further fine of $203m. The fine took into account the failure of the remedial action taken to improve risk management and compliance systems at the heart of the LIBOR case. (Barclays was similarly held to have breached its 2012 NPA and fined $60million for

[73] *SEC v. Bank of Am. Corp.,* 653 F. Supp. 2d 507, 510; for an Australian example of judicial disquiet, see *ASIC v Ingelby* [2012] VSC 332.

[74] See Rakoff, above n19.

[75] For latest manifestation, see S Yates, 'Memorandum for the Assistant Attorney General' (Washington, DC, 9 September 2015), available at https://www.justice.gov/archives/dag/file/769036/download. For review of inconsistency in application, see Government Accountability Office, *Use and Oversight of Deferred Prosecution Agreements and Non-Prosecution Agreements* (Washington DC, 25 June 2009).

[76] This was particularly apparent in the Department of Justice's handling of the KPMG case. For vehement judicial criticism, see United States of America v Jeffrey Stein et al, S1 05 Crim.0888 (LAK) 27 June 2006, 8 (in which Judge Lewis Kaplan admonished the DOJ for allowing its 'zeal to get in the way of its judgment. It has violated the Constitution it has sworn to defend.' The criticism entered on the Department mandating that as part of a deferred prosecution agreement KPMG would cease paying the legal fees of former partners involved in an abusive tax shelter case whose defence was that the strategy was approved by KPMG itself, for discussion, see J O'Brien, *Engineering a Financial Bloodbath* (London, 2009), 53-56.

[77] See Department of Justice, 'Five Major Banks Agree to Parent Guilty Pleas,' (Press Release, Washington, DC, 20 May 2015).

this violation).[78] In addition, the European Union has reached a settlement with major banks involved in corrupting benchmarks referencing LIBOR but denominated in the Euro and Yen with the Competition Directorate settlement referencing directly the extent to which collusion took place. In Australia, enforceable undertakings have been secured for both FX manipulation and distortion of the BBSW.[79] The UK has not formally applied the DPA mechanism to its resolution of benchmark and currency cases (taken in tandem with US authorities, as indeed was its resolution of the Rolls Royce case). There too, however, there has been considerable questioning of the rush to settle rather than prosecute to a judicial conclusion.

Transcending the limitations of rule-compliance approaches that mandate intervention only after an infraction has occurred, is a corporate as well as a public policy necessity. As the head of UBS, Andrea Urcel told the British Parliamentary Commission on Banking Standards: 'Regulators monitor, and control frameworks monitor and try to catch issues, *but the difference is made by the people who are on the front line*. They need to change their standards and abide by certain rules, not because they are imposed on them but because they believe in them.'[80] How to secure that mind set shift remains one of the most pressing issues in financial regulation and an externally monitored code of conduct offers the most advantageous way of doing so. It should be a prioritiy in cases moving forward that compliance or deviance form the FX Global Code are taken into consideration. This is particularly the case given the need for signed certification by the senior management of the market participant. Ignorance of actual practice, therefore, is no longer a defence. Moreover, any additional reporting requirements can have a wider demonstration effect, signaling to the broader industry expectations of what in fact constitutes substantive compliance.

[78] Ibid. The Assistant Attorney General, Leslie Caldwell argued 'we will enforce the agreements that we enter into with corporations. If appropriate and proportional to the misconduct and the company's track record, we will tear up an NPA or a DPA and prosecute the offending company.'

[79] The Australian Securities and Investments Commission (ASIC) has accepted enforceable undertakings deriving from deficiencies in FX Spot market trading from National Australia Bank (making a community benefit payment of $2.5 million towards advancing financial literacy education related to the aged care sector and the promotion of ethical behaviour in Australian financial markets' and Commonwealth Bank of Australia (making 'a community benefit payment of $2.5 million towards advancing financial literacy education related to the aged care sector.' (16-455MR, 21 December 2016); Westpac ($3m payment to charity promoting financial capabilities of victims of domestic abuses) and ANZ ($3m to Financial Literacy Australia) (17-065MR, 15 March 2017); and Macquarie ($2m payment to a charity promoting young people's knowledge of money management (17-144MR, 19 May 2017). In addition, ASIC concluded three EUs in relation to manipulation of the Bank Bill Swap Rate - UBS (13-366MR 23 December 2013); BNP Paribas (14-014, 28 January 2014) and RBS (14-169MR, 21 July 2014). The banks made 'voluntary contributions' of $1m, S41m and $1.6m respectively to fund independent financial literacy programs. Failed attempts to negotiate a settlement means that Westpac, NAB and ANZ face charges of manipulating the BBSW, with the case due to be heard in October 2017.

[80] Evidence of Andrea Urcell, Parliamentary Commission on Banking Standards Public Hearing (Ev 322, Westminster, 9 January 2013).

5. Conclusion: The Politics of Nudging

While cultural change within these institutions and across wholesale markets is likely to be slow, we have to find concrete mechanisms that can further embed restraint and encourage higher ethical standards. In the announcement accompanying the guilty pleas in relation to the FX Market, US Attorney General Loretta Lynch was purposively expansive: 'The penalty these banks will now pay is fitting considering the long-running and egregious nature of their anti-competitive conduct. It is commensurate with the pervasive harm done. And it should deter competitors in the future from chasing profits without regard to fairness, to the law, or to the public welfare.'[81] Unfortunately there is no evidence that fine escalation has had any demonstrable impact on policy, although the decision to add corporate guilty pleas may prove more efficacious if problematic. It is indicative, for example, that one of the main reasons why the BBSW cases in Australia have not reached a settlement is the determination by the chair of the Australian Securities and Investments Commission that the banks admit wrongdoing. Given the realities of the class action market in Australia, where litigation funders are listed on the stock market, this opens the possibility of further litigation risk that the banks fear.

A further refinement of the NPA/DPA process in the US is worth commenting on. The Department of Justice introduced a new provision that mandated that the settlement would be publicly disclosed to all of their customers and counter-parties. This fits neatly with the shaming mechanism envisaged in the FX Global Code of Conduct. The banks involved, therefore, have a direct vested interest in demonstrating how cultural change has been embedded. Further evidence could be provided if the remedial corporate governance and risk management reforms undertaken were reported on in a much more granular and systematic manner and made publicly available. It is indicative of a lack of transparency, for example, that the external monitor report in the HSBC Mexico case, for example, which includes a review of global operations, has not been made public.

It was never realistic to assume that major financial institutions would be prosecuted to a judicial conclusion given the potential externalities involved in cases of licence revocation. This did not mean, however, that regulatory and prosecutorial authorities were powerless to effect change. In large measure they declined to use latent power (either through nationalisation in the UK, a condition of participation in the Troubled Assets Recovery Program or through stringent contractual terms in application of the DPA/NPA mechanism in the US or EU regimes, or in Australia). This was a mistake. The FX Global Code offers an appropriate mechanism to both evaluate the extent to

[81] Department of Justice, above n77.

which compliance programs actually work and a laboratory for the testing of further reform by trialing more stringent conditions that if work could become part of industry best practice. It is now time for the wholesale markets to demonstrate their word is indeed their bond.

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