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# SCAPEGOATS AREN'T ENOUGH: A LEVESON FOR THE BANKS?

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Centre for Research on Socio-Cultural Change

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**Andrew Bowman[1] Ismail Ertürk[2] Julie Froud[2] Sukhdev Johal[3]**

**Michael Moran[1] John Law[4] Adam Leaver[2] Karel Williams[1]**

[1] CRESC · [2] Manchester Business School · [3] Royal Holloway, University of London · [4] Open University


## Introduction: What's it about and what needs to be done?

Barclays' role in Libor fixing is only the beginning of a much bigger scandal. Some 20 banks are reported to be under investigation by various national authorities in connection with Libor fixing. Several (or many) are likely to be incriminated by their emails and the investigative trail will probably then lead to other instances of indicator fixing and market rigging by banks.

But Barclays alone may do for the banks what expenses did for MPs and phone hacking did for the tabloid press. Here we have a structurally rotten system whose defects are well known to close observers, which becomes the subject of popular outrage with the uncovering of corruption so blatant that it's impossible to ignore. The other more alarming issue is that these crises demonstrate the interconnection of different power elites in ways that undermine confidence in existing institutions and lead to cynicism about the possibility of reform.

The crisis immediately centres (once again) on Barclays whose insurance mis-selling and tax avoidance have already made headlines within the past year.[1] Bob Diamond tried to draw a line under the financial crisis when he announced in January 2011 that "the time for

[1] Most significantly, in August 2011 Barclay's was ordered to set aside £1 billion to pay customers mis-sold payment protection insurance. In February 2012, it was ordered to pay £500 million to the Treasury after a tax avoidance scheme was uncovered, 'A bad year for Barclays', *The Guardian*, 27 June 2012, http://www.guardian.co.uk/business/2012/jun/27/barclays-bad-year

remorse is over" for the banks.[2] Since then, Barclays has gone on to demonstrate that our banks have learnt nothing and forgotten nothing, showing a complete disregard for their customers, their shareholders, their regulators and – despite benefiting from state deposit guarantees and finance-friendly monetary policy – the wider good of UK society.

It is easy to be indignant but what exactly has gone wrong and what should be done? The standard British answer to these questions is some kind of investigation and the punishment of a few (usually middle ranking) scapegoats. Stage managed inquisitions, if led by a reliable establishment figure with a narrow brief, have become the favoured management strategy of British political elites. Media pressure is now pushing inexorably towards some form of public inquiry.

Our first and most important point in this paper is that scapegoats are not enough. We argue instead that any inquiry needs to be broad ranging. And crucially, the remit of the inquiry should include the relations between financial elites and their political peers in successive New Labour and Coalition governments; as well as the question of what seniors at the Bank of England and the FSA knew and should have known. Put another way, if there is to be an inquiry into the Libor and banking it needs to be less like the spectacularly timid Chilcot Inquiry into the Iraq war, and more like the recent Leveson inquiry. Leveson has also helped to turn the legal-technical issue of phone hacking into one that is also political, by uncovering the corrupt media-police-government nexus surrounding News International. Unfortunately, if media reports are to be believed, the government is pushing towards a far more narrow, technical and depoliticized inquiry into the practice of setting the Libor.[3] This response is completely inadequate, not least because the inaccuracy of the Libor and Euribor as measures of real credit conditions is already well known and the BBA were already considering options for replacing it before the current scandal broke.[4]

Before a broader inquiry is set up we have an opportunity to ask some fundamental questions about what is going on – and going wrong – and what should be done. And this is the second aim of this paper. In what follows we examine and explain why it is that British elites continue to get it wrong and are simply too kind to banks which threaten the common good. The paper thus delivers another instalment of the critique of 'socially useless' banking developed by radical technocrats such as Adair Turner and Andrew Haldane. In doing this it returns to questions which CRESC has previously raised about the interconnections between the banks and political power over recent decades.

We need to a Leveson style of political inquiry into the 'Nelsonian' knowledge (commonly known as 'wilful ignorance') of those in charge of economic scrutiny of what banking

[2] 'Diamond says time for remorse is over', *Financial Times*, 11 January 2011, http://www.ft.com/cms/s/0/d4f02d66-1d84-11e0-a163-00144feab49a.html

[3] 'Ministers to order Libor bank review', *BBC News*, 30 June 2012, http://www.bbc.co.uk/news/uk-politics-18640916

[4] See Part 2 below. 'Euribor has been vaporised', *FT.com/alphville*, http://ftalphaville.ft.com/blog/2010/08/16/315556/euribor-has-been-vaporised/, 'Libor affair shows banking's big conceit'. *Financial Times*, 28 June 2012, http://www.ft.com/cms/s/0/24ee82f4-c12b-11e1-8179-00144feabdc0.html

contributes to British society. The inadequacies of the Vickers reforms have been acknowledged by expert observers but denied by key politicians in both the Conservative and Labour parties. Their position now stands fully exposed, and the opening created by the Libor scandal needs to be used to press for more radical change.

The paper starts by deconstructing the tropes about leadership and the culture of banking which the media, politicians and regulators have used to understand the Libor crisis. The message is that this is a *cultural* crisis - but that culture also connects with structure and structural problems. This leads to the second argument in this section. This is about the need for a broad ranging Leveson style inquiry which analyses the economic and social contribution of finance and scrutinises the connections between politics and finance which explain the British paradox of big financial crisis/small reform. We end this first section with the questions a Leveson inquiry should ask.

In the second section, we observe that post 2008 research by CRESC and others has already provided empirical answers to some of these questions about the economic and social contribution of banking, and we begin by summarising the evidence. The problem here is not that the evidence is not to hand. Rather the problem is that those in elite positions are in denial about the following uncomfortable truth: that the activities of London finance contribute little socially, and are economically negative if we consider costs to the ordinary citizen. Beyond this, we argue that the Libor crisis is symptomatic of the pathology of investment banking which uses tools such as the Libor as weapons of war. This then leads us to offer a series of proposals for reform of finance which should form the basis for radical demands.

# PART 1: Rethinking the causes of the scandal and arguing the scope of the inquiry

## Culture? The right issue posed the wrong way

Last year Bob Diamond collected £17m in pay and bonuses[5] (plus £5.7m to cover his tax) and (like the disgraced bankers of 2008) cannot admit that he did wrong or should have done anything differently. Diamond and Barclays, it seems, will become for this phase of the continuing financial crisis what Fred Goodwin and RBS were to an earlier phase.

