Anything for You Big Boy: A Comparative Analysis of Banking Regulation in the United States and the United Kingdom in Light of the LIBOR Scandal

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Anything for You Big Boy: A Comparative Analysis of Banking Regulation in the United States and the United Kingdom in Light of the LIBOR Scandal

By Christopher Hall*

Abstract: In June 2012, Barclays Bank PLC entered into a settlement agreement with the United Kingdom’s Financial Services Authority and the United States’ Commodities Futures Trading Commission that settled Barclays’s role in manipulating the London Interbank Offered Rate, or LIBOR. The Barclays episode, and related scandal, provides an opportunity to examine approaches to financial regulation in the United Kingdom and the United States. This Note uses that opportunity to compare and contrast the approach to financial regulation in the United Kingdom and the United States. In particular, this Note contends that the LIBOR scandal reveals three problems with the then-existing approaches to financial regulation in the United Kingdom and United States. The three issues presented are 1) a problem with the people involved in setting LIBOR; 2) a problem with the publicity that banks face when they submit their rates to LIBOR; and 3) a problem with the way LIBOR is calculated that allows it to diverge too far from market realities. This Note also argues that the “light-touch” approach that characterizes financial regulation in the United Kingdom should be combined with the more intensive approach to regulation found in the United States. The Wheatley Review of LIBOR is held up as an example of this hybrid approach. This Note proceeds by first briefly presenting the history of LIBOR as well as presenting an account of the manipulation. The Note then reviews the structure of financial regulation in the United Kingdom, with special attention paid to the recent Wheatley Review of LIBOR. This Note presents a similar account of financial regulation in the United States, before comparing and contrasting the two approaches. This comparison generates the primary thrust of this Note’s argument that the two approaches should be combined. Before concluding, this Note deals with several counter-arguments. The conclusion then explains how the Wheatley Review embodies the hybrid approach advocated in this Note.

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I. INTRODUCTION

In late June 2012, the United Kingdom’s Financial Services Authority (FSA) and Barclays Bank PLC (Barclays) announced a settlement agreement in which Barclays agreed to pay a fine of £59.5 million ($92.8 million U.S. dollars) and acknowledged its role in manipulating the London Interbank Offered Rate (LIBOR).\(^1\) Shortly thereafter, the United States Department of Justice (DOJ) and Commodity Futures Trading Commission (CFTC) each announced similar settlements.\(^2\) All told, Barclays paid nearly half a billion dollars to settle with British and American authorities for its role in manipulating LIBOR.\(^3\) In late 2012 and early 2013, similar

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\(^3\) Alexandra Alper & Kristin Ridley, Barclays Paying $453 Million to Settle LIBOR Probe,
settlements were announced with both the Royal Bank of Scotland and UBS.4

This Note focuses on the structure and philosophy guiding banking regulation in the United States and the United Kingdom in light of the LIBOR scandal. The LIBOR scandal provides an interesting opportunity to compare the approaches that the authorities in the United States and the United Kingdom have taken in regulating an increasingly complex financial system. This Note argues that the LIBOR scandal reveals at least three problems that can be used to evaluate financial regulation: (1) a problem with the motivations of the people involved in manipulating LIBOR; (2) a publicity problem that makes banks fear honesty; and (3) a reality problem that lets rate setting become too divorced from real-world transactions.

This Note further argues that the “light-touch” approach to financial regulation that has guided regulators in the United Kingdom for much of the twenty-first century, which is characterized by a cooperative, principle-based approach to regulation,5 ought to be reasonably combined with the more intensive regulatory scheme of the United States to arrive at a hybrid solution. In responding to a few objections to regulation in the light of the recent financial crisis, as well as some empirical data on the impact of financial regulation and economic performance, I argue that this hybrid approach can prevent future rate-rigging without stifling growth. I also contend that the recommendations of the Wheatley Review6 embody this hybrid approach by addressing some of the causes of the LIBOR scandal without completely abandoning the light-touch approach to economic regulation.

This Note proceeds in seven parts. Part II follows this introduction and presents a brief history of LIBOR and a discussion of its significance in the global marketplace. Part III explains the facts of the LIBOR rate-rigging scandal. Part IV reviews the British approach to financial regulation both before and after the LIBOR scandal. This part also discusses how the traditional approach to banking regulation in the United Kingdom is changing in the face of the scandal. Part V presents the U.S.

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6 See infra Part IV.B.
financial regulation framework and two of the agencies involved in the LIBOR scandal: the CFTC and the DOJ.

Finally, Part VI uses the LIBOR scandal to highlight some of the relevant differences and similarities of the U.K. and U.S. approaches to banking regulation. Ultimately, this Note suggests that a combination of the two approaches is best. It also considers an objection to this hybrid approach and uses some empirical data to evaluate the argument and the objection. Finally, this Note argues that a hybrid position is largely embodied in the recommendations of the Wheatley Review because these recommendations provide for stronger oversight while not stifling economic growth. Part VII concludes by providing a summary of this Note’s main argument.

II. THE HISTORY AND SIGNIFICANCE OF LIBOR

LIBOR was created in the mid-1980s, when banks developed increasingly complex trading instruments that allowed them to participate in a variety of transactions. Generally, these transactions involved trading currency futures with each other.\(^7\) While these investment vehicles were attractive, many of them relied on interest rate agreements that had to be ratified before a contract could be signed.\(^8\) The British Bankers Association (BBA) created LIBOR in 1984 as a response to this problem and as a means to standardize the rate-setting process.\(^9\)

At its inception, the BBA calculated LIBOR by averaging responses from participating banks to the question: “At what rate do you think interbank term deposits will be offered by one prime bank to another prime bank for a reasonable market size today at 11am?”\(^10\) In 1988, the BBA updated this question to ask: “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?”\(^11\)

Thompson Reuters, who calculates the rate on behalf of the BBA, performs the LIBOR calculation daily after participating banks submit their responses.\(^12\) The calculation ignores the highest and lowest quartiles of submissions and averages the remaining submissions. The result is the

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\(^8\) *Id.*

\(^9\) *Id.*

\(^10\) *Id.*

\(^11\) *Id.*

\(^12\) This change was driven by a consensus that the notion of a “prime bank” was no longer meaningful. See *id.*

LIBOR rate for that day. At the time of the scandal, the BBA offered the LIBOR rate for ten different currencies with a variety of different hypothetical loan durations, varying from overnight to twelve months. Thus, 150 different LIBOR rates are actually calculated each day.

Although originally created as a tool for interbank lending, LIBOR has been widely used as a financial benchmark. According to the CFTC, use of LIBOR includes “U.S. based swaps transactions and futures contracts, as well as home mortgages and commercial and personal consumer loans.” The value of “Forward Rate Agreements” between banks, based on LIBOR, had a value exceeding $500 trillion by the end of 2011. In other words, LIBOR has implications for wide ranging classes of borrowers “from Russian oil producers to homeowners in Detroit . . . . Fibbing by banks could mean that millions of borrowers around the world are paying artificially low rates on their loans.” It is no wonder that allegations of rate-fixing have gained such widespread attention.

