

**INSTITUTIONAL CORRUPTION AND THE CAPITAL MARKETS:
*FINANCIAL BENCHMARK AND CURRENCY MANIPULATION,
ENFORCEMENT STRATEGIES AND REGULATORY RE-DESIGN***

HARVARD LAW SCHOOL
MAY 23, 2014

Please join us for the second in an international series of five major workshops. Scholars, practitioners and regulators will explore the divergent enforcement agendas followed in the aftermath of the financial benchmark and broader currency manipulation scandals. The workshop builds on the pioneering work on institutional corruption at the Edmond J. Safra Center for Ethics at Harvard University and on the work of the Centre for Law, Markets, and Regulation at UNSW on the dynamics of regulatory policy. It is generously supported by the Centre for International Finance and Regulation, an Australian federal and state government research initiative. The workshop will assess the trajectories of the investigative and enforcement process across multiple markets and will fuse detailed empirical analysis with recommendations for policy reform linked to a core normative agenda: how to enhance market integrity.

The timing of the workshop is critical. Mark Carney, the Governor of the Bank of England, has stated that the investigation into the currency manipulation scandal, which involved collusion among traders using electronic chat-rooms with names such as ‘The Pirates’ and ‘The Cartel,’ could be even more significant than that into the corruption of the initial London Inter-bank Offered Rate (Libor). It is rendered more so because of the role that agencies such as the Bank of England play as both participants in and overseers of the multi-trillion dollar FX market. The management of those conflicts of interest is critical to the re-building of trust in the capital markets. Has enforcement and regulatory reform gone too far or not far enough? Can securities regulation ever protect against systemic risk? What lessons can be learned from attempts to deal with other manifestations of institutional corruption across the capital markets and other regulatory domains?

The workshop follows an initial scoping workshop in March 2014 in Sydney that mapped the problem. A third workshop in London in September 2014 will evaluate the progress made in engendering confidence that institutional corruption has been curbed. A fourth is planned for Dubai in October, in conjunction with the American University of Sharjah. The fifth and final workshop, to be held in Sydney in November, coincides with the G20 Summit. Each workshop will result in papers published in *Law and Financial Markets Review*. The workshops will be filmed and linked to a multi-media archive of opinion pieces, articles, and interviews. The Centre for Law, Markets, and Regulation at UNSW acknowledges the Australian Research Council and the Centre for International Finance and Regulation for their generous financial support.

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- 8:00-8:30 **Registration**
- 8:30-8:40 **Opening Remarks: Institutional Corruption and Capital Markets**
William English
- 8:40-9:10 **Who Put the “Lie” in LIBOR (and Who Should Take it Out?): Civil LIBOR Litigation in the US**
Eric Talley and Samantha Strimling
This paper examines the underpinning legal bases on which enforcement actions have been undertaken in the United States, with particular reference to private civil litigation filed on behalf of various antitrust and securities classes as well as the FDIC, Fannie Mae, and Freddie Mac, against various participants in the LIBOR rate-setting process and the British Banking Association, the trade body that administered the benchmark until earlier this year. It evaluates the strengths and limitations of these actions, contrasting the US approach to that taken in the European Union.
- 9:10-9:40 **The Corruption of Financial Benchmarks: Financial Markets, Collective Goods, and Institutional Purposes**
Seumas Miller
Financial benchmarks play a linchpin role in capital markets, providing reliable readings on metrics like currency valuations and interest rate movements. But scandals surrounding alleged manipulation of financial benchmarks, epitomized by rate-rigging Libor revelations and skewed currency valuations linked to the London 4 p.m. fix, reveal systems rife with influences and incentives that produce institutional corruption. In theory, benchmarks are a collective good that serves markets. But, implicit in that role is the public’s faith in the institutional integrity of those who produce and administer them. In the near term, manipulation can produce distortions that harm investors. More significantly, longer term, the deliberate distribution of false data reflects a breach of moral obligations and is a paradigm of institutional corruption, which endangers the public trust on which all markets must rely.
- 9:40-10:10 **Increasing the Evidential Base: Whistleblowers as Accountability Enhancers or Bounty Hunters**
Michael Flaherman
Recent changes in federal law have provided individuals with new or greatly enhanced rights to receive whistleblower awards for turning in tax underpayments or securities/commodities related fraud. The structure and scope of the reward program at the IRS and SEC/CFTC are largely