The treatment of Goodwin and Diamond, RBS and Barclays, is more significant than simple scapegoating: it represents a common tendency to anthropomorphise, individualise and moralise the problems of the financial system. This makes good copy in much of the media, but on a broader level this framing of the financial crisis as a story of bad apples spoiling the

[5] Harry Wilson, 'Bob Diamond will receive £20 million if he resigns from Barclays', *The Sunday Telegraph*, 1 July 2012, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9363514/Bob-Diamond-will-receive-20-million-if-he-resigns-from-Barclays.html

barrel is a distraction from the much more important political issues that are at stake. As was observed in an earlier CRESC paper on the Eurozone crisis[6] there is a kind of 'romance of leadership' at play in the elite representations of the problems and solutions in the financial system. In this case, attention homes in on the defects of the leaders that we have (like Diamond) and by implication all would be well if we had leaders with the right virtues.

Following the attacks on Diamond's leadership qualities by both Labour and Conservative frontbenchers, even the Institute of Directors have weighed in to say "high time for a clear out of leaders who created this mess".[7] Similarly, for Mervyn King this week, the resolution of the crisis requires "leadership of an unusually high order" – one which, it is implied, Diamond no longer possesses.[8]

The situation represents an interesting turnaround given Diamond's previously exalted status as a strongman who helped orchestrate Barclay's purchase of Lehman brothers and steer the bank through the crisis without state aid – he was the natural leader to succeed John Varley in 2011 as Group Chief Executive. As one of his predecessors as chief exec, Martin Taylor (1994-1998), has said this week in Diamond's defence: "[he has] amazing leadership qualities and huge personal following in the organisation …. Bob runs an extraordinarily competitive and aggressive ship, and that is one reason why Barclays Capital has been so successful in the first decade of the century."[9]

Diamond's leadership response has been to attempt to pass blame downwards towards his subordinates, using the defence that he was not in charge at the time of the most serious instances of Libor manipulation identified by regulatory investigations. In his first public apology on the Libor scandal, Diamond stated: "I am sorry that some people acted in a manner not consistent with our culture and values."[10] The actions were he said "wholly inappropriate" but "limited to a small number of people". Diamond is one among many who have chosen to use the frame of 'culture' to interpret the scandal, though he stands alone in his generous assessment of Barclays' own ethics.

Another layer of interpretation offered by elites has been that Barclays' problem lies not just with its leadership but in a more pervasive and reckless 'culture' which Diamond came to personify. David Cameron, in deflecting early calls for an inquiry stated: "The most important thing people want to see is a really concrete set of actions that will help change

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[6] *Deep Stall? The Eurozone Crisis, Banking Reform and Politics*, http://www.cresc.ac.uk/publications/deep-stall-the-euro-zone-crisis-banking-reform-and-politics

[7] 'Interest-rate swap mis-selling and Libor abuse show the need for new blood at the top of the banks', *Institute of Directors*, 29 June 2012, http://press.iod.com/2012/06/29/interest-rate-swap-mis-selling-and-libor-abuse-show-the-need-for-new-blood-at-the-top-of-the-banks

[8] 'Bank of England head says banks much change culture', *BBC News*, 29 June 2012, http://www.bbc.co.uk/news/business-18642732. King also noted the need for structural changes.

[9] 'No apologies Barclays boss Diamond fights for his job, *Reuters Edition Uk,* http://uk.reuters.com/article/2012/06/28/uk-barclays-libor-diamond-idUKBRE85R1AB20120628

[10] 'Barclays fined a record £290m', *Financial Times*, 27 June 2012, http://www.ft.com/cms/s/0/2a4479f8-c030-11e1-9867-00144feabdc0.html

the culture. You don't change culture by changing laws and changing regulations alone."[11] The *Financial Times*, in an editorial calling for Diamond's resignation argues, "Mr Diamond may not have been the top boss at the time, but he was clearly responsible for its hard-driving culture."[12] Adair Turner says: "There is a degree of cynicism and greed which is really quite shocking...and that does suggest that there are some very wide cultural issues that need to be strongly addressed."[13] Mervyn King is reported as calling "for a change in the culture of the banking industry."[14] Ed Balls tells us that "[w]e need … [a] proper independent and public inquiry into the culture of banking".[15]

So it's not a few rotten apples. It's culture that needs to be put right. But what is culture? Bob Diamond said, "Culture is difficult to define … but for me the evidence of culture is how people behave when no-one is watching."[16] To which the *FT* comments tartly: "Well, now we know".[17] The short answer to the question is: the term is contested. Perhaps it's the values and commitments shared by – and transmitted within – a group. Then it's the normal, naturalised, character of those values (as in 'the bonus culture'); just as important, it's also the practices that go with those values – which then become natural, obvious, and even invisible to those who live them. And, let's be fair, it's also about stereotyping by outsiders, as in 'banker bashing'.

But how far does talk of 'culture' get us? Joris Luyendijk, the anthropologist of finance workers who writes for the *Guardian*, notes that not everyone in finance is driven by greed.[18] Some "are afraid, powerless or both". But then, and crucially, he adds: "If you had to define a working environment that encouraged short-termist conformism … then the finance sector would be your blueprint." There's no job security. You've probably become dependent on your over-inflated salary. And your identity is stapled to the job and the success of your team. "This is about tribal bonding, about belonging and sticking with your mates" says one of his interviewees.[19] In short, and here's the bottom line, *cultures go with structures*. They go with affiliations and links. They go with arrangements that make and maintain those links. So it's you and your mates. Or you and your church. Or you and your