III. THE STORY OF THE LIBOR RATE FIXING SCANDAL

As mentioned in Part II, the BBA derives LIBOR from responses submitted by individual banks to a hypothetical question. Since those responses were not linked to transactional data, they were not based on actual market conditions. This lack of connection to empirical trading data left LIBOR open to manipulation by those responsible for determining its value.

Although Barclays is not the only bank guilty of LIBOR manipulation, it was the first bank to enter into a LIBOR-related settlement with the FSA and CFTC. Accordingly, the relevant authorities have laid out the facts of

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13 Id.
15 Id.
17 Id. A Forward Rate Agreement is a contract that sets the interest to be paid between parties for an obligation that has a future start date. See Forward Rate Agreement, INVESTOPEDIA, http://www.investopedia.com/terms/f/fra.asp#axzz2LSZfgoX (last visited Feb. 16, 2013).
20 The Barclays settlement was announced in June 2012, the RBS and UBS settlements followed several months later. For a timeline of events surrounding the scandal, including when the settlements were announced, see Timeline: LIBOR-fixing Scandal, BBC NEWS (Feb. 6, 2013) http://www.bbc.co.uk/
Barclays’s case more clearly and made those facts available for analysis longer than the facts surrounding manipulation at other banks. This Note uses Barclays as a proxy to explain how and why various persons and institutions manipulated the LIBOR rate.

On June 27, 2012, the FSA announced its settlement with Barclays.21 In its findings, the FSA charged Barclays with inappropriate LIBOR submissions, alleging that Barclays’s LIBOR submissions were fraudulent for two reasons. First, the FSA found that “Barclays acted inappropriately on numerous occasions between January 2005 and July 2008 by making US dollar submissions . . . that took into account requests made by its [own] interest rate derivatives traders.”22 Barclays’s LIBOR submissions also considered requests from derivatives traders from other banks.23 Second, the FSA found that Barclays had manipulated LIBOR submissions by “taking into account concerns over the negative media perception of Barclays’s LIBOR submissions.”24 LIBOR submissions are supposed to be formed only as a response to the prompt question. Consideration of either of these factors was therefore inappropriate because neither factor was directly related to the cost of borrowing money.25 The CFTC’s charges and findings in the United States echoed those of the FSA.26

A. Manipulations of LIBOR at the Request of Traders

Barclays made its LIBOR submissions through its London Money Market Desk, where a small number of individuals were charged with submitting the bank’s daily LIBOR responses.27 At the time, the Money Market Desk was charged with “manag[ing] Barclays’s liquidity position and . . . ensur[ing] that Barclays [was] fully funded each day in all currencies . . . .”28 Both the FSA and CFTC found that Barclays did not have sufficient internal controls or monitoring in place to determine how these submitters should operate.29

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21 See Final Notice to Barclays, supra note 1.
22 Id. at 2. For an analysis of the FSA finding, see infra Part III.A.
23 Id.
24 Id. at 3.
25 Id.
27 See id. at 7. According to the CFTC, one Senior LIBOR submitter was primarily assisted by another, more junior money market trader. Id. at 7. It is not clear exactly how many Barclays employees were involved in the process of submitting LIBOR rates.
28 See id.
29 See id. Noting that Barclays did not have any controls or procedures in place that detailed how LIBOR submissions should be determined or monitored. See also Final Notice to Barclays, supra note
On many occasions, from at least the middle of 2005, traders with connections to the Barclays Money Market Desk would send requests that Barclays change their LIBOR submission that day. Traders would generally ask for either a direction for manipulation or a specific number the requestor hoped to see Barclays submit. Because of the way LIBOR was calculated, Barclays’s submission of a particular rate number had the potential to influence the official LIBOR rate for that day. For example, a trader who held a position that would benefit from a lower LIBOR might ask the Barclays Money Market Desk to lower its submission that day so that the trader’s position benefited. Some of the specific messages highlighted by the CFTC concerning the one month (1m) and three month (3m) LIBOR show how transparent these requests were:

“Your annoying colleague again . . . Would love to get a high 1m Also if poss a low 3m . . . if poss . . . thanks” (February 3, 2006, Trader in London to Submitter).

“Hi Guys, We got a big position in 3m libor for the next 3 days. Can we please keep the libor fixing at 5.39 for the next few days. It would really help. We do not want to fix any higher than that. Tks a lot.” (September 13, 2006, Senior Trader in New York to Submitter).

The record leaves no doubt that the submitters at the Money Market Desk responded to these requests. Sometimes, Barclays’s LIBOR submitters would respond generally that they would “do [their] best.” Other times, the submitters would specifically confirm that they had made a change in response to a request or would tell the trader exactly where they planned to set their LIBOR submission:

1, at 3.
32 Id. at 9–10. These communications occurred almost entirely over email or instant messaging programs, so the original message formatting is retained above in order to illustrate the lack of formalities in these messages. They suggest an extremely close and informal relationship between traders benefitting from specific LIBOR rates and the Barclays employees in charge of setting those rates. The FSA specifically noted “[t]he routine nature of requests demonstrates that the Derivatives Traders considered Barclays took their requests into account when determining its submissions.” Final Notice to Barclays, supra note 1, at 12.
33 In re Barclays PLC, Barclays Bank PLC & Barclays Capital Inc., CFTC Docket 12-25, 10 (June 27, 2012).
“Am going 13, think the market will go 12-12 ½.” (November 14, 2005, Submitter’s response to a swaps trader request for a very high one-month U.S. Dollar LIBOR submission, preferably a submission of “13+”).

“Done . . . for you big boy . . .” (April 7, 2006, Submitter’s response to swaps trader requests for low one-month and three-month U.S. Dollar LIBOR). 34

In response to this acquiescence by Barclays’s LIBOR submitters, traders often expressed profound gratitude. 35 The overall picture is one of a close working relationship between Barclays’s LIBOR submitters and the traders who stood to benefit one way or another by changes in LIBOR. Both the CFTC and the FSA found that this relationship led Barclays to submit LIBOR rates that impermissibly considered external factors and were not simply in response to the prompt question that the BBA used in defining LIBOR. 36

B. Manipulation of LIBOR at the Request of Barclays’s Management

Barclays derivative traders were not the only employees applying pressure on the bank’s LIBOR submitters. Both the CFTC and FSA found that Barclays’s management pressured its LIBOR rate submitters to set rates based on public image as it related to the perceived link between its LIBOR rate-submissions and the bank’s financial health.