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unprecedented. The existence of such large-scale rewards is likely to have a significant, positive impact on federal tax and securities/commodities law compliance over time. The new whistleblower reward provisions offer economic incentives to such individuals that, by design, weigh in favor of disclosing the wrongdoing to the government, even after taking into account the significant risks. Opponents of these reward programs have offered a variety of arguments against them, largely based on concerns about the programs' potential negative impacts on business. However, these concerns are at best speculative and are frequently self-serving, suggesting that business interests see the whistleblower programs as a significant threat to established norms that tolerate significant amounts of tax underpayment and securities/commodities fraud.

10:10-10:30 **Break**

10:30-11:00 **The Fiduciary Duty to Protect: Institutional Investors and Governance**

Jay Youngdahl

Institutional investors currently have little ability to locate or remedy institutional corruption present in the capital markets. This institutional corruption and a lack of transparency make meaningful market reforms nearly impossible. Institutional corruption both causes and covers for a myriad of unfortunate results for asset owners. Transparency is necessary for efficient and effective activities by investors; yet opaque financial processes and products, a weak regulatory structure, and a compliant political structure leave investors with few allies or tools to use to establish transparency. Considered in a new way, however, with a focus on institutional corruption and upon a robust use of the concept of fiduciary duty, solutions are possible.

11:00-11:30 **Culture and the Future of Financial Regulation: How to Embed Restraint in the Interests of Systemic Stability**

George Gilligan, Seumas Miller, and Justin O'Brien

This paper examines the challenge associated with settling or recalibrating "the philosophy, principles, and objectives underpinning the development of a well-functioning financial system," a core term of reference for the Australian Financial System Inquiry. The current philosophy is informed by an emphasis on structure, leaving it to market participants to self-police through a combination of rules and principles. It is informed by a high degree of trust in market ordering and acceptance of conflicts of interest as long as they are managed, thereby delivering beneficial outcomes. Specialization and expertise are deemed to ensure that risk-taking takes

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place in fair, orderly, and transparent markets. The Global Financial Crisis has severely tested that assumption. As in other markets, trust in the integrity of financial markets and their participants have evaporated. The key policy question is whether the operation of the financial system is, in the vernacular, *fair dinkum*, according to or deviating from Australian belief in fairness. This paper explores the defects in the regulatory paradigm through each of the key themes: (1) balancing competition, innovation, efficiency, stability, and consumer protection; (2) how financial risk is allocated and systemic risk is managed; (3) assessing the effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry, and among users; and (4) the role of government and the role, objectives, funding, and performance of financial regulators, including an international comparison. The evaluation demonstrates profound limitations with the current paradigm. We argue that culture is a critical driver of behavior. It can justify, embed, or restrain action. Unless the underpinning philosophy defines duties and responsibilities, as well as rights, and links this to a framework that places culture at its core, we risk failing to learn from history. This would be both a tragedy and a farce.

11:30-12:00 **Forensic Psychiatric Contributions to Understanding Financial Crime**
Sara Brady, Harold J. Bursztajn, Omar Sultan Haque, Erick Rabin, and Daniel Wu

Forensic psychiatric evaluation and consultation can make significant contributions to understanding, preventing, and responding to financial crimes. Drawing on forensic psychiatric principles and experience, and research and analysis from related fields of inquiry, this paper explores the individual psychological dimensions of financial crimes in their social context, the group dynamics of corrupt organizations, and the interrelationship between the two. What or who is perceived to be rewarding for the organization, or for the individual within the organization, may not be consistent with the law, ethical norms of fairness and equity, or a company's or society's long-term interests and obligations. Addressing this major social pathology from a forensic psychiatric perspective provides insight into what motivates people either to create or to join such corrupt collectives.