[11] 'Ministers to order Libor bank rate review', *BBC News*, 30 June 2012, http://www.bbc.co.uk/news/uk-politics-18640916
[12] 'Shaming the banks into better ways', *Financial Times*, 28 June 2012, http://www.ft.com/cms/s/0/6dc5b9a2-c117-11e1-853f-00144feabdc0.html
[13] 'The gathering storm'. *Financial Times*, 29 June, 2012, http://www.ft.com/cms/s/0/26d8a33c-c1e0-11e1-8e7c-00144feabdc0.html
[14] BoE governor urges reform of Libor, *Financial Times*, 29 June 2012, http://www.ft.com/cms/s/0/7a76a74a-c1d2-11e1-b76a-00144feabdc0.html
[15] 'Cameron orders review of interbank rates', *Financial Times*, 30 June, 2012 http://www.ft.com/cms/s/0/f57e8cc0-c2a7-11e1-8d12-00144feabdc0.html
[16] 'Shaming the banks into better ways', Editorial, *Financial* Times, 29 June 2012, http://www.ft.com/cms/s/0/6dc5b9a2-c117-11e1-853f-00144feabdc0.html.
[17] 'Shaming the banks into better ways', Editorial, *Financial Times*, 29 June 2012, http://www.ft.com/cms/s/0/6dc5b9a2-c117-11e1-853f-00144feabdc0.html.
[18] Joris Luyendijk, 'It's not just your job – it's your identity', *The Guardian*, Friday 29 June, 2012, page 10.
[19] Joris Luyendijk, 'It's not just your job – it's your identity', *The Guardian*, Friday 29 June, 2012, page 10. Here he is quoting a former treasurer.

family. Or you and your profession. Or you and your party. Or you and your community. Or you and your country. *It's the arrangements that bind you to other people*.

So here's a working definition of structure. Structures are mechanisms of 'you and …'. Some structures don't reach far: only as far as the next transaction. Again, some structures are very simple too. They only reach as far as others playing the same game. The structures simplify themselves because other possible affiliations evaporate – or are severed. And then, in contrast, there are other structures that work over time. These are chains of affiliation and mechanisms that bind different *kinds* of people together. Like, say, the mosque. Or the workshop. In practice the dynamics are very, very, complicated, but here's the bottom line. Structural mechanisms that generate and sustain groups that are able to disconnect themselves from heterogeneous affiliations (and therefore from the tensions that necessarily arise in holding these together) are dangerous. And they are particularly dangerous when those disaffiliated groups hold the fate of millions of others in their hands. As Fintan O'Toole puts it in *The Observer*, 'It is closed, arrogant, unaccountable cultures that turn ordinary people into sociopaths.'[20]

This is the culture of finance which must be addressed via structural and organisational reforms which get to the heart of banking business models, but instead the term 'culture' is being used in a much more simplistic fashion implying that getting rid of the most irresponsible individuals who personify the 'bad culture' of greed will allow the ambient 'good culture' of corporate responsibility to flourish. This follows in the lineage of one of the most popular framings of the financial crisis as the result of what Alan Greenspan would have called 'irrational exuberance' – greed out of control – amongst key individuals

The danger is that 'radical' solutions proffered hereby become limited to sacking Diamond and rooting out those responsible for the fixing – with the more 'radical' commentators and Labour politicians calling for the use of criminal charges. More significant reforms or searching questions into causes and effects may hereby get side-lined in favour of witch-hunts and show trials. Culture is clearly the right issue to discuss, but it's being done in the wrong way.

## The politics of the financial oligarchy

The details of LIBOR fixing plainly need to be uncovered, criminal behaviour punished and the moral bankruptcy of the City revealed. But there are deeper roots to all this. The fact that these calls for an inquiry into the banking system are coming nearly five years after the start of the financial crisis in 2007 shows how lenient the official response has been so far: both the 2009 Bischoff Report and the 2011 Independent Commission on Banking were packed with finance-friendly insiders – in the case of the latter including the ex-Barclay's

[20] 'In corrupt systems, decent people have two options: conform or be crushed.' *The Observer*, 1 July 2012, http://www.guardian.co.uk/commentisfree/2012/jun/30/fintan-otoole-banking-decency-corrupt-system

chief executive Martin Taylor – and produced predictably tame recommendations.[21] As an earlier CRESC working paper argued, banking in the UK since 2008 has been marked by the paradox of big crisis/small reform.[22]

What the Libor episode reveals is a sense of invulnerability to the normal restraints which should govern the everyday dealings of ordinary citizens and organisations. Where does that invulnerability come from? Immediately, it arose from the practice of 'light touch' regulation. That practice in turn was a political creation: which is to say, it was the creation of a world where democratic policy makers were enchanted by the glamour of City markets and City operators; where the elite of the City had privileged access to the top of policy making; where the government of the City was franchised out to institutions controlled by the City elite; and where cash-strapped political parties were in hock to donors from the financial services industries. Under Cameron, for example, the proportion of Conservative Party funding derived from the City rose by 25% in five years to make up 50.8% of the Party's total – 27% of this came from hedge funds and private equity.[23]

Libor fixing is thus only one bit of the scandal. Barclays itself provides an apt demonstration of the extent to which the major banks exert influence through elite networks. Martin Taylor, the former Chief Executive, sat on the board of the Independent Commission on Banking. Barclay's current chair, Marcus Aegius, also chairs BBA Libor.

Some Conservatives are relishing the opportunity for an inquiry which would give them the opportunity to tear into the pre-crisis record of the current Shadow Chancellor, Ed Balls, who was a key advisor to Gordon Brown on banking regulation.[24] Balls in turn claims "George Osborne (and) City figures were pressurising me all the time when I was a financial services minister, saying I was being too tough, too heavy-handed, undermining the competitiveness of the City of London", and has demanded that the inquiry stretches back to the Conservative's self-regulation City reforms of the 1980s and 1990s.[25] What these self-

[21] Analysis by CRESC of the Bischoff Report working group shows that of the members' combined 662 years of work, 495 were spent in City institutions. The eight person secretariat contained only one civil servant as compared to four from Citigroup and three from the City of London Corporation. http://www.cresc.ac.uk/sites/default/files/Alternative%20report%20on%20banking%20V2.pdf

[22] *Groundhog Day: Elite power, democratic disconnects and the failure of financial reform in the UK*, http://www.cresc.ac.uk/sites/default/files/Groundhog%20Day%20Elite%20power,%20democratic%20disconnects%20and%20the%20failure%20of%20financial%20reform%20in%20the%20UK%20CRESC%20WP108%20(Version%202).pdf

[23] 'Tory Party funding from City doubles under Cameron', *The Bureau of Investigative Journalism*, 8 February, 2011, http://www.thebureauinvestigates.com/2011/02/08/city-financing-of-the-conservative-party-doubles-under-cameron/ , 'Hedge funds, financiers and private equity make up 27% of Tory funding', *The Bureau of Investigative Journalism*, 30 September 2011, http://www.thebureauinvestigates.com/2011/09/30/hedge-funds-financiers-and-private-equity-tycoons-make-up-27-of-tory-funding/

[24] 'Barclays Libor scandal: Ed Balls 'failed to regulate banks'', *Daily Telegraph*, 28 June 2012, http://www.telegraph.co.uk/news/politics/9362667/Barclays-Libor-scandal-Ed-Balls-failed-to-regulate-banks.html

[25] 'Will there be a 'banking Leveson' next? Labour's two Eds demand inquiry into financial ethics', *The Daily Mail*, 29 June 2012, http://www.dailymail.co.uk/news/article-2166592/Will-banking-Leveson--Labours-Eds-demand-inquiry-financial-ethics.html

serving attempts to shift the blame inadvertently display is the collective responsibility of the entire political elite for the banks' under-regulation.