During the sub-prime mortgage crisis of 2008, there was considerable worry about the health of individual banks and their ability to withstand the crisis. 37 This fear affected Barclays’s LIBOR submissions in several ways. Barclays did not “want to report the high rates they [were] paying for short-term loans because they [did not] want to tip off the market that they [were] desperate for cash.” 38 Barclays’s managers apparently believed that an appearance of desperation could result from the way LIBOR is calculated. 39

A bank might appear desperate because the LIBOR rate it submits is supposed to represent the cost of currency to that bank, but because banks

34 Id.
35 For instance, one trader exclaimed, “Dude. I owe you big time! Come over one day after work and I’m opening a bottle of Bollinger.” Final Notice to Barclays, supra note 1, at 19.
36 Id. at 22; In re Barclays PLC, Barclays Bank PLC & Barclays Capital Inc., CFTC Docket 12-25, 11 (June 27, 2012).
37 Final Notice to Barclays, supra note 1, at 23.
38 Mollenkamp, supra note 18.
39 Id.
tend to charge struggling institutions a higher rate, a higher rate submission could be seen as a sign that the bank was struggling financially. If the market believed that Barclays was paying more to borrow than other banks, the market might view that as a sign that Barclays was struggling to survive. That perceived weakness would hurt Barclays’s ability to raise capital or otherwise be competitive in the marketplace. Additionally, because of the financial crisis, lending between banks had come to a virtual standstill, leaving very few transactions to compare a bank’s quoted LIBOR rate and the rate they were actually paying to borrow money. In other words, due to the lack of real-world transactions, there was no way to verify the truthfulness of a bank’s statement on what borrowing money might cost them.

Banks’ fears that their LIBOR submissions could be viewed as a sign of weakness had some basis in reality. A September 2007 blog post on the influential business website Bloomberg.com pointed to a Barclays LIBOR submission—which was the highest on the U.S. dollar LIBOR panel—as a sign that Barclays might be having liquidity problems. It then asked, “So what the hell is happening at Barclays and its Barclays Capital securities unit that is prompting its peers to charge it premium interest rates in the money market?” This kind of media scrutiny makes banks’ fears more understandable. Additionally, Barclays believed that banks were unfairly submitting numbers that were too low for market conditions and expressed their concerns to both the FSA and BBA.

Nevertheless, in an effort to avoid negative media attention, Barclays’s management gave specific instructions to the effect that Barclays “should not ‘stick its head above the parapet’ in terms of its LIBOR submissions.” In other words, Barclays did not want to risk being seen as financially weak by submitting LIBOR rates that might attract unwanted attention. The FSA and CFTC each found that Barclays’s consideration of media reports and its public image were also impermissible under the definition of LIBOR.

The Barclays episode reveals three distinct problems. First, because of the close relationship between LIBOR submitters and those who benefit from their submissions, there is a distinct “people problem” where personal relationships and personal gains incentivize manipulation. Second, there is
a corresponding “publicity problem” since the submitting institution has an incentive to manipulate its submissions to influence public perception of the institution’s health. Finally, there is an identifiable “reality problem” that stems from the hypothetical nature of the LIBOR submission process. Because LIBOR has not been tied to real-world transactions, it lacked a means to verify the numbers that banks submit. These three problems are revisited below as a means of analyzing the different approaches to banking regulation in the United Kingdom and the United States.

IV. BANKING REGULATIONS IN THE UNITED KINGDOM

This part discusses the structure and philosophy of financial regulation in the United Kingdom. Subpart A presents the Financial Services Authority and its guiding policies articulated prior to the LIBOR scandal. After the LIBOR scandal became known, authorities in the U.K. created the Wheatley Review (Review) to examine LIBOR and suggest improvements. The Review represents a break from the guiding philosophy of the pre-LIBOR scandal era. Subpart B presents the Review and the corresponding changes in financial regulation in the United Kingdom.

A. The Financial Services Authority

The main financial regulator in the United Kingdom is the Financial Services Authority, “a one-stop regulatory shop for virtually all aspects of financial services in the United Kingdom.” Parliament created the FSA when it passed the Financial Services and Markets Act of 2000 (FSMA). Parliament enacted the FSMA in order to “provide for a single, statutory, financial service regulator . . . .” The FSA is thus the result of an intentional effort to simplify the United Kingdom’s regulatory structure.

Banking supervision responsibilities were transferred from the Bank of England to the newly created FSA in the Bank of England Act 1998. The Bank of England gained statutory authority to regulate banks in the

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46 See The Chancellor Has Commissioned Martin Wheatley to Undertake a Review of the Framework for the Setting of LIBOR, HM TREASURY (July 30, 2012), http://www.hm-treasury.gov.uk/wheatley_review.htm. The Wheatley Review was named after Martin Wheatley, a former director of the FSA and the current head of the newly created Financial Conduct Authority.


49 Id.

United Kingdom in 1979.51 Until then, the regulatory relationship between
the government and banks had only been informal.52 Hesitancy to invoke
statutory authority in regulating banks exemplifies the general approach of
self-regulation that the United Kingdom has taken toward financial
institutions.

The FSA is operationally independent from the government of the
United Kingdom.53 A Treasury-appointed board governs the FSA and this
board is headed by an executive chairman.54 Perhaps most striking is the
fact that the FSA is not funded by the government of the United Kingdom.
Instead, it is “funded entirely by the firms [it] regulate[s].”55 Although it is
operationally independent, the FSA reports to Parliament annually.56

The FSMA provides four guiding principles to direct the FSA’s
operation.57 The FSMA charges the FSA with: (1) maintaining confidence
in the U.K. financial system;58 (2) contributing to the protection and
enhancement of the stability of the U.K. financial system;59 (3) securing the
appropriate degree of protection for consumers;60 and (4) reducing the
extent to which it is possible for a business carried on . . . to be used for a
purpose connected with financial crime.61

In order to guide the firms it regulates, the FSA published a handbook
which includes principles that “are a general statement of the fundamental
obligations of firms under the regulatory system.”62 These general
principles are the standard by which the FSA measures financial firms in
the United Kingdom. Violation of the principles exposes a firm to

51 See Marianne Ojo, The Financial Services Authority: A Model of Improved Accountability?,
52 See id.
54 The Board, FIN. SERV. AUTH., http://www.fsa.gov.uk/about/who/board (last visited Nov. 18, 2012);
Management Structure, FIN. SERV. AUTH., http://www.fsa.gov.uk/about/who/management (last
visited Nov. 18, 2012).
55 Who Are We?, supra note 53. Although striking, the potential conflict of interest is outside the
scope of this paper. The funding structure of the FSA can be compared with the structure of the BBA,
LIBOR’s parent organization. The BBA is “the leading trade association for the [U.K.] banking and
financial services sector.” See About Us, BRITISH BANKERS ASS’N, http://www.bba.org.uk/about-us
(last visited Nov. 18, 2012).
56 Cole, supra note 47, at 268.
57 Id.
58 Financial Services and Markets Act, 2000, c. 8, § 3 (U.K.).
59 Financial Services Act, 2010, c. 28, § 1 (U.K.) (amending the Financial Services and Markets
Act of 2000 to include financial stability as an objective). See also Statutory Objectives, FIN. SERV.
60 Financial Services and Markets Act, 2000, c. 8, § 5 (U.K.).
61 Financial Services and Markets Act, 2000, c. 8, § 6 (U.K.).
62 FIN. SERV. AUTH., FINANCIAL CONDUCT AUTHORITY HANDBOOK princ. 1.1.2 (2013),
disciplinary sanctions. It was these “Principles of Businesses” that Barclays violated in the LIBOR scandal, specifically Principles Two, Three, and Five. The FSA has been an advocate for this principles-based approach towards regulation where “the focus is on the outcomes rather than on the prescription of detailed rules.”