12:00-12:45 **Lunch**

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- 12:45-1:45 **From the Outside Looking In: Industry and Regulatory Perspectives**
Ian Russell, Deen Sanders, and Sally Wheeler
Moderator: *Justin O'Brien*
Since the onset of the Global Financial Crisis, Australia and Canada have been lauded for the relative strength of their financial systems. Does this represent better regulatory design, more effective regulatory frameworks, or the embedding of restraint, linked to broader cultural dynamics? The narrative advanced in both Canada and Australia is fraying, not least because of the naming of Canadian and Australian banks in regulatory investigations into misconduct in the rate-setting process. How different are Canada and Australia, what lessons can we take from their experience, and what are the implications?
- 1:45-2:00 **Break**
- 2:00-2:30 **Information Challenges in Identifying Institutional Corruption in Financial Regulation**
Daniel Carpenter and Laurence Tai
Detecting the presence of institutional corruption in U.S. financial regulation is a challenge because this phenomenon cannot be directly inferred from policy outcomes that seem to favor financial firms. Instead, information about the details of the policymaking process is necessary to indicate what sorts of actions by firms indicate undue influence on regulators, compared to a theoretical public interest ideal. Investigative journalists and watchdog organizations have used the Freedom of Information Act to gain insight into the inner workings of financial regulatory agencies. This paper evaluates how their news articles and reports contribute to accounts of institutional corruption, compared to more commonly known information about the regulatory processes.
- 2:30-3:00 **Into the Future: Institutional Corruption Concerns in Regulatory Reform**
Gregg Fields
Research has clearly demonstrated that institutional corruption played a critical contributory role in unleashing the global financial crisis. Six years later, however, reform efforts are only now gaining momentum. A number of laws, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act, have been passed. And recent initiatives aimed at bolstering bank capital levels should reduce the risk profiles of systemically important financial institutions. However, true reform must identify the potential for, and solutions to, institutional corruption as new oversight mechanisms are developed and implemented. The paper



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examines how post-crisis institutional corruption challenges differ from those that pre-dated the Great Recession. It provides frameworks for how the problem can be addressed, to prevent the lapses in institutional integrity that crippled the world economy in 2008.

3:00-3:30

Reinventing Regulation from the Inside Out: The *Professionalizing Culture War Inside Corporations*

Deen Sanders

Is the legislative struggle for a model of regulation that *merely encourages* corporations to be publicly-oriented exhausted? As rhetoric and enthusiasm falters for the single minded economic purpose of corporations, questions about obligation of the individual emerge. Have we paid enough attention to the role of the human agents inside corporations? The financial services industry may be the perfect crucible for a whole new way of thinking about the intersection between corporate and public purpose with the appetites of communities and governments aligned and financial institutions seeking to regain their credibility and trustworthy brand status. This paper examines the potential for a new way of thinking about the regulation of corporations, working through emerging models of self-regulatory theory and practice. We posit that building a framework of professional obligation at the centre of corporate structure and responsibilities could spark a new approach to regulation that delivers on the *implicit* and *explicit* promises of public duty. As a tool of regulation, professional (personal) obligation is poorly understood and poorly applied but it has the potential to provide a new language and a formal framework of normative rules that can assist the modern corporation to better realize its public and shareholder purpose.

3:30

Closing Remarks

Justin O'Brien

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Speaker Biographies

SARA BRADY

Sara Brady is a second year resident at the Harvard Longwood Psychiatry Training Program in Boston. She graduated with a BS in political science from Grinnell College in Iowa, and she completed medical school at the University of Colorado. She hopes to pursue forensic fellowship training after graduation from residency.