The Libor scandal therefore encompasses not only what happened immediately before the crisis, it also covers the history of decades spineless reform initiatives under both Labour and the Coalition; the continuing closeness between the Treasury and the City elite; the domination of UKFI, the key institution managing public holdings in the bankrupt banks, by City grandees and City functionaries; the fact that the Conservative Party, in particular, is even more indebted than before the crisis to City finance; and the fact that the local government of the City of London itself is, uniquely in British democracy, controlled by a financial oligarchy.

The outcome, alongside pervasive tax avoidance is, as US Congresswoman Carolyn Maloney, says in the *FT*, a "disturbing pattern in the last few years of London becoming the centre of financial trading disasters."[26] Without (as yet) any self-knowledge amongst financial elites or commitment to reform by their political peers. The journalist Heather Brooke has said that access to "unlimited public funds, unaccountability and anonymity all lead to one thing - never having to say you're sorry"[27]. She was talking about MPs but her observation applies just as easily to bankers. Ask yourself, what other industry enjoys near limitless state guarantees, brushes aside financial scandals, polices itself and places itself under the protection of Westminster elites?

## Leveson for the banks: the questions to be addressed

In the midst of the current outrage, we should note that the regulatory authorities have reached a judgement which states Libor manipulation merits a modest fine. And that's with the regulators baring their teeth. The message is that Barclays has little to fear from regulation because no-one was blamed, no-one arrested, no director indicted for failure of fiduciary duty, there was no withdrawal of the banking licence, no proceeds of criminal indictment and no sequestration of assets. It is business as usual with the £290m fine equating to just 4.2% of Barclays pre-tax profit – do also note the fine is tax deductible – which is equivalent to 13 days of profit. More serious consequences need to be a first priority.

However, scapegoating and punishment of individuals will be far from sufficient. As discussed above, manipulation of the kind which took place around the Libor in Barclays has tended to be treated as a 'bad operator' or 'rotten apple' problem – a few errant actors who bring shame upon their colleagues and institution are sacrificed to quell public disquiet. Public 'show trials' of the malefactors will however leave untouched much of the institutional and structural apparatus, and thus internal incentives and culture intact,

[26] City braced for tougher regulation, *The Financial Times*, 29 June 2012, http://www.ft.com/cms/s/0/3828a106-c211-11e1-bffa-00144feabdc0.html
[27] Heather Brooke, *The Silent State*, Random House, 2011

ensuring that the process is repeated over and over again. We need to rethink our approach. This should be treated more like the aftermath of a war where codes of conduct have been breached and moral transgressions became habitual; the local atrocity is a collateral and incidental part of the apparatus of the war machine. In such circumstances, the aim should not only be to prosecute the individuals responsible, but also to dismantle the apparatus as well. Any Leveson style enquiry should therefore take as its object a deep-rooted reform of the institutions as well as prosecution of the fraudsters (put simply, we need to dismantle structures to change cultures).

Leveson moved quickly from the specifics of phone hacking to the political regime which gave News International a sense of invulnerability from the normal processes of the law. In the same way, a Leveson for bankers needs to move beyond the specifics of criminal manipulation. (Indeed if it does not do this, it will find itself hamstrung in the manner of Leveson by the plea that there are some areas that cannot be probed because criminal prosecution is imminent). In the manner of Leveson, it needs to command access to the private world of the City and governing elites in recent years: to details of the volume of meetings that have taken place; to minutes, e-mails and texts. The experience will be intensely embarrassing to the policy elite, probably especially to the new Labour leadership which was at the centre of the regulatory regime which conferred invulnerability on the City. But this is a necessary cleansing.

The inquiry needs to have a combination of judicial powers, a broad remit, freedom from government influence and a panel of investigators representative of a wide range of interests in British society rather than the narrow interests of financial services. The following questions need to be addressed:

i. **Who has been meeting whom?** The banking Leveson needs to uncover the web of connections between the City and Whitehall.

ii. **Who has been paying for what?** This is not just a matter of the financing of the parties, but the wider web of jobs, consultancies and so on which have so enriched the City elite.

iii. **Who is ruling the City?** This is a matter of uncovering the anti-democratic coup which the City carried out in reforming local government in the square mile in the early decades of the millennium, the result of which is that the City is the only part of mainland Britain exempt from even the formalities of democratic control.

iv. **What does investment banking contribute to society?** The pre-crisis mantra of politicians that the City was the most strategically important industry for the UK economy has remained post-crisis, despite an accumulation of evidence that its net contribution is far less significant than commonly assumed. A different understanding of the social purpose of the City (i.e. from a value creating industry to a public utility) may radically change the way new regulatory options are approached (see section 5 below).

v. **What makes banks so adept at avoiding regulation?** The Libor scandal exemplifies the major banks' operational ability to bend or ignore the rules – and there are many other examples. Questions of reform need to go beyond considering more complex regulation or powerful regulators, to exploring whether the size and complexity of the financial system has rendered it ungovernable in practice.

# PART 2: Revaluing the contribution of finance and pressing radical reform

## The economic and social contribution of finance

"Financial services remain Britain's economic engine. But at home, political pressure is becoming relentless, the Libor rate fixing scandal at Barclays adding venom to long simmering public anger over bonuses and bail outs" This quotation comes from a potboiler story by two junior FT reporters on the weekend after the Libor crisis broke.[28]

The quote encapsulates the self-knowledge of London finance and the image of London finance held by Westminster political elites. In this view, the financial services sector is a nationally valuable asset whose activity is now threatened by political resentment arising from banker misconduct (the implication is that a narrow investigation into fraud and regulatory failure will deal with the problem while a few sackings and show trials will soon make us feel better).