As a matter of policy, the guiding principle behind the FSA’s enforcement branch prior to the LIBOR scandal has been a light-touch approach to regulation. Regulators using the light-touch approach “do not engage in aggressive regulation, preferring [instead] to intervene only when necessary[,] and only in limited ways.” Light-touch aims at a cooperative relationship with regulated entities, in part, to overcome the inevitable information disadvantage that regulators face as they try to monitor and control their constituents.

Margaret Cole, the Director of the Enforcement Division of the FSA from 2005 to 2012, characterized the light-touch approach as one where “the FSA is not an enforcement-led regulator at all, but one that uses supervision and ongoing relationships with the firms [it regulates] as its front-line means of regulation.” Cole described the relationship between the FSA and the firms it regulates as one where the FSA “create[s] incentives for firms to focus on compliance in return for a regulatory dividend, and that [dividend is] less regulatory intervention.” The light-touch approach views regulatory intervention as something of a last resort, which should only be used after all market-based solutions have failed.

The main benefit of the light-touch approach is a greater attraction of business capital to the United Kingdom. At least one financial

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63 Id. princ. 1.1.7.
65 Cole, supra note 47, at 270.
68 Cole, supra note 47, at 267.
69 Id. at 271.
70 Id. at 269.

71 See Banking Regulation, supra note 66; Myles Neligan, UK’s FSA to Propose Overhaul of Global Bank Regulation, REUTERS (Mar. 17, 2009), http://www.reuters.com/article/2009/03/17/fsa-idUSL94367220090317 (“Legal experts warn any tightening of the FSA regime could trigger an exodus of leading banks away from the City of London unless it forms part of a coordinated international clampdown.”).
commentator has called the FSA an asset that the London market has in contrast to other major markets with more invasive regulators. Former Economic Secretary to the Treasury, Ed Balls, provided the following summary:

The Government’s interest in this area is specific and clear: to safeguard the light touch and proportionate regulatory regime that has made London a magnet for international business. . . . [New] legislation will confer a new and specific power on the FSA to veto rule changes proposed by exchanges that would be disproportionate in their impact on the pivotal economic role that exchanges play in the UK and EU economies.73

Prior to the LIBOR scandal, FSA officials proudly touted their light-touch approach to economic regulation. One can easily imagine how this focus on a light-touch approach set the stage for the LIBOR scandal. Banks like Barclays and their individual employees, constrained only by general principles, may have felt too much freedom or at least may have believed that they could get away with their manipulative practices. By itself, the light-touch approach makes for an interesting comparison to the approach taken by the United States because it represents a clear contrast to U.S. financial regulations. However, the United Kingdom’s reaction to the LIBOR scandal, contained in the recommendations of the “Wheatley Review,” alters any assessment of U.K. banking regulation because these recommendations are more restrictive than the light-touch approach.

B. The Wheatley Review

As the LIBOR rate manipulation scandal became public, the Chancellor of the Exchequer74 commissioned a review to investigate and report on the necessity of reforms to LIBOR. The review would consider the adequacy of sanctions in the face of LIBOR manipulation, and the implications of LIBOR manipulation for other similar financial benchmarks.75 The Review was named after Martin Wheatley, the man appointed to head it.76 When he was appointed, Wheatley was the

75 THE WHEATLEY REVIEW: INITIAL DISCUSSION, supra note 19, at 5.
76 Press Release, The Rt Hon. George Osborne MP, HM Treasury, The Wheatley Review (July 30,
managing director of the FSA, as well as the chief-executive designate of the newly-created Financial Conduct Authority (FCA). The Review published an initial discussion paper in August 2012, which was followed by a period in which affected parties could submit responses. A final report, which included the Review’s recommendations, was published in September 2012. This subsection explains the recommendations of the Review that have been adopted by the U.K.

Many findings of the Review mirror the findings of the FSA and CFTC in their cases against Barclays. The Review found that “[b]anks and individuals working for banks have an incentive to attempt to manipulate the submissions . . . either to signal their perceived institutional creditworthiness or to support trading positions.” The Review also found that the decline in inter-bank lending had forced LIBOR submissions to rely increasingly “on expert judgment rather than transaction data.” In other words, the Review identified the people problem, publicity problem, and reality problem described in Part III.

In its initial paper, the Review identified several key weaknesses in the then-current U.K. regulatory model as it related to LIBOR. Those weaknesses included the opportunity for manipulation, the lack of independence and oversight, and the potential lack of sanctions to deter individual actors. After a period for comment on its initial paper, the Review presented its final report. The final report made a number of specific recommendations to address the problems identified with LIBOR. First, the report recommended that authorities “introduce statutory regulation of administration of, and submission to, LIBOR.” The Review argued that this change would allow the FSA to more directly regulate LIBOR submissions by giving the FSA power it had previously lacked.

The Review also advocated for the creation of new criminal offenses under the FSMA. Previously, the FSMA did not empower the FSA to

77 Id. The Financial Conduct Authority was created in June 2012 as one of two new agencies to replace the FSA. The FCA became active in April 2013. It is “responsible for regulation of conduct in retail, as well as wholesale, financial markets, and the infrastructure that supports those markets.” Regulatory Reform—Background, FIN. SERVS. AUTH., http://www.fsa.gov.uk/about/what/reg_reform/background (last updated Feb. 2, 2012).

78 THE WHEATLEY REVIEW: INITIAL DISCUSSION, supra note 19.


80 Id.

81 Id. at 9.

82 Id. at 9.

83 Id. at 18.
pursue criminal charges against individuals for attempting to manipulate LIBOR. Specifically, the Review suggested “[amending the] FSMA to include, as an offence, the making of a false or misleading statement in order to manipulate LIBOR.” While acknowledging the United Kingdom’s general aversion to proliferating criminal sanctions, the Review argued that civil penalties may not “be sufficient to prevent such behaviour in all cases.”

The Review also recommended that the administration of LIBOR be removed from the BBA and moved into a new institution that would be distinct from the submitting banks in a way the BBA, whose mission is to be an advocate for the banks, could not be. However, the Review remained committed to the idea “that market participants should continue to play a significant role in the production and oversight of LIBOR.”

Finally, the Review made several recommendations to alter the mechanics of calculating LIBOR. In order to counter the concern that LIBOR submissions are not adequately connected to market conditions, the Review recommended that submitting banks “explicitly and transparently” use actual transaction data to corroborate their rate submissions. The Review also recommended a delay of three months before publishing any individual bank’s LIBOR submission. This change was suggested to counter the creditworthiness-signaling concern.