HAROLD J. BURSZTAJN

Harold J. Bursztajn, MD has over twenty-five years of service as a distinguished patient care-focused clinician and as a senior clinical faculty member at Harvard Medical School. He is co-Founder of the Program in Psychiatry and the Law at the Beth Israel Deaconess Medical Center Department of Psychiatry of Harvard Medical School and Associate Clinical Professor of Psychiatry at Harvard Medical School. Dr. Bursztajn consults clinically and forensically, provides second opinions in patient care, teaches medical students, and conducts continuing medical education courses for professionals. He also advises institutions, the courts, and public health-oriented media on forensic psychiatry and clinical ethics-related issues.

DANIEL CARPENTER

Daniel Carpenter is Allie S. Freed Professor of Government and Director of the Center for American Political Studies in the Faculty of Arts and Sciences at Harvard University and Director of the Social Sciences Program at the Radcliffe Institute for Advanced Study. He taught previously at Princeton University (1995-1998) and the University of Michigan (1998-2002). He joined the Harvard University faculty in 2002. Dr. Carpenter mixes theoretical, historical, statistical and mathematical analyses to examine the development of political institutions, particularly in the United States. He focuses upon public bureaucracies and government regulation, particularly regulation of health and financial products.

GREGG FIELDS

Gregg Fields is a prize-winning journalist at *The Miami Herald* and *Daily Business Review*. He has investigated regulatory roles in economic crises, including the 1987 market crash, the S&L debacle, Enron, and the 2008 mortgage meltdown. He was a member of the *Herald* staff that won the 1993 Pulitzer for Public Service. During his fellowship at the Edmond J. Safra Center for Ethics, Fields has examined how the growing axis of interdependence between Wall Street and Washington blunts the efficacy of regulatory institutions. He has also analyzed future threats institutional corruption poses to the domestic economy and U.S. global leadership.

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MICHAEL FLAHERMAN

Michael Flaherman is a Senior Advisor at New Mountain Capital LLC. Before joining New Mountain in January 2003, Mr. Flaherman was Chairman of the Investment Committee of CALPERS, the nation's largest pension system with approximately \$140 billion in assets. In his capacity as chairman, Mr. Flaherman led board decision-making on all aspects of CALPERS investment strategy, including asset allocation, as well as CALPERS investment program in domestic and international equity and fixed income, real estate, and private equity.

GEORGE GILLIGAN

George Gilligan is a Senior Research Fellow at the Centre for Law, Markets and Regulation at the University of New South Wales. His research interests center on: governance; regulatory theory and practice, especially in relation to the financial services sector; climate change; white-collar crime; organized crime; and corruption. He has published extensively in these areas, conducted numerous field research projects examining the praxis of regulation, and appeared as an expert witness before the Commonwealth of Australia Senate and Joint Parliamentary Committees.

OMAR SULTAN HAQUE

SEUMAS MILLER

Seumas Miller is Professor of Philosophy at Charles Sturt University and Senior Research Fellow at 3TU Centre for Ethics and Technology, Delft University of Technology (joint position). He was Foundation Director of the Centre for Applied Philosophy and Public Ethics, an Australian Research Council funded Special Research Centre (2000-2007). His extensive publications include writings on social action and institutions, terrorism, business ethics, and police ethics.

JUSTIN O'BRIEN

Justin O'Brien is Director of the Centre for Law, Markets, and Regulation at the University of New South Wales. In 2012 he was awarded a prestigious Australian Research Council Future Fellowship for a four-year project measuring and evaluating regulatory performance in the aftermath of the Global Financial Crisis. He is a Network Fellow at the Edmond J Safra Center for Ethics at Harvard University. He is currently completing a biography of James Landis, the key architect of the Securities and Exchange Commission.

ERICK RABIN

Erick Rabin graduated from Duke University with a BA in philosophy and economics. He holds an MA in philosophy from Boston University and is currently pursuing a JD/MBA at New York University.