This account misstates the problem in all kinds of ways, most fundamentally by misrecognising finance. In its present form, finance combines two elements. First, a utility system of payments, savings accounts and credit for business and individuals which almost everyone needs and uses. Plus, second, a superstructure of self-serving and economically useless finance which primarily benefits elite bankers and has incidentally imposed huge costs on the tax payer since 2008.

The issue of "socially useless" finance was first raised by Financial Services Authority chair Adair Turner[29], and its costs have been documented by our leading radical technocrat, Andrew Haldane of the Bank of England. Successive CRESC reports and working papers, since the *Alternative Banking Report* (2009) have accumulated a mass of empirical evidence which establishes the economic and social uselessness of finance; and the earlier work is summarised in our book *After the Great Complacence*.[30]

[28] Alex Barker and Daniel Schafer, 'City braced for tougher regulation', *The Financial Times*, 30/31 June 2012, http://www.ft.com/cms/s/0/3828a106-c211-11e1-bffa-00144feabdc0.html
[29] 'An appropriate but improbably BoE boss', *The Financial Times*, 17 April 2012, http://www.ft.com/cms/s/0/b5c997e8-8871-11e1-a526-00144feab49a.html#axzz1zHBUy3lA
[30] Engelen *et al* (2011) *After the Great Complacence*. Oxford University Press

But it may be useful now to summarise the CRESC argument and evidence about the bubble and its aftermath in two main points:

I. As the bubble inflated, the finance sector booked private profits and huge bonuses, but did very little directly for the real economy; after the bubble burst, finance imposed huge costs on the taxpayer. Bank lending to productive business declined sharply from 30% of all bank lending towards 10% during the bubble as bank lending to other financial institutions and the property market expanded.[31] After the bubble burst, the immediate bail out costs to the tax payer in 2008-9 were larger than the taxes paid by the whole financial sector in the five years up to 2006/7.[32]

II. The statistical evidence directly contradicts the claims (made in finance's PR narrative and accepted by Westminster politicians) that the finance sector was indirectly socially valuable because it created jobs and paid taxes. The finance sector created no net new jobs in the bubble because in 2007 (as in 1992) finance employed just one million. In terms of taxes paid, finance contributed less than 8% of government revenue at its peak, which was much less than manufacturing.[33]

Since 2008, we have come to understand that London finance is not a leading component of the national economy but a dividing sector which actively increases inequality within the London area and outside. The beneficiaries of London finance are a couple of football stadiums full of the working rich from London finance. And the multiplier effects of their spending are limited by labour market disconnects when London imports its labour from outside the UK: LSE research shows that London residents born outside the UK hold 85% of new jobs created 1997-2006.[34]

Matters have been made much worse nationally by New Labour and Coalition policy mistakes since 2008. The Treasury and Bank of England have tried to keep the banks going through a policy mix of tight fiscal policy (public expenditure cuts) and ultra-loose monetary policy (zero interest rates and quantitative easing). This means austerity for the masses and

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[31] *CRESC, Alternative Banking Report*, p. 65.
http://www.cresc.ac.uk/sites/default/files/Alternative%20report%20on%20banking%20V2.pdf

[32] *CRESC, Alternative Banking Report*, p. 32-3. Similarly, Andrew Haldane points out that when the 2008 crash is factored in, financial equities performed no better during the boom years of the mid-1980s to the mid-2000s than at any other point in history – close to break-even. Finance delivered no more value than any other major industry, but excess leverage before the crisis made it (briefly) appear otherwise. Andrew Haldane, 'Small lessons from a big crisis', Remarks at the Federal Reserve Bank of Chicago 45th Annual Conference, "Reforming Financial Regulation", 8 May 2009,
http://www.bankofengland.co.uk/publications/Documents/speeches/2009/speech397.pdf and Andrew Haldane, 'The Contribution of the Financial Sector, Miracle or Mirage?' at the Future of Finance Conference, London 14 July 2010,
http://www.bankofengland.co.uk/publications/Documents/speeches/2010/speech442.pdf

[33] *CRESC, City State against National Settlement*, p. 15.
http://www.cresc.ac.uk/sites/default/files/City%20State%20and%20National%20Settlement%20CRESC%20WP101.pdf

[34] *CRESC, City State against National Settlement*, p. 5.
http://www.cresc.ac.uk/sites/default/files/City%20State%20and%20National%20Settlement%20CRESC%20WP101.pdf

a system of bank welfarism for the working rich. Policymakers have thus allowed London finance to make easy profits without imposing any effective behavioural conditions about lending to SMEs and such like.

Finance is the wrong kind of engine (of social division and economic disaster). The first aim of policy should be to shrink the size of a financial sector whose assets of five times GDP and network of cross border lending will simply become more liabilities for the British taxpayer in the event of worsening Eurozone crisis. Banking in its current state does not serve the national interest (and arguably doesn't serve the shareholders either) so reform must begin with returning the banks to their utility state with limits on returns, a separation of investment banking and the reorienting of lending to the productive economy rather than inflating assets and selling worthless financial products to the masses.

## Investment banking: tools become weapons

The Libor scandal is the latest in a series of instances in which financial tools have become weapons in the hands of what CRESC has called 'market bricoleurs'.[35] The Libor is designed and used by the international financial community to price the cost of money in major currencies in wholesale markets that involve interbank lending, corporate lending and interest rate swaps. The size of the loan market is estimated to be $10 trillion, the notional size of the interest rate swap market $550 trillion, and the size of short-term interest rate contracts €477 trillion in 2011. In addition to the wholesale loan and interest rate swap markets Libor indirectly influences almost all financial contracts from forward exchange rates to residential mortgages.

The British Banking Association oversees the calculation of this important benchmark rate and all banks and non-bank corporations outside the group of Libor-fixing international banks trust the integrity of the participating banks and the process. As such, the Libor is a crucial tool in financial markets. Our argument is that this tool was turned into a weapon of trading war by the banks operating as nomadic war machines (see chapter 3 of our work Engelen *et al* 2011[36] for our conceptualisation of nomadic war machine in financial markets).