The Review’s final report represents solutions to the three problems identified in Part III, as well as a move away from the light-touch approach to financial regulation. The reality problem is solved by tying LIBOR submissions to actual transactions, so that the veracity of a bank’s submission can be confirmed. The publicity problem is solved, or at least its severity is diminished, by delaying the publication of submitted rates.

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86 Id.
87 Id.
88 Id.
89 Id. at 21–22.
90 Id. at 7.
91 In July 2013, NYSE Euronext purchased LIBOR from the BBA. Although this sale eliminates the BBA’s participation in LIBOR, it is unclear how the sale will change the regulation surrounding the rate as it will still be under the jurisdiction of the U.K.’s financial regulators. See Phillipa Leighton-Jones, Sold for £1 NYSE Euronext Takes Over Libor, WALL ST. J. MONEYBEAT BLOG (Jul. 9, 2013 8:05 AM), http://blogs.wsj.com/moneybeat/2013/07/09/libor-sold-to-nyse-euronext-how-did-we-get-here/?KEYWORDS=libor+scandal; Max Colchester, Is Libor Now Beyond Manipulation?, WALL ST. J. MONEYBEAT BLOG, (Jul. 9, 2013 12:54 PM), http://blogs.wsj.com/moneybeat/2013/07/09/is-libor-now-beyond-manipulation/?mod=wsj_nview_latest.
92 THE WHEATLEY REVIEW: FINAL REPORT, supra note 79, at 27. The Review also made suggestions concerning which actual transactions submitting banks should look to corroborate their LIBOR submissions, particularly during periods of low market activity.
93 Id. at 38.
94 Id.
While it is conceivable that the media or analysts will still speculate on a bank’s financial health based on these delayed publications, the value of three-month-old data is questionable.

The Review’s solution to the people problem—proposing new criminal sanctions—is particularly important. The Review acknowledged the traditional hesitancy of creating new sanctions, but came to the conclusion that some new sanctions were needed to solve this problem. This appears to be a move away from the principles-based approach of light-touch, a conclusion confirmed by the FSA’s suggestion that their regulatory power be increased and the administration of LIBOR be moved from the BBA.

Yet, the Review’s suggestions are not a total break from the light-touch approach. The Review tempered its call for new powers and criminal sanctions by declining to call for government administration of LIBOR and by reaffirming its commitment to the involvement of banks in the LIBOR regulatory process. Even though it appears that the principles-based approach that characterizes light-touch regulation has receded some in the Review’s final report, the cooperative relationship with firms remains prominent. For instance, although the Review suggests the development of “clear principles” for global financial benchmarks such as LIBOR, the Review also calls for the power to compel banks to participate in the LIBOR rate-setting process.\(^{95}\) In other words, as the light-touch approach would suggest, the Review remains committed to banks being involved in the LIBOR process while at the same time calling for the power to compel bank involvement if necessary, a regulatory power that appears to allow for greater intervention than characterized in the light-touch approach. What remains after the Review’s recommendations is a more nuanced approach to financial regulation that balances regulatory power and bank involvement in how the government regulates them.

C. Responses to the Wheatley Review

The U.K. government responded to the Wheatley Review with a full-throated endorsement of its recommendations.\(^{96}\) The Treasury announced it would amend the Financial Services Bill to bring LIBOR submissions under statutory authority and expand criminal sanctions to cover attempts to manipulate LIBOR.\(^{97}\) The Treasury also agreed with the Review’s recommendation that the administration of LIBOR be moved from the

\(^{95}\) Id. at 8–9.


\(^{97}\) Id. at 2.
BBA to a successor still to be determined.\textsuperscript{98}

Public reception to the Review was mixed. Some sources suggested that the changes meant nothing less than “the death of LIBOR.”\textsuperscript{99} Others believed that the Review was “a welcome step” and that stripping the BBA of its role in administering LIBOR was appropriate.\textsuperscript{100} The BBA indicated that it would support moving LIBOR’s administration to a new body.\textsuperscript{101}

The government’s embrace of the Review’s recommendations strengthens the conclusion that the light-touch approach to financial regulation in the United Kingdom has come to an end. When coupled with similar regulatory changes made as a result of the sub-prime lending crisis, this conclusion seems inescapable.\textsuperscript{102} Although firms will remain involved in the administration of LIBOR,\textsuperscript{103} the expansion of procedures and regulations LIBOR-submitting banks now face is unprecedented in the United Kingdom. Indeed, LIBOR-submitting banks and their individual employees may even face criminal sanctions if they manipulate LIBOR in the future.\textsuperscript{104} Perhaps more telling of the future of financial regulation in the United Kingdom is the total absence in the Treasury’s comments of a commitment to involvement of affected firms in the regulatory process.\textsuperscript{105}

V.  BANK REGULATION IN THE UNITED STATES

This part outlines some of the financial regulatory structure in the United States. It is necessarily a sketch because of the complexity involved in the overlapping state and federal regulatory schemes present in the United States. According to one account, the financial sector in the United States has as many as 115 regulatory agencies operating at various levels of government.\textsuperscript{106} Given the proliferation of regulatory agencies, it is no surprise that banks face a daunting array of regulators:

\textsuperscript{98} Id.
\textsuperscript{99} Andrew Marder, \textit{The Death of Libor, THE MOTLEY FOOL} (Sept. 27, 2012), http://www.fool.com/investing/general/2012/09/27/the-death-of-libor.aspx (“I think that if enough are found with blood on their hands, we could be looking at the beginning of the end for the post 1980s bank.”).
\textsuperscript{101} \textit{BBA Statement on Conclusions of Wheatley Review into LIBOR, BBA} (Sept. 27, 2012), http://www.bba.org.uk/media/article/bba-statement-on-conclusions-of-wheatley-review-into-libor.
\textsuperscript{103} \textit{See Written Ministerial Statement, supra} note 96, at 3.
\textsuperscript{104} \textit{See id.} at 1 (endorsing the creation of new criminal sanctions for future rate manipulation).
\textsuperscript{105} Id. This absence is particularly noticeable compared to the Review’s comments on firm involvement.
\textsuperscript{106} Yesha Yadav, \textit{Looking for the Silver Lining: Regulatory Reform After the “Credit Crunch,”} 15 STAN. J.L. BUS. & FIN. 314, 323 (2010).
A firm that is engaged in banking, securities, and insurance business, or offering products that overlap within these categories (e.g. certain types of annuities) may find itself being supervised by the Federal Reserve System (Fed), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Securities and Exchange Commission (SEC), the Commodities and Futures Trading Commission (CFTC), the Securities Investor Protection Corporation (SIPC), the National Credit Union Administration (NCUA), and the Pension Benefit Guaranty Corporation (PBGC), together with relevant banking, securities and insurance regulators at the state level.107