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IAN RUSSELL

Ian Russell is President and Chief Executive Officer of the Investment Industry Association of Canada (IIAC), a position he has held since its inauguration in April 2006. Prior to his appointment at the IIAC, Mr. Russell headed the Industry Relations and Representation group of the Investment Dealers Association of Canada. He has participated actively in many committees and working groups involved in regulatory and tax issues related to the securities industry and capital markets in Canada. He is a frequent columnist in industry publications and a presenter and speaker on industry issues and developments. In January 2014, Mr. Russell was appointed Chair of the International Council of Securities Associations (ICSA).

DEEN SANDERS

Deen Sanders is Chief Executive Officer of the Professional Standards Authority, the meta-regulator of the professions in Australia. Prior to that he was Chief Professional Officer at the Financial Planning Association, where he led the professionalization of financial advice at a global and domestic level. His professional background includes regulation of Australia's qualifications system and standards as well as eclectic experience in corporate financial services and psychological practice. His academic background has traversed psychology, law, and business. He holds a doctorate in regulation, ethics, and professionalization.

SAMANTHA STRIMLING

Samantha Strimling is a student at the University of California at Berkeley. She is a frequent collaborator with Professor Talley, including on their most recent co-authored chapter "The World's Most Important Number: How a Web of Skewed Incentives, Broken Hierarchies, and Compliance Cultures Conspired to Undermine Labor," in J. O'Brien and G. Gilligan, *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Hart Publishing, 2013).

LAURENCE TAI

Laurence Tai is a Lab Fellow at the Edmond J. Safra Center for Ethics at Harvard University, where he is researching how to identify and remedy regulatory capture. He earned his PhD in Public Policy and JD at Harvard in 2013. For 2014-15 he will be a Law and Economics Fellow at NYU School of Law, where he will further develop his research on the benefits and costs of transparency of government information.

ERIC TALLEY

Eric Talley is a leading authority on corporate law and law and economics. In addition to teaching corporate law, he serves as faculty co-director of Boalt's Berkeley Center for Law, Business, and the Economy. Professor Talley has taught both law and economics classes at Georgetown Law Center, the California Institute of Technology, the RAND Graduate School, and Stanford University. Talley has served as senior economist at the

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RAND Corporation's Institute for Civil Justice, director of the LRN-RAND Center for the Study of Corporate Ethics, Governance, and Law, and interim director of the RAND-Kauffman Foundation Center for the Study of Small Business Litigation and Regulation.

SALLY WHEELER

Sally Wheeler is Professor of Law and Head of School of Law at Queen's University, Belfast. Her research interests include socio-legal studies in the area of company law, corporate governance, contract law, and legal history. She has published widely in these areas. Prior to taking up her Chair at Queen's Belfast she was Professor of Law at the University of Leeds and then the University of London. She was elected as an Academician of the Social Sciences in 2011 and to membership of the Royal Irish Academy in 2013.

DANIEL WU

Daniel Wu is a joint JD/PhD student in Sociology and Social Policy. Wu is interested in the efforts of leaders and communities across the world that are reworking how we think about the modern business corporation for social good in our cities. Currently, he is developing a project examining technology and social enterprise clusters, how brokers from diverse institutional backgrounds build trust to sustain collaborations, and this phenomenon's implications for inequality and regional health. He is trained in qualitative case analysis and computational methods that can inform a complex, yet rigorous and dynamic understanding of social life, using statistical methods and programming, social network analysis, and text analysis.

JAY YOUNGDAHL

Jay Youngdahl is a Senior Fellow at the Hauser Center for Civil Society at the Kennedy School of Government, Harvard University. He is a lawyer and writer active in the field of responsible investment. He is a partner in the Houston-based law firm Youngdahl & Citti, P.C. For over thirty years, he has served as Fund Counsel to a number of Taft-Hartley employee benefit funds and is retained to provide expert legal opinions to public and private funds. Since 2007 he has served as an independent Trustee of the Middletown Works Hourly and Salaried Union Health Care Fund (VEBA). Youngdahl has written a number of pieces on the issue of responsible investment and the role of trustees in such efforts.