We would add the supplementary point that everybody who was on or near the inside knew that something of this sort was going on long before the present crisis broke. The BBA has said it is "shocked"[37] by the revelations of Barclays' wrongdoing, but manipulation of the Libor has been discussed for years amongst academics and the business press. Suspicions about manipulation of Libor by the major investment banks were first publicly raised by in April 2008 by the *Wall Street Journal*[38] which does investigative journalism of a kind which the *Financial Times* does not. In this exemplary piece of investigative journalism, the *WSJ*

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[35] Ertürk *et al* (2008) *Financial Innovation: Frame Conjuncture and Bricolage*. http://www.cresc.ac.uk/publications/financial-innovationframe-conjuncture-and-bricolage

[36] Engelen *et al* (2011) *After the Great Complacence*, Oxford University Press

[37] BBA, LIBOR Statement - Thursday 28 June, 2012, http://www.bba.org.uk/media/article/libor-statement

[38] Wall Street Journal 16 April 2008

authors reflected the voices of bankers who suspected the manipulation of the Libor rate and then carried out their own tests (by using data on credit risk from the Credit Default Swap Market) which supported the view that Libor was not accurately measuring the real cost of borrowing by the banks involved.

This manipulation of the Libor means that a tool for international markets has become a weapon in the new post-Lehman conjuncture whereby some traders at Libor-fixing banks turned their unprofitable positions in credit and derivatives markets to profitable ones at the expense of non-participating banks and non-banks. The FSA's Final Notice informing Barclays FSA's fine confirmed that "The Derivatives Traders were motivated by profit and sought to benefit Barclays' trading positions."[39] In our earlier work[40] we have shown that hedge funds turned tools like shorting and corporate governance into weapons to attack companies and sovereigns in bond and equity markets for private financial gains.

This view of financial actors contested the mainstream view of hedge funds as useful arbitrageurs that facilitate price discovery in markets. Such nomadic war machine activity in financial markets also contests the mainstream view of financial innovation as the result of engineering-like rational activity. Instead, we see financial innovation as bricolage where banks use conjunctural opportunities ranging from low interest rates to regulation like Basel II to create structures that produce high bonuses.[41] Now we know that the suspicions of the *Wall Street Journal* were true and traders turned tools into weapons.

As well as assisting investment banking divisions with derivative trading strategies, once the crisis broke in August 2007 banks gained a further purpose for mis-reporting their borrowing costs. To quote the US Commodity Futures Trading Commission (CFTC), "the Bank routinely made artificially low LIBOR submissions to protect Barclays' reputation from negative market and media perceptions concerning Barclays' financial condition."[42] It is important to bear in mind that in the immediate post-crisis period Barclays were vigorously attempting to avoid state intervention in the bank of a kind which Lloyds TSB and RBS were subjected to. The under-reporting also has serious implications not only for savers and investors (in particular large pension funds) who received lower returns as a result, but also for the efficacy of monetary policy. As the *FT* reports, many central banks (including the BoE) use the Libor as one of their formal means of judging overall market liquidity needs and working out their own interest rate setting operations. As the banks report lower rates, the risk increases that the central bank misjudges the liquidity needs of the market. This constrains liquidity further, increasing the incentive for the banks to under-report and increasing the

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[39] FSA, *Final Notice to Barclay's bank Plc,* 2012 p.2, http://www.fsa.gov.uk/static/pubs/final/barclays-jun12.pdf
[40] Ertürk et al. (2010), 'Hedge Funds as 'War Machine': Making the Positions Work', *New Political Economy*, 15:1; Engelen *et al*., (2011) *After the Great Complacence*. Oxford University Press
[41] Engelen *et al*., (2010), 'Reconceptualizing financial innovation: frame, conjuncture and bricolage', *Economy and Society*, 39 (1).
[42] CFTC, *CFTC Orders Barclays to pay $200 Million Penalty for Attempted Manipulation of and False Reporting concerning LIBOR and Euribor Benchmark Interest Rates*, 2012, http://www.cftc.gov/PressRoom/PressReleases/pr6289-12.

inaccuracy of monetary policy.[43] The Libor scandal therefore adds a further layer to the story of the banks reckless behaviour following the crisis and the underhand measures taken to avoid the further scrutiny or state intervention.

Barclays could well be just the tip of the iceberg. In February 2011 the Japanese authorities disciplined Citibank[44], and the investigation into Libor manipulation has been going on for some time involving major international regulators. So we should expect other banks whose names appeared in this context including Citibank, UBS, WestLB, etc. to receive similar fines. We need to remember that out of the total fine of about £290 million, Barclays will only have to pay only £59.5 million to the FSA. The rest will be paid to the US authorities and regulators who are more ruthless pursuers of wrong doing at home and abroad. For the international community London is fast acquiring a reputation as a dodgy offshore financial centre because the Barclays scandal comes right after JP Morgan-Chase losing about $5bn (the exact figure can be as high as $10bn) in speculative trading at its London office.

Therefore, Cameron and Osborne and other elite political defenders of banking increasingly look out of touch with the way the City operates. Similarly, the Bank of England and BBA do not appear favourably as both are proven to be ineffective bystanders in the Libor scandal. When the *Wall Street Journal* reported suspicions of Libor manipulation back in 2008 it made references to the minutes of a meeting at the BoE which raised concerns over unusually low Libor fixings that were not in line with the actual borrowing costs of the banks involved. Maybe this got no further because the Bank of England accepted the BBA response to the Wall Street Journal allegations which denied any wrong doing. In which case, maybe Mervyn King should start a culture change first in his own backyard.

## Radical reform: some recommendations

The Libor scandal has put the question of banking regulations and state intervention back on the political agenda and the inadequacy of the Vickers reforms back under the spotlight. An opening has been created in which more radical financial sector reforms can be achieved, and a broad Leveson inquiry is only worth pursuing under this expectation.