In addition to this multitude of agencies, the history of banking regulation is rather chaotic as well. Banking regulation in the United States “represents a set of accumulated responses to a long history of financial crises, scandals, happenstance, personalities[,] and compromises among a broad and competing array of industry and governmental units.”108 This Note focuses on two of the federal regulatory agencies relevant to the LIBOR scandal: the CFTC and the DOJ.109

A. The Commodities Futures Trading Commission

As Part II described, the CFTC fined Barclays significantly for violating sections 6(c), 6(d), and 9(a)(2) of the Commodity Exchange Act (CEA).110 One of the purposes of the CEA was to “ensure fair practice and honest dealings on commodity exchanges, for the protection of the market itself as well as those who could be injured by unreasonable fluctuations in commodity prices.”111 As the CFTC summarized the relevant sections of the CEA, “Together, Sections 6(c), 6(d), and 9(a)(2) of the Act prohibit acts of attempted manipulation.”112

107 Id. at 324.
112 In re Barclays PLC, Barclays Bank PLC & Barclays Capital Inc., CFTC Docket 12-25, 26 (June
The creation of the CFTC was a Congressional response to increased participation in the futures market as “the shift to a market-oriented economy . . . caused merchandisers and processors to make greater use of the futures markets to hedge their risks against substantial price rises.”113 The CFTC is responsible for “assur[ing] the economic utility of the futures markets by encouraging their competitiveness and efficiency, protecting market participants against fraud, manipulation, and abusive trading practices, and by ensuring the financial integrity of the clearing process.”114

The Dodd-Frank Wall Street Reform Bill and Consumer Protection Act (Dodd-Frank) greatly expanded the historically meager enforcement powers of the CFTC.115 They now rival the Securities and Exchange Commission’s enforcement powers.116 This increased enforcement authority has led to an increase in enforcement actions: from 2010 to 2011, CFTC enforcement actions increased 74% and included seventy criminal convictions and indictments.117 The scope of these actions range from fines levied against international banks like Barclays, UBS, and RBS for millions of dollars to fines against individuals for several hundreds of thousands of dollars.118 This sort of prosecutorial activity is in stark contrast to conditions described above in the United Kingdom, where regulators are only now getting the power to criminally prosecute manipulators.

As a matter of policy, the CFTC’s mission of public protection drives the agency.119 The Chairman of the CFTC, Gary Gensler, has articulated

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priorities of transparency, separation of consumer investment funds from operational funds, and a preference for benchmark interest rates like LIBOR to be tied to real-world transactions. However, despite its mission and policy preferences, the CFTC’s jurisdiction is limited to the futures market. Given this limited jurisdiction, it makes sense to turn to the DOJ, a government agency with broader enforcement powers that has also been involved in the LIBOR scandal.

B. The Department of Justice

In June 2012, the Fraud Section of the DOJ announced a settlement agreement with Barclays where the Fraud Section agreed to forgo further prosecution in exchange for a significant fine and Barclays’s cooperation with the Fraud Section’s investigations. As this section explains, the presence of the Fraud Section and its powers of criminal enforcement suggest that the “people problem” discussed in Part III may not be as prevalent in the United States, at least insofar as the “people problem” is associated with a lack of criminal enforcement.

The Fraud Section is the DOJ’s “front-line litigating unit that acts as a rapid response team, investigating and prosecuting complex white collar crime cases throughout the country.” The Fraud Section is a sub-agency of the DOJ, and is guided by its mission to enforce the law and control crime.

As it applies to corporate crimes, principles promulgated by the Attorney General, the federal government’s chief law-enforcement official, guide the Fraud Section. These general principles provide guidance for

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120 Id. (expressing support for the “clearinghouse” protections stemming from Dodd-Frank whereby firms are prevented from “using the collateral attributable to cleared swaps customers who haven’t defaulted to cover losses of defaulting customers”).


122 In cases analogous to the LIBOR scandal where the parties involved are international entities subject to both U.K. and U.S. regulation, the distinction between the two systems should not be of much practical difference because they overlap. Of course, it is not clear that the threat of criminal sanctions would be an effective deterrent to some individuals. See, e.g., David Enrich, Rate-Rig Spotlight Falls on ‘Rain Man,’ WALL ST. J. (Feb. 8, 2013, 9:29 AM), http://online.wsj.com/article/SB10001424127887324445904578285810706107442.html?KEYWORDS=Department+of+Justice+Libor.


both federal prosecutors and corporate leaders, with the goal of better securing “public confidence in business entities.”\textsuperscript{126} The principles also provide a list of factors to consider in determining whether to prosecute a crime.\textsuperscript{127}

These general principles give federal prosecutors room to settle with corporations as the Fraud Division did with Barclays. But, the DOJ also touts the success of federal prosecutors in “root[ing] out corruption in financial markets and corporate board rooms across the country.”\textsuperscript{128} However, rather than boasting a conviction rate or incarceration rate of criminals, the DOJ suggests that “[t]he most significant result of this enforcement initiative is that corporations increasingly recognize the need for self-policing, self-reporting, and cooperation with law enforcement.”\textsuperscript{129} The fact that the DOJ chooses to emphasize the need for self-policing in the business community along with the success of federal prosecutors demonstrates a balance within the DOJ of aggressively pursuing criminal conduct and encouraging firms to self-police.

There are limits to the DOJ’s talk of “principles.” It might be tempting to see the DOJ’s use of “principles” terminology as an analog to the light-touch approach to regulation in the United Kingdom. However, even though this approach has led to more self-policing by firms, that change must be viewed in light of the DOJ’s aggressive efforts to root out corruption. Coupled with the CFTC’s recent prosecutorial efforts discussed above, financial regulation in the United States clearly has greater sanctions for individuals than in the United Kingdom.

In the face of the United States’ complex financial regulatory scheme, it is difficult to synthesize conclusions or policies guiding regulation. However, three points are clear. First, in the United States there is, as the proliferation of agencies demonstrates, an underlying tendency towards intensive regulation. The broadening of CFTC enforcement powers under Dodd-Frank in response to the recent financial crisis also affirms this tendency.

Second, in the federal system, there is a robust role for criminal prosecutions. Not only did Barclays pay steep fines to the CFTC, it also paid a fine to the DOJ. There is also reason to think that there may be criminal charges levied against other banks as a result of ongoing investigation into the LIBOR scandal.\textsuperscript{130} Additionally, the DOJ has

\textsuperscript{126} Id. at 1.
\textsuperscript{127} These factors include the seriousness of the crime, the pervasiveness of wrongdoing within the corporation, the adequacy of prosecution of individual wrongdoers within the corporation, and the adequacy of civil or regulatory remedies. Id. at 4.
\textsuperscript{128} Id. at 1.
\textsuperscript{129} Id.
\textsuperscript{130} See Letter from Denis McInerney, supra note 121. For further suggestion that the DOJ will
recently taken steps to bolster the Fraud Section, which will increase its ability to prosecute fraud.\textsuperscript{131}

Finally, the proliferation of agencies and the varied enforcement messages each agency might send toward affected firms suggests that compliance with the regulatory scheme is more difficult than it needs to be. While any individual agency might adopt a more lenient approach, banks still face a maze of administrative and criminal regulations.

VI. COMPARING THE UNITED STATES AND THE UNITED KINGDOM IN LIGHT OF THE LIBOR SCANDAL

Parts IV and V briefly explained the structure and philosophy of bank regulators in the United Kingdom and United States. Part VI compares the regulatory structures of the United States and United Kingdom. Part VI also uses the three LIBOR-scandal problems (people, reality, and publicity) identified above to examine the regulatory structure of both the United Kingdom and the United States. Additionally, Part VI examines the question of which model ought to be favored more fully.

A. Towards a Hybrid Approach

In the United Kingdom, the Review marks the end of the light-touch era of financial regulation. The government’s adoption of the Review’s recommendations appears to have significantly increased the agency-based oversight as well as the criminal sanctions involved in setting future LIBOR. In other words, it represents a move towards the U.S. model characterized by more invasive regulation and sanctions. However, in comparison to the plethora of state and federal agencies and government entities regulating a financial firm in the United States,\textsuperscript{132} the Review seems to be only a small step toward the U.S. model.

It might seem as though the United States has an advantage in solving the people problem when it comes to criminal sanctions, at least if the prosecution of offenders is taken as a measure of success. This conclusion must be tempered by the fact that, thus far, Barclays received essentially the same kind of penalty in the United States and the United Kingdom. As of this writing, only a single individual has been targeted for criminal


\textsuperscript{132} Which, as discussed \textit{supra} in Part V, the CFTC and DOJ are only a small sample.
sanctions in the United States in connection with the LIBOR scandal.\textsuperscript{133} Regardless of this fact, it remains true, as discussion of the DOJ and CFTC above shows, that the financial regulatory apparatus in the United States offers a greater threat of criminal sanctions.

Overall, determining which model works better is a matter of priorities and values. If the light-touch approach was in fact a “regulatory dividend”\textsuperscript{134} for banks that drove them to do business in London, then the economic impact of increased regulation might encourage banks to move their business elsewhere.

Yet, this reasoning also suggests that the United Kingdom retains the upper hand in direct comparison to the United States. Even after implementing the Review’s recommendations, the United Kingdom remains less regulated than the United States. As confirmation, one financial commentator has suggested that Dodd-Frank’s tougher rules are leading some international banks to reconsider their contracts with banks in the United States.\textsuperscript{135} If so, then it stands to reason that when a bank has a choice between the United Kingdom and the United States, it will prefer the milder regulatory structure of the United Kingdom, even after the Review’s recommendations have been enacted.

On the other hand, it may have been the permissive stance toward regulation in the light-touch era that gave rise to the LIBOR manipulations in the first place. If the goal of financial regulation is to avoid this sort of manipulation, then one might reasonably favor the more rigorous regulatory scheme of the United States over the United Kingdom. After all, the LIBOR scandal is not the only scandal currently facing the United Kingdom’s banks.\textsuperscript{136} For instance, the light-touch approach has also been linked to recent allegations against U.K. banks of illicitly processing Iranian financial transactions and accepting deposits from money launderers.\textsuperscript{137} A more robust regulatory scheme might have prevented

\textsuperscript{133} See Enrich, supra note 122. Only three individuals have currently been charged in the U.K. See Kristin Ridley & Tommy Wilkes, Judge Sets October As Showtime in UK Libor Hearings, Reuters (July 30, 2013, 12:29 PM), http://www.reuters.com/article/2013/07/30/us-britain-libor-idUSBRE96T0Z A20130730.

\textsuperscript{134} Cole, supra note 47.


\textsuperscript{137} Deborah Hargreaves, Why UK Banks Deserve to Sweat Under the Scrutiny of US Regulators,
some of this malfeasance.

A better path lies somewhere in the middle of the two positions occupied by the United States and the United Kingdom. It seems clear that the era of light-touch regulation gave rise to conditions that allowed fraudulent manipulation of LIBOR to flourish. Without fear of regulators or criminal sanctions, bankers in London were able to act in less than ethical ways without fear of reprisal. However, it is difficult to defend the regulatory excesses of the U.S. system. Such invasive oversight, after all, failed to prevent the sub-prime mortgage crisis or the wave of high profile “Ponzi schemes” in recent years.\textsuperscript{138}

An ideal solution would meet in the middle by strengthening the regulatory structure in the United Kingdom while simplifying the regulatory scheme in the United States. The recommendations of the Review can be viewed as embodying this kind of hybrid approach since they strengthen the regulatory powers of the government without losing sight of the important role that financial firms can play. By adequately striking this balance, future manipulation may be prevented without risking the alienation of firms.

B. Some Objections Considered

One practical objection to this compromise solution is that it is too difficult to accomplish in reality. In response to crises like the LIBOR scandal, one tactic for regulators or lawmakers is to simply insist on passing new laws or enacting new regulation without critically evaluating their impact. Luca Enriques, former Commissioner of the Italian Commissione Nazionale per le Società e la Borsa (CONSOB),\textsuperscript{139} captures the rationale behind this “knee-jerk” reaction well:

\begin{quote}
[A]s conventional wisdom has it, if there is a crisis, then regulators must have previously failed to do their job by omitting to take action, whether regulatory or supervisory, that could have
\end{quote}

\footnote{\textsuperscript{138} Unfortuantly, examples of recent Ponzi schemes are easy to come by. For a timeline of Bernard Madoff’s scheme, see \textit{Bernard L. Madoff, Times Topics, N.Y. TIMES}, http://topics.nytimes.com/top/reference/timestopics/people/m/bernard_l_madoff/index.html (last visited Aug. 9, 2013). For a description of a particularly modern Ponzi scheme involving the electronic currency bitcoin, see Kevin Roose, \textit{Shockingly Something Called The ‘Bitcoin Savings And Trust’ Was A Ponzi Scheme, The Daily Intelligencer, N.Y. MAG.} (Jul. 23, 2013, 2:41 PM), http://nymag.com/daily/intelligencer/2013/07/was-a-ponzi-scheme.html.}

prevented it. Thus, further inaction, however justified in theory, is intolerable . . . a diffused sense of urgency implies that everyone is expected to do his or her part to avert the meltdown, and it would be embarrassing for any institution to confess that there is nothing it can do to help . . . .

According to Enriques, political realities force regulators and lawmakers to act in the face of a crisis, even if they were not to blame for the underlying crisis. This is true, he argues, even if empirical data suggests a change in laws or regulation will not solve the underlying problems that precipitated the crisis in question. His somewhat cynical conclusion is that the best approach for regulators in the wake of crises is “maintaining pretense of doing something while actually innovating very little . . . .” Essentially, Enriques argues that the kinds of regulations and laws that crises generate are not very effective, so those lawmakers and regulators who earnestly desire well-functioning markets should leave the markets alone during times of crisis, even if they need to put on a political show to satisfy the public.

Author David John of the Heritage Foundation makes a similar argument. He argues that in response to the LIBOR crisis, no new laws are necessary, but financial regulators should simply enforce already existing laws and regulations. In explaining the LIBOR scandal, John blames delay on the part of some regulators to act when they first learned of the potential LIBOR manipulation. John points to the fact that Barclays and other banks that manipulated LIBOR will pay large fines as proof that existing laws are adequate. Implicit in John’s argument is the idea that regulatory reform either cannot or should not attempt to prevent manipulation if post-hoc remedies are capable of punishing those responsible. In short, John argues that current laws, if adequately enforced, are sufficient.

140 Luca Enriques, Regulators’ Response to the Current Crisis and the Upcoming Reregulation of Financial Markets: One Reluctant Regulator’s View, 30 U. PA. J. INT’L L. 1147, 1148 (2009). Although Enriques is responding to the sub-prime credit crisis at the end of the last decade, his reasoning can easily extend to the sort of crisis of confidence that the LIBOR scandal represents.

141 Id. at 1148–49.

142 Id.

143 Id. at 1147.


145 Id. In particular, John points to the failure of Treasury Secretary Timothy Geithner to act when he learned of the potential manipulation by Barclays as early as April 2008.

146 Id.

147 Id.
C. Does Financial Regulation Really Stifle Growth or Prevent Crises?

Enriques and John are both suspicious of the idea of passing new laws in response to a financial scandal. Although the hybrid approach advocated for above would not always call for passing new laws, the objection is worth considering. In evaluating the objection, it would be helpful to examine empirical evidence. However, there is a lack of decisive empirical evidence that would indicate when regulation prevents a crisis or when too much regulation stifles economic growth.\textsuperscript{148} According to one group of scholars from the Central Bank of Chile: “[T]here appears to be a universal belief among those who have studied these issues that inappropriate regulations and supervisory standards in a country not only retard its long-run economic growth but also increase the likelihood of financial crisis that could spread beyond the country’s own borders.”\textsuperscript{149}

Yet, despite this widespread belief that over-regulation can stifle growth and hasten crises, it is not clear that empirical data supports it. In their study, the Central Bank of Chile scholars gathered information from 45 countries and came to several conclusions.\textsuperscript{150} First, weaker central governments tend to impose harsher restrictions on banking activities.\textsuperscript{151} Second, countries with more restrictive systems of regulation do not necessarily have poorer functioning banking systems.\textsuperscript{152} Finally, countries with more restrictive regulatory systems have a greater probability of suffering a banking crisis.\textsuperscript{153}

The second and third conclusions of their study are striking, especially in the context of proposing a direction for financial regulatory reform. The empirical evidence seems to contradict the notion that a stricter regulatory system, by itself, hurts economic development. At the same time, the evidence shows that a stricter regulatory regime actually correlates with a greater likelihood of suffering a banking crisis. Focusing on the kinds of regulations a country puts in place can resolve this discrepancy: “Our findings indicate that countries with weak governments— that is,\textsuperscript{148} The argument that too much regulation stifles growth is clearly implied in the “regulatory dividend” said to result from Britain’s light-touch approach. \textit{See supra} Part IV.A.
\textsuperscript{150} \textit{Id.} at 33–34 (noting that “a country is considered to have experienced a crisis only when the estimated losses [to the government due to banking sector problems] were greater than 5 percent of GDP”).
\textsuperscript{151} \textit{Id.} at 4.
\textsuperscript{152} \textit{Id.}
\textsuperscript{153} \textit{Id.}
governments that are less likely to (a) supervise banks approximately or (b) create proper incentives for private sector participants to supervise banks—also on average impose harsher restrictions on the activities of banks."

In other words, weaker governments that do not appropriately supervise banks or incentivize private sector supervision of banks appear to overcompensate for this weakness by imposing harsher restrictions on banks. These harsher restrictions were not merely harsher than alternatives. They were the kind of restrictions that tended to lower the value of banks by hampering their ability to diversify assets and investments, thereby making them more susceptible to crisis.

The Central Bank of Chile study suggests two points relevant to the discussion of financial reform. First, financial regulation, by itself, is not likely to be a barrier to economic growth. Second, the evidence suggests that laws or regulations that tend to lower the value of a bank make countries imposing those restrictions more likely to suffer economic crisis.

Although the Central Bank of Chile study found that regulations did not necessarily hamper growth, it did find a correlation between harsh restrictions and banking crises. The study suggests that one need not follow the cynical or skeptical path of Enriques or John in assessing financial reform because the right kinds of regulations do not hamper economic growth. The Review’s recommendations that LIBOR be tied to actual market data and that the FSA have broader criminal enforcement powers do not appear to limit the kind of activities that add value to banks, since they do not preclude banks from diversifying their activities.

Although nothing in the plethora of regulations faced by banks in the United States requires harsher restrictions, the risk of harsher laws or regulations seems greater where there are more parties involved, each with the potential to impose regulations or sanctions. Even though the United Kingdom has moved on from the light-touch era of regulation, its banks do not face anything like the legal and regulatory apparatus in the United States. Ideally, the United States could simplify its regulatory structure to more closely resemble that of the United Kingdom. While the practical and political steps needed for the United States to accomplish this simplification are outside the bounds of this Note, the empirical evidence in the Central Bank of Chile study suggests that reducing the risk of financial regulations that are so harsh as to threaten diversification may well be worth the practical or political costs.

\footnote{154 Id. at 18.}

\footnote{155 In general, restrictions that keep banks from diversifying their activities made those countries more susceptible to crises. See id. at 5.}
VII. CONCLUSION

The LIBOR scandal illustrates the strengths and weaknesses of approaches to banking regulation in both the United States and the United Kingdom. The light-touch era of financial regulation in the United Kingdom was, perhaps, a blessing and a curse: while it may have attracted banks to do business in the United Kingdom, it may have also facilitated the LIBOR scandal. Despite the fact that regulators in the United States have greater power to pursue criminal sanctions against individual manipulators, it remains too difficult to justify the overwhelming complication of the U.S. regulatory structure.

Although neither the United States nor the United Kingdom can stake a claim to perfection, the recently adopted recommendations of the Wheatley Review in the United Kingdom offer a promising compromise. The Review’s recommendations offer solutions to the people, reality, and publicity problems presented by the LIBOR scandal without being so harsh as to threaten economic growth. Despite its departure from the light-touch approach to financial regulation, the Review’s approach is likely to minimize the risk of future manipulation, while not imposing too great a cost on financial firms. The United Kingdom has the better model of financial regulation, especially once it enacts the recommendations of the Review. In the future, the United Kingdom will likely continue to enjoy the benefits of its simpler regulatory structure, while preventing the problems that the LIBOR scandal exposed.