As we have stressed throughout this report, the problem of the banks at present is thoroughly political, and is tied up with excesses of elite power and deficits of democracy. Therefore, no selection of technical reforms, no matter how ambitious, will suffice by themselves. Nonetheless, concrete demands form the means by which diverse interests can mobilise and coordinate to create pressure for change, and we would recommend the following as a direction of travel:

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[43] 'The Swiss National Bank and the Libor', *Financial Times*, 27 June 2012, http://blogs.ft.com/money-supply/2012/06/27/the-swiss-national-bank-and-libor/#axzz1z5S8bgJZ, 'Libor, the liquidity consequences' *Financial Times*, 28 June 2012, http://ftalphaville.ft.com/blog/2012/06/28/1063801/libor-the-liquidity-consequences/

[44] 'Citigroup took $50m loss over Libor probe', *Financial Times*, 10 February 2012, http://www.ft.com/cms/s/0/7089ffda-534a-11e1-aafd-00144feabdc0.html

i. **Complete the split between retail and investment banks:** After the Libor scandal, the Vickers proposal to establish ring-fences or 'Chinese walls' between retail and investment divisions looks less adequate than ever. Allowing the two activities to remain together serves nobody bar the banks themselves. A growing number of people – most recently Lord Myners and Lord Lamont – are now calling for a complete split, and this stands as the most simple and most politically attainable of the banking reforms proposed.

ii. **End the ultra-loose monetary / tight fiscal policy mix:** the Bank of England's provision of abundant liquidity for the banking system has kept zombie banks on their feet by providing feedstock for speculative activity, and thereby diminished the impetus for more serious reforms. Tight fiscal policy meanwhile has sucked demand out of the economy and thereby lowered the appeal for the banks of productive lending. The government needs to create more accommodating macro-economic conditions as a context for banking reform.

iii. **Shrink investment banking:** As the previous sections have shown, the social contribution of investment banking to the UK economy is, in light of the risks it creates, either negligible or negative. Bank assets worth several times the value of UK GDP represent a threat to the UK taxpayer which cannot be sustained into the future. Since these risks were exposed by the 2008 crash, proposals for how to minimise them have revolved around either strengthening regulators or making regulation more complex. Most notably, the Coalition have given the Bank of England responsibility for the FSA's supervisory duties, under the assumption that greater a greater concentration of regulatory power will create greater levels of efficiency in spotting and acting upon systemic risks as compared to the previous tripartite system. However, the size, complexity and opacity of the modern banking system – particularly its shadow and offshore aspects – have made modern finance near ungovernable. Given the pace of financial innovation, new pieces of regulation are likely to act only as inputs to an on-going process of opportunistic improvisation (or 'bricolage') – just as the rise to Basel II capital requirements led to an expansion of banks off balance sheet activities.

iv. The task is therefore to take the more radical step of shrinking and simplifying the investment banking sector to drastically diminish socially useless speculative activity and leave behind a smaller but more effective system which acts as the servant of industry and wider society rather than the master. This would be best achieved not by shutting down operations directly but by frustrating the business models on which they thrive. A variety of measures can be brought to bear to reduce the volume of financial transactions taking place, but most immediately feasible would be a financial transactions tax – for which there is already substantial public support – an increase in trading margin requirements, and as discussed in the following point, a restriction of the use of compensation ratios as a basis for paying senior staff

v. **Re-engineer incentives:** that the working rich of the banking sector are encouraged to misbehave by their incentive structures has become accepted as common sense. And yet despite the widespread public anger surrounding the use of bonuses, little has been done to restrict bonuses and nothing has been done about pay. Even the timid reforms proffered in 2009/10, concerned with deferring payment or reducing the proportion given in cash, have been ignored. Government cannot rely simply on instances such as the 'shareholder spring', and must step in for the public good. The most simple and effective action would be a large tax on firm's compensation funds. More significant and less acknowledged than bonuses (as a form of pay) are the use of compensation ratios (to determine the size of the pay pot), whereby senior investment bankers are paid a share of net revenues. Thus, higher pay comes from higher trading volumes secured by the increased use of leverage and forms of financial innovation. Restricting compensation ratios is therefore an obvious step to both re-engineer incentives and reduce the size of investment banking

vi. **Complicate affiliations:** The need for re-engineering incentives returns us to the issue of culture. A dose of fear might help. By which we mean fear of penalties. (Fear is its own form of affiliation). And, conversely, so might the right kinds of rewards. But incentives tend to work in terms of an individual calculus, which is its own sweet problem. This is because it is also the very calculus of individualism that needs to be undone. Our suggestion, then, is that we need mechanisms for complicating affiliations so that those in power are bound to people unlike themselves. National Service worked this way. (No, we are not recommending a return to National Service, but it is notable that the one-nation Toryism of, say, a Harold Macmillan was born in the trenches). Certain kinds of collectivities (think of the NHS) work in this way for those – most of the population of the UK – who use them. The schools never did this particularly well, and under Coalition policies, they are doing it ever less well. Our argument, then, is that alongside the macro-politics we also need micro-structural interventions to complicate the affiliations of people such as traders. In our earlier writing we made one suggestion. This is that people in elite positions should spend two weeks a year working on the shop-floor, or its equivalent.[45] (If we were after long-term affiliations, then it would be the same shop floor, year after year.) Or (this is done in some companies) they should donate substantial amounts of time to working within an NGO or a church or a voluntary association. Again over time. But these are just two small suggestions: We need many small-scale forms of structural re-engineering if we are to create new mechanisms for weaving complicating affiliations.

**vii. Force new ownership models:** The incentive for banks to engage in risky or corrupt practices stems in part from high returns targets demanded by PLC shareholders and continual stock market pressures. Given its status as a public utility, PLC ownership

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[45] *Deep Stall? The Eurozone Crisis, Banking Reform and Politics*, http://www.cresc.ac.uk/publications/deep-stall-the-euro-zone-crisis-banking-reform-and-politics

forms should be restricted in retail banking, with moves towards mutual ownership and regionalisation encouraged in order to ensure that banks serve the interests of their customers first and foremost rather than the current pathological fixation with the delivery of shareholder value.

viii. **Break up too big to fail/jail banks:** The high levels of concentration in retail banking creates institutions which are, to use the popular phrase which emerged in 2008, too big to fail. A new phase entering the public lexicon at present is 'too big to jail'[46]: the concentrated political power of the banks and their ability to extract favourable policies from government to the detriment of other social interest groups also comes from the high levels of concentration in the sector. One implication is that retail oligopolies need to be broken up. Another is that this breakup might be arranged along regional lines.

ix. **Make the nationalised banks behave like public banks:** The taxpayer has ploughed enormous sums of money into rescuing the banking system. Northern Rock, RBS and Lloyds TSB, have received direct bailouts, but all banks have benefited from other forms of public subsidy, in particular QE and deposit guarantees. Public support has not, however translated into banks acting in the public interest. The taxpayers' stake in the part-nationalised banks has been managed with 'arms-length' technocratic detachment by UKFI, which has ensued minimal disruption to the banks' existing priorities and practices and sought a return to business as usual as quickly as possible (even if, in the case of Northern Rock/Virgin Money, it means that the taxpayers have taken a substantial loss on their investment). Generously low Project Merlin lending targets were barely reached by the major banks, and there is a need for more targeted, socially useful investment to help stimulate the UK economy. The public stake in RBS should be used to transform the institution into a state-backed industrial bank, and the other major banks should have non-voluntary targets for productive lending set by government.

x. **The democratization of finance:** The crisis of the banks is a crisis of politics and the democratic disconnects which allow finance to work against the common good. The redemocratisation of finance will require many measures. First a number of overtly *political* measures are needed. These include: greater transparency and restrictions around lobbying to avoid the capture of regulators and politicians; the transformation of the City of London into a public organisation, instead of being an anomalous territorial-state preserve of finance; reforms to the funding of political parties in the hope that they can rebuild themselves with a mass membership of citizens rather than reflecting the concerns of a small elite of wealthy backers. These political interventions need to be paralleled with measures that will reduce the ability of special interests to capture knowledge and expertise, since it is only with the *democratisation of knowledge* that it will become possible to scrutinise the

[46] 'In a nutshell: too big for jail', *The Guardian*, 28 June 2012, http://www.guardian.co.uk/theguardian/2012/jun/28/barclays-diamond-ricci-scandal?newsfeed=true

operations of finance and render these accountable. Once again the potential list of interventions is long. It might start: by handing greater power to Select Committees (already one of the more significant locations of financial scrutiny), for instance by introducing expert cross-examiners (as has been so effective in the extra-parliamentary Leveson inquiry); by creating independent institutions and locations for cross-examining the operation of systemically significant financial institutions, supported by expert counsel, but also by an informed but heterogeneous membership drawn from sectors other than finance; by extending the freedom of information act to systemically important financial institutions; and by creating appropriately funded public research institutions with the remit to produce pluralist and dissenting forms of expertise and knowledge about finance.

xi. **Restrictions on the use of secrecy jurisdictions:** As authors like Nicholas Shaxon have demonstrated, secrecy jurisdictions are not so much an adjunct to the modern financial system as an integral part of it, enabling banks to dodge taxation and keep their most risky activities hidden from regulators.[47] In the aftermath of the 2008 crash world leaders, led by Barack Obama, produced a flurry of promises to clamp down on the banks' use of secrecy jurisdictions. So far little has been done. The City of London and its offshoots in the British island protectorates remains the most significant secrecy jurisdiction in the world, and pressure for change should begin in the UK.

[47] N. Shaxon (2011) *Treasure Islands: Tax Havens and the Men who stole the World*. Vintage

## APPENDIX: A GUIDE TO THE LIBOR

Libor, or the London Interbank Offered Rate, is a benchmark indicator of the average rate at which a leading bank can obtain unsecured funding in the London interbank market for a given period, in a given currency. Different Libor rates are therefore produced for loans denominated in 10 different currencies and with 15 different maturities, resulting in a total of 150 Libor rates.

The process at the setting end is relatively transparent, and is described at length by the British Bankers Association (BBA), who licence out the Libor data, and reinforced by the anthropological analysis of Donald Mackenzie who studied Libor setting at the office in Docklands.[48]

### PANELS

The Libor rate is calculated by collecting submissions from a bank panel, made up of the largest, most active banks in each currency the Libor is quoted for. The banks are ranked twice yearly to assess their representativeness within each currency. The ranking is done by the independent Foreign Exchange and Money Markets Committee (FX&MM Committee) and draws on three indicators: i) the scale of market activity, ii) the credit rating of the institution, and iii) their perceived expertise in the currency concerned. Scale refers in this case to their total cash and foreign exchange (FX) swap activity over two quarters. Any bank can submit themselves to the evaluation process for any currency by submitting the required market activity data.

### THE PROCESS OF LIBOR RATE SETTING

Libor aims to reflect the rate at which the average leading bank can obtain unsecured funding in the London interbank market for a given period, in a given currency. The process requires a named individual responsible for cash management in a Libor contributor bank to submit a figure for the lowest possible unsecured rate available between the hours of 11am and 11.10am via a Thomson Reuters application. This rate is an *estimate*, not a reflection of an *actual* borrowing rate because, according to the BBA, "not all banks will require funds in marketable size each day in each of the currencies/ maturities quoted (but)… It is assumed that a bank will know what its credit and liquidity risk profile is from rates at which it has dealt and can construct a curve to predict accurately the correct rate for currencies or maturities in which it has not been active"[49]. The question asked to each contributor bank is:

"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?"

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[48] Donald MacKenzie (2008), 'What's in a Number', *London Review of Books*, 30, 18, 11-14; http://www.lrb.co.uk/v30/n18/donald-mackenzie/whats-in-a-number

[49] 'Welcome to bbalibor the basics', *British Bankers' Association*, http://www.bbalibor.com/bbalibor-explained/the-basics

Data submitted by panel banks into the Libor process is received and processed by Thomson Reuters and the data is calculated using guidelines provided by the FX&MM Committee. Notionally a bank cannot see other contributor rates during the submission window, but is able to do so after final publication of the BBA Libor data. Once the data is collected by Thomson Reuters the Libor rate is produced by working out the interquartile mean – that is, the reported borrowing rates of banks in the middle two quartiles, once all rates have been ranked in descending order and the highest and lowest 25% of submissions discarded. This is so that a small number of excessively high or low returns do not distort the average; meaning, in theory, that any individual panel contributor cannot influence the calculation and affect the Libor quote. All Libor rates are quoted as an annualised interest rate. For example, if an overnight Sterling rate from a contributor bank is given as 2.00000%, this does not indicate that a contributing bank would expect to pay 2% interest on the value of an overnight loan. Instead, it means that it would expect to pay 2% divided by 365.

**LIBOR IMPORTANCE**

The Libor is an important rate because it is the primary benchmark for short-term interest rates globally. It is written into standard derivative and loan documentation such as the ISDA terms, and is used on a range of retail products such as mortgages and other loans. It is also the basis for settlement of interest rate contracts on many of the world's major futures and options exchanges. For this reason, it is a hugely important measure: at a purely financial level, a low Libor rate will benefit borrowers and a high Libor rate will benefit lenders. However, it is also used as a barometer to measure strain in money markets and as a gauge of market expectation for future central bank interest rates. It therefore has a significant signalling effect to the market, regulators and governments about the relative distress of a particular bank at a particular